UNIVERSITY OF CAMBRIDGE

FOUNDERS WITHOUT LIMITS: DUAL-CLASS STOCK AND THE PREMIUM-TIER OF THE LONDON STOCK EXCHANGE

Bobby V. Reddy

Girton College
Faculty of Law

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FOUNDERS WITHOUT LIMITS:
DUAL-CLASS STOCK AND THE PREMIUM-TIER OF THE LONDON STOCK EXCHANGE

BOBBY V. REDDY

Abstract

The US has recently seen a surge in the use of 'dual-class stock' or 'weighted voting rights' (WVR) by publicly-listed companies in the technology sphere. Google, Facebook and Snap, amongst others, have adopted WVR-structure where the founders own unlisted shares to which enhanced voting rights are attached, while public shareholders only hold inferior-voting shares. This can enable founders to diversify their wealth and generate equity finance without losing control. Founders can retain control only holding a minority of the equity, and take long-term decisions largely insulated from the whims of the public markets. Founders without limits. In the UK, WVR-structure is proscribed on the premium-tier, the London Stock Exchange's most prestigious listing-tier. With a dearth of large tech-companies listing in the UK, and a plethora of acquisitions of UK tech-companies by foreign acquirors, the premium-tier prohibition of WVR-structure could be throttling the UK's tech-industry.

In this thesis, a theoretical and evidentiary approach is taken to the analysis of WVR-structure, one of the most significant topics in corporate governance today. It will be shown that a WVR-tradeoff operates, and, in certain circumstances, particularly in the context of long-term orientated, high-growth tech-companies, the structure's benefits can outweigh the detriments to public shareholders. It will also be shown that the existing empirical evidence is not indicative of WVR-firms harming public shareholders. The market adequately protects itself from the perceived risks by imposing discounts on WVR-firms. If the prohibition of WVR-firms from the premium-tier stems from a fear that public shareholders will be harmed, given that the market prices-in its risk, the prohibition is not justified by the evidence.

In fact, the level of discounts imposed on WVR-firms by the market is unwarranted by stock returns and operating performance. It is contended that if WVR-structure were to be permitted on the premium-tier, it would be prudent to implement judicious public shareholder protections, which will moderate the risks associated with the structure, and reduce the cost of capital for WVR-firms. High costs of capital could deter issuers from listing even if WVR-firms were permitted on the premium-tier. Crucially, any measures must tread a fine line between protecting public shareholders, and ensuring that restrictions are not so severe that they undermine the benefits of WVR-structure and cause founders to continue to eschew the premium-tier. A balanced protection package is proposed that provides a policy-driven roadmap toward the premium-tier finally embracing founders without limits.

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CHAPTER 1:
INTRODUCTION

1. The Cult of the Google Capital Structure

As of 31 December 2018, the founders of Google Inc. (with its holding company Alphabet Inc, hereinafter referred to as Google),[1] A, owned shares allocating them 51 per cent of the voting rights of the company, but only 11.3 per cent of the cash-flow rights.[2] As will be described in this thesis, the separation of cash-flow rights from voting rights accords the founders with greater freedom in the manner in which they can manage Google's business – 'founders without limits' so to speak. This is a clear deviation from the concept of 'one-share, one-vote' (OSOV) – the euphemistic term for the notion that each equivalent share in the equity of a company should have attached to it the right to a single vote on matters to be determined by shareholders, thereby ensuring that a shareholder's voting rights are directly proportional to its equity ownership. How did the founders engineer their ownership rights? On 19 August 2004, Google made an initial public offering (IPO) of its stock on NASDAQ, redesignating a proportion of the founders' stock as Class B shares, to which ten-votes-per-share were attached, and listing new Class A shares, which enjoyed only one-vote-per-share.[3] Only the Class A shares were made publicly available. The situation was further exacerbated in April 2014, when Google split its Class A stock into Class A and non-voting Class C stock, allowing Google to issue further stock without diluting the insiders' control of the corporation. Accordingly, Google's founders can retain control of their firm by holding a majority of the voting rights, whilst, by relinquishing the majority of cash-flow rights in the company, crystallising part of their investment in the company and tapping the public markets for finance.

In and of itself, Google's divergence from OSOV is not particularly noteworthy. NASDAQ and the New York Stock Exchange (NYSE) have permitted the listing of weighted voting rights (WVR) stock, often referred to as dual-class stock, for decades. However, more pertinently, as of the tenth anniversary of Google's IPO, its listed stock had gained 30.15 per cent a year on average, being the eleventh best performing stock on the Standard and Poor's 500 (S&P 500) during that time period, and the stock had increased in value by 1,293 per cent.[4] The company has gone on to become the third largest company in the world by market capitalisation.[5] This is even though the proxy advisor, Institutional Shareholder Services (ISS), soon after Google's IPO, rated the company near the bottom of its corporate governance rankings primarily as a result of its WVR-structure.[6] Google's remarkable stock performance, and the subsequent high

[1] On 2 October 2015, Alphabet, Inc. became the new listed holding company of Google.
[2] Ownership information gathered from: Schedule 13G/A filings by Larry Page (filed on 12 February 2018) and Sergey Brin (filed on 14 February 2019); Form 4 Statement of Changes in Beneficial Ownership filing by Sergey Brin (filed 3 December 2018); Form 5 Annual Statement of Changes in Beneficial Ownership filing by Larry Page (filed 8 February 2018); Schedule 14A Proxy Statement dated 27 April 2018.
[3] Registration Statement of Google Inc. (29 April 2004) [at iii].
[4] M. Krantz, 'Google's stock soars 1,293% in first 10 years' *USA Today Money* (19 August 2004).
[5] T. Bradshaw and A. Samson, 'Alphabet overtakes Apple as world's third-biggest company' *Financial Times* (3 January 2019) <https://www.ft.com/content/56ad7d64-0f66-11e9-acdc-4d9976f1533b> All URLs were last accessed on 1 April 2020 unless otherwise stated.
[6] J. Chemmanur, 'Dual Class IPOs: A theoretical analysis' (2012) 38 *J. Bank. Finance* 305, 305.

profile listings adopting WVR-structure (such as the flotations of Facebook, Inc. (Facebook),[7] Groupon, Inc. (Groupon),[8] and LinkedIn Corporation (LinkedIn)[9]), have recently brought into sharp focus the potential merits of WVR-structure. Equally, Snap Inc's (Snap) recent controversial NYSE-listing, which only offered non-voting stock to the public,[10] led to a resurfacing of the discussion surrounding the detriments of WVR-structure, even though the listing was oversubscribed.[11] The trend in WVR-structure has continued, almost becoming a cult in the technology sphere since Google's IPO, with the highly publicised listings of Lyft, Inc. (Lyft), Slack Technologies, Inc. and Pinterest, Inc. (Pinterest) in 2019.[12]

In bygone times, the UK was very much open to WVR-firms, with mainstays of the City such as Marks & Spencer, Shell, Whitbread, ITV, Burton Group, Ranks and House of Fraser all implementing WVR-structure. However, now, the London Stock Exchange's (LSE) main market (the Main Market) is divided into two tiers, a standard-tier and a premium-tier, and a capital structure similar to Google's would not be admitted to a premium-listing.[13] Although WVR-structure is permitted for standard-listings (and, indeed, on the Alternative Investments Market (AIM)), the most high profile public companies that are seeking the greatest access to equity finance in the UK will pursue a premium-listing. With greater corporate governance standards applying to premium-listings, companies are able to garner reputational benefits, since investors will view those companies as being less risky investments due to the more rigorous governance arrangements to which they have adhered,[14] and, significantly, only shares with a premium-listing may be included on the UK FTSE indices.[15]

This thesis will, from a UK context, analyse WVR-structure, specifically where a single shareholder (or a group of connected shareholders) retains control of a publicly-listed company while holding a disproportionately smaller portion of the equity. The analysis is undertaken with a view to liberalising the UK's approach to the listing of WVR-firms. As further discussed in Chapter 2, the regulators in the UK and the US do not appear to have formed their approaches to WVR-firms based upon normative considerations. The LSE's premium-tier prohibition of WVR-firms has been influenced by the views of the institutional investors that dominate the market. Conversely, the NYSE relaxed its rules based upon competition from other US-exchanges, lobbying by issuers and their managers, and the serendipity of a huge listed conglomerate flouting the NYSE's erstwhile prohibition on WVR-structure by issuing inferior-voting

[7] Upon listing, Facebook issued OSOV-shares to the public, while the founder Mark Zuckerberg and other initial investors retained shares with ten-votes-per-share (Registration Statement of Facebook, Inc. (1 February 2012) at 8).
[8] The founders of Groupon retained shares with 150-votes-per-share and issued OSOV-shares to the public (Amended Registration Statement of Groupon, Inc. (1 November 2012) at 134).
[9] LinkedIn issued OSOV-shares to the public, while one of the founders and certain venture capital investors retained shares with 10-votes-per-share (Amended Registration Statement of LinkedIn Corporation (17 May 2011) at 26). The company was subsequently taken private by Microsoft Corporation in 2016.
[10] Snap offered non-voting shares to the public, while certain initial investors and insiders retained OSOV-shares, and the co-founders, Bobby Murphy and Evan Spiegel, retained shares with ten-votes-per-share (Amended Registration Statement of Snap Inc. (8 February 2017) at 8.
[11] R. Levy, 'Snap's IPO is oversubscribed by $7 billion' *Business Insider UK* (24 February 2017) <http://uk.businessinsider.com/theres-more-than-10-billion-in-demand-for-snaps-hot-ipo-2017-2>
[12] Both Lyft and Pinterest implement a 20:1 voting ratio, and Slack Technologies a 10:1 voting ratio, between superior-shares and inferior-shares (Registration Statement of Lyft, Inc. filed 1 March 2019 at 194 (Lyft Registration Statement); Registration Statement of Pinterest, Inc. filed 22 March 2019 at 163; Registration Statement of Slack Technologies, Inc. filed 26 April 2019 at 154).
[13] See: Chapter 2.
[14] n 80 below, and accompanying text.
[15] n 86 below, and accompanying text.

shares.[16] In contrast, this thesis will take a theoretically and evidentiary robust approach toward WVR-firms, with a view to forming normative UK-policy.

This introductory Chapter will give a brief overview as to the reasons why a company may seek to utilise WVR-structure, and the reasons why a regulator may seek to limit its employment. It will continue with an explanation of why the topic of WVR-structure is important and topical in the context of the UK, and how this thesis contributes to the existing literature on WVR-structure. Finally, the scope and the assumptions of the thesis will be delineated, together with an explanation of the approach that this thesis takes to assessing WVR-firms.

2. It's All About Control

A first point of call is to briefly discuss why a company would list with WVR-structure, and why a regulator may wish to prohibit its use. Upon IPO, the existing owners of a company's stock will offer part of their stock to the public, cause the company to issue new shares to the public, or both. The IPO allows the existing owners to immediately, and in the future, cash-out part of their investment in the company, and also, if the company is issuing new shares, raise further finance for the company's business. Since a premium-listing in the UK entails OSOV, an IPO would require the existing owners to relinquish a proportion of their voting rights in the company through selling shares they own and/or dilution of their ownership from the issuance of further shares. Unless the existing owners retain a significant portion of their interest in the company, which limits the extent to which they can diversify wealth and the company can generate equity funding, they will lose control, since decision-making over the composition of the board[17] (which, in turn, generally possesses the power to select the management team of the business[18]) will shift to the public shareholders. In a dispersed-ownership system like the UK,[19] control would therefore be distributed amongst a disparate group of investors with varying investment horizons and agenda. A WVR-structure, currently excluded from premium-listings, involves certain shares in the company possessing a greater number of votes-per-share than other shares, allowing the pre-IPO owners of the company to retain high-voting 'superior-shares' while offering lower-voting 'inferior-shares' to the public. Accordingly, pre-IPO owners can sell a majority of their investment in the company and raise significant equity finance while potentially retaining control of the company through voting rights. Consequently, a wedge develops between the proportion of voting rights and the proportion of cash-flow rights owned by the holders of superior-shares (hereinafter termed the 'Wedge').

[16] n 98 Chapter 2, and accompanying text.
[17] Under the Companies Act 2006 (CA 2006), s.168, directors may be removed from office by the passing of an ordinary resolution (which requires approval by a majority of the votes exercised at the relevant shareholders' meeting (CA 2006, s.282)). Additionally, The Companies (Model Articles) Regulations 2008 (SI 2008/3229) (the Model PLC Articles), article 20, specifies that directors may be appointed by ordinary resolution, or by resolution of the board (provided that in the latter case, such director retires at the subsequent annual general meeting and is re-appointed by ordinary resolution (article 21)). In the absence of bespoke articles of association (articles), the Model PLC Articles will apply (s.20, CA 2006), and, commonly, public companies adopt an amended version of the Model PLC Articles.
[18] The board has the power to employ and dismiss managers under the Model PLC Articles, article 3.
[19] n 66 Chapter 2.

Studies show that the controllers of WVR-firms do indeed implement Wedges. US-studies from 1985[20] and 2010[21] found that the average Wedge was between 20 and 35 per cent. In the UK, before WVR-firms were discouraged by the LSE, a study of firms adopting WVR-structure between 1955 and 1982 found that insiders only held 17.5 per cent of the cash-flow rights on average.[22] Figure 1 sets-out 2015 data deduced by Bebchuk and Kastiel (2017)[23] framing the cash-flow rights held by the controllers (of voting rights) of the ten largest (by market capitalisation) US WVR-firms. For these companies, the Wedge is significant and tends to increase post-IPO. Although, in some cases, the votes held by insiders also change post-IPO, those insiders ensure retention of effective control over the company. Clearly the potential for a WVR-firm to exhibit a large Wedge plays out in practice, and further indicates that there is not a real-world equivalence between controlling shareholder and WVR-firms.

In contrast, why might a regulator be concerned about WVR-firms? A potential mischief, as discussed in Chapter 3, is that the controller could install a management team that prioritises the private interests of the controller over shareholder-wealth maximisation. However, control is not, in and of itself, the determinative factor. After all, controlling shareholder OSOV-firms, where the controller owns a sufficient proportion of the shares in the company to be able to appoint the board, are permitted on the premium-tier. Indeed, the companies Sports Direct International plc (Sports Direct), Ferrexpo plc (Ferrexpo), Fresnillo plc (Fresnillo) and Antofagasta plc are well-known examples of premium-listed companies where a single shareholder or group of affiliated shareholders hold more than fifty per cent of the shares (and therefore voting rights) in the company. However, the mischief identified is mitigated in a OSOV-system where the controller will necessarily need to own a large level of cash-flow rights in order to maintain control. With WVR, where the potential for a Wedge exists, the fear emerges that those in control of the company fail to fully feel the consequences of their actions.[24] To the extent that actions of the company are detrimental to shareholder-value, the controller will only suffer pain commensurate with its cash-flow interest in the company, which could be small if the Wedge is large. The public shareholders, holding inferior-shares, will not have any ability to replace the management team since control will reside with the holders of the superior-shares, and the incentive on the controller to replace a management team that does not maximise shareholder-value reduces as its cash-flow rights fall; a state of affairs that is exacerbated where the controller itself serves on the management team. In essence, the regulators have determined that WVR-structure incentivises the potential mischiefs of controllers.

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[20] H. DeAngelo and L. DeAngelo, 'Managerial Ownership of Voting Rights, A Study of Public Corporations with Dual Classes of Common Stock' (1985) 14 *J. Financ. Econ.* 33, 46 - finding insiders on average holding 56.9% and 24.0% of the voting and cash-flow rights, respectively.

[21] P. Gompers et al, 'Extreme Governance: An Analysis of Dual-Class Firms in the United States' (2010) 23 *Rev. Financial Stud.* 1051, 1053 – finding insiders on average holding 60% and 40% of the voting and cash-flow rights, respectively.

[22] J. Ang and W. Megginson, 'Restricted Voting Shares, Ownership Structure, and the Market Value of Dual-Class Firms' (1989) 12 *J. Financ. Res.* 301, 317.

[23] L. Bebchuk and K. Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock' (2017) 4 *Va. Law Rev.* 585, 608.

[24] F. Easterbrook and D. Fischel, 'Voting in Corporate Law' (1983) 26 *J. Law Econ.* 395, 409; J. Dammann, 'The Controlling Shareholder's General Duty of Care: A Dogma That Should Be Abandoned' (2015) 2 U Ill L Rev 479, 494; *The Economic Structure of Corporate Law*, eds. F. Easterbrook and D. Fischel (1991) (Massachusetts: Harvard University Press) at 73; C. Li et al, 'Ownership Structure and the Cost of Corporate Borrowing' (2011) 100 *J. Financ. Econ.* 1, 2; H. Hu and B. Black, 'The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership' (2006) 79 *S. Cal. L. Rev.* 811, 851; HKEX Concept Paper, 'New Board' (June 2017) at 18.

Company	Date of First Available Filing	Initial Cash-Flow Rights of Controller(s)	Cash-Flow Rights of Controller(s) as of 2015
Berkshire Hathaway Inc.	1999	32%	20%
Facebook, Inc.	2012	28%	15%
Alphabet, Inc.	2004	28%	12%
Comcast Corporation	1978	42%	0.4%
Nike, Inc.	1984	68%	31%
Ford Motor Company	1969	7.1%	1.8%
Regeneron Pharmaceuticals, Inc.	1991	7%	5%
Twenty-First Century Fox, Inc.*	2005	16%	15%
CBS Corporation	1995	26%	8%
Broadcom Corporation	1999	45%	8%
Average		**30%**	**11.6%**

* Subsequently taken private

Figure 1 - Cash-Flow Rights of the Controllers of the Ten Largest US WVR-firms as of 2015

3. Why WVR Bears Discussion?

'The most important issue in corporate governance today is dual class capitalization' – J. Coffee, the Adolf A. Berle Professor of Law at Columbia University Law School.[25]

The preceding quote is indicative of the significance attributed to the topic of WVR-structure, particularly in the US, but how is the subject topical in the UK? As outlined in Chapter 2, a prohibition of premium-listed WVR-firms has existed formally since 2014, and, informally, for far longer. However, a recent UK-Government Green Paper, in the context of supporting high-growth and innovative companies, raised the prospect of revisiting whether it should be easier for WVR-firms to list so that those companies can continue to take long-term business views without being beholden to short-term market tensions.[26] Subsequently, the UK's Financial Conduct Authority (FCA) published a discussion paper exploring the effectiveness of the UK-primary markets,[27] including the support of science and technology company growth, specifically examining potential market enhancements to encourage the provision of scale-up and patient

[25] J. Coffee, 'Dual Class Stock: The Shades of Sunset' CLS Blue Sky Blog (19 November 2018) <http://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/>

[26] The Department for Business, Energy and Industrial Strategy's Green Paper (January 2017), 'Building our Industrial Strategy' at 67.

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

capital to such companies.[28] It recognised that WVR-structure may be a method enabling founders to focus on long-term company performance, and that a new listing segment may be appropriate for large international companies with premium-listing incompatible control rights structures in place.[29] The possibility that WVR-structure can promote long-termism is discussed in more detail in Chapter 3, but, briefly, enabling a controller to retain control post-IPO allows that controller to protect the long-term vision of the managers, by insulating them from removal by public shareholders or opportunistic takeover approaches, as a result of short-term moribund share performance. Although a OSOV-controlling shareholder could similarly insulate the management team, if the controller desires to divest of a significant portion of its investment in the company or raise significant finance through the IPO, it runs the risk of losing control. Encouraging a long-term approach to business is a regulatory priority in the UK.[30]

Competitively, the FCA will, going forward, need to consider the implications of continuing with a premium-tier prohibition of WVR-firms in an environment where, recently, several jurisdictions have either opened the door to WVR-firms, or are contemplating the possibility. The primary exchanges of Japan,[31] Hong Kong[32] and Singapore[33] have all recently relaxed their rules to permit the admission of WVR-firms, and the Shanghai Stock Exchange (SSE) has created a new board to accommodate technology firms with WVR-structure.[34] India is currently consulting on whether to support the easier adoption of WVR-structure by listed-companies.[35] Along with the fact that all the major US-exchanges and the Toronto Stock Exchange (TSX) have permitted the listing of WVR-firms for 30-years or longer, the LSE may face significant competition for listings in the event of an increasing trend in the use of WVR-structure in the public sphere. Indeed, WVR-listings have shown a meteoric rise since Google's 2004 IPO – only 1 per cent of US-IPOs in 2005 adopted WVR-structure, as compared to 15 per cent in 2014 and 24 per cent in 2015[36] (even taking listings generally, rather than IPOs, 13.5 per cent of companies listing shares on US exchanges in 2015 involved WVR-structure, compared to 1 per cent in 2001[37]). More recently, 26 per cent of US-IPOs adopted WVR-structure in the first half of 2019.[38] Notably, in relation to large tech-companies, the use of WVR-stock in the US has accelerated in recent years, beyond the proportions seen for IPOs as a whole; Figure 2 shows the trend in WVR-firm IPOs for larger US-companies, splitting-out data for technology companies.

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[28] Ibid at Chapter 4.
[29] Ibid 8 and 22. Also, see: HM Treasury, 'Financing growth in innovative firms: Consultation' (August 2017) at 33.
[30] For example: The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report (July 2012) at 20; HM Government, 'Building our Industrial Strategy: Green Paper' (January 2017) at 64.
[31] K. Yoshii, 'A New Share-listing System in Japan' Asia Law Corp. Fin. Rev. (July 2008) 16.
[32] HKEX, 'Research Report: Listing Regime Reforms for Dual-Class Share Structure and Biotech Industry' (November 2018).
[33] SGX News Release, 'SGX launches rules for listing of dual class shares companies' (26 June 2018) <http://infopub.sgx.com/FileOpen/20180626_SGX_launches_rules_for_listing_of_DCS_companies.ashx?App=Announcement&FileID=511967>
[34] K. Ho, 'Examining the viability to allow dual-class share structure companies to list in the financial market of the People's Republic of China: Lessons and experiences from Hong Kong' (2019) 1, 26 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3408873&download=yes>
[35] Securities and Exchange Board of India, 'Issuance of shares with Differential Voting Rights [DVRs]' (March 2019).
[36] S. Feldman, 'Companies opting to go public offer investors class A one-vote-per-share stock, while founders and other insiders retain the class B super-voting shares for themselves' (2016) 47 SRLR 1342, 1342.
[37] S. Solomon, 'Shareholders Vote With Their Dollars to Have Less of a Say' *The New York Times* (4 November 2015) <https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html>
(4 November 2015) <https://www.nytimes.com/2015/11/05/business/dealbook/shareholders-vote-with-their-dollars-to-have-less-of-a-say.html>
[38] Council of Institutional Investors (CII), 'Dual-Class IPO Snapshot: 2017-2019 Statistics' <https://www.cii.org/files/issues_and_advocacy/DualClassStock/2019 Dual Class Update for Website FINAL.pdf>

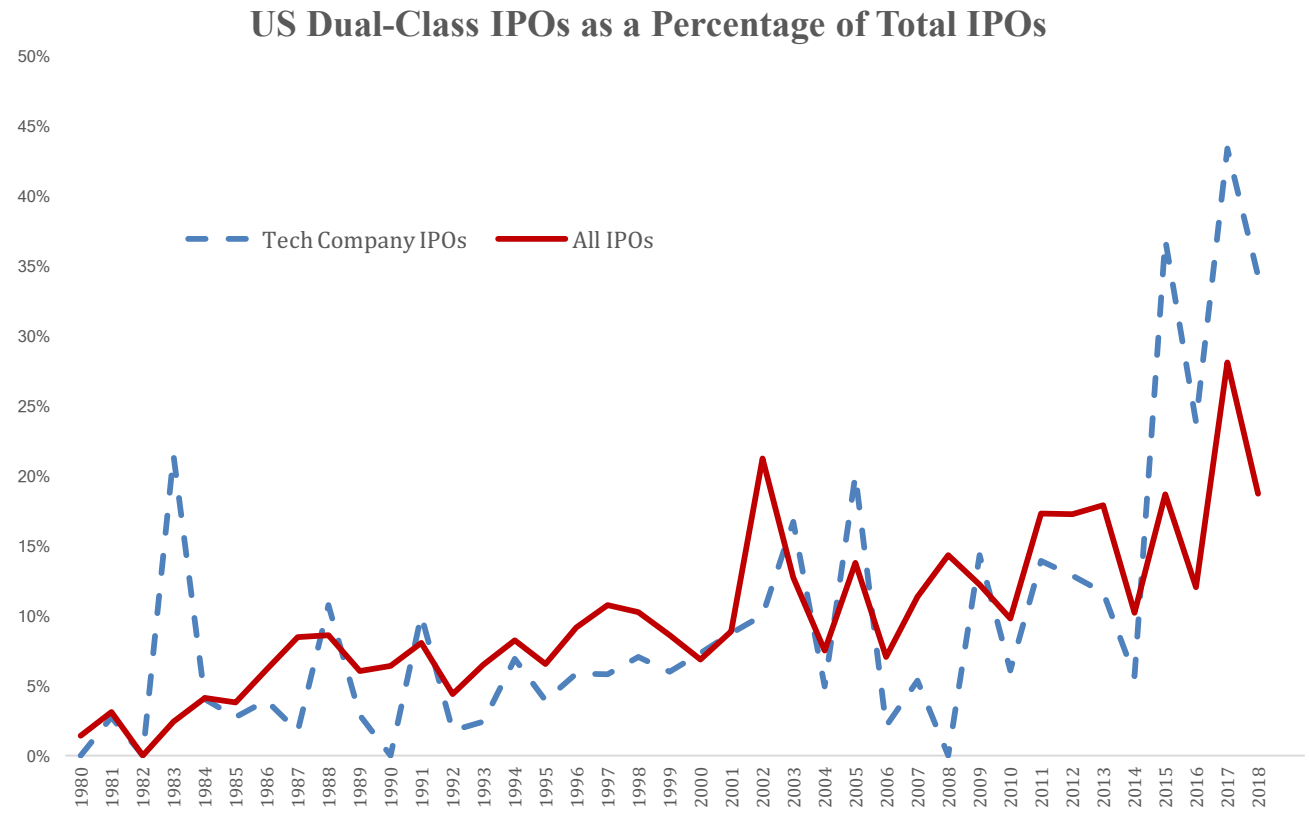


Figure 2 - US Dual-Class IPOs as a Percentage of Total IPOs

Data derived from: J. Ritter, 'Initial Public Offerings: Dual Class IPOs' (updated as of 19 December 2018) [39] <https://site.warrington.ufl.edu/ritter/files/2019/04/IPOs2018DualClass.pdf>

The discussion on WVR-structure does not run in a single direction, and, even in a bastion of WVR-firms, like the US, a backlash of sorts has arisen, with certain index-providers excluding, in whole or in part, WVR-firms from their indices.[40] A somewhat internecine battle has emerged in the US, with, on the one hand, individual institutional investors and representative bodies, such as the Council for Institutional Investors (CII), either deriding WVR-firms or endorsing OSOV,[41] and, on the other hand, issuers bemoaning that an aspiration toward shareholder democracy has morphed into a shareholder primacy that puts shareholder interests above those of other stakeholder groups.[42] In a provocative move, CII has recently 'named-and-shamed' individual directors who have signed-off on WVR-structure.[43] Despite the vitriol, however, the evidence is mixed as to whether institutional investors do, in fact, shun WVR-firms.[44] This can,

[39] Sample includes only Amex, NYSE, and NASDAQ IPOs with an offer price of at least $5.00.
[40] See: Chapter 2.
[41] For example, see: CII, 'Dual-Class Stock' <https://www.cii.org/dualclass_stock>; ProxyInsight, 'An interview with W. Robert Main III, Head of Portfolio Company Engagement, Analysis and Voting at Vanguard' *Proxy Monthly* (July 2017) at 4; Calpers Investment Committee, 'Dual Class/Non-Voting Shares Update' (April 2018) at 9.
[42] Business Roundtable, 'Statement on the Purpose of a Corporation' (August 2019) <https://opportunity.businessroundtable.org/ourcommitment/>
[43] CII, 'Dual-Class Enablers' < https://www.cii.org/dualclassenablers>
[44] Finding that institutional investor ownership in WVR-firms was the same or greater than such ownership in OSOV-firms: R. Anderson et al, 'The Dual Class Premium: A Family Affair' (2017) 1, 28 <https://ssrn.com/abstract=3006669>; Smart et al, 'What's in a vote? The short- and long-run impact of dual-class equity on IPO firm values' (2008) 45 *J. Account. Econ.* 94, 99; S. Smart and

perhaps, be explained by the real-world consideration that firms will possibly only list with WVR-structure if institutional investors will be attracted to the listing, which, as discussed in Chapter 3, will be associated with the market's faith in the controller of the company.[45] The recent abandonment of The We Company's (WeWork) WVR-structure IPO is a case-in-point.[46] Given the strong views on both sides, unsurprisingly, no coherent picture emerges from the approaches taken by various jurisdictions to WVR-firms, fluctuating between (i) an immutable devotion to OSOV in jurisdictions such as Australia; (ii) restricting WVR-firms to specific listing tiers, such as in the UK and Shanghai; (iii) permitting WVR-firm admissions on the main board subject to stringent conditions, such as in Hong Kong, Tokyo and Singapore; and (iv) a broad permissive environment for WVR-firms, such as in the US and Canada.

Given the increasing usage of WVR-structure by large US-listed technology firms, and the FCA's stated ambition to attract more science and technology companies to the Main Market, the WVR-debate should be pushed to the head of the queue of corporate governance issues meriting discussion. If numerous 'British Googles' are sought, felicitously, from an internet 'Google-search', only two technology companies – Micro Focus plc and Sage Group plc – have been consistent members of the FTSE-100 since the dotcom bubble burst of the early 2000s, and, after Sophos plc was recently taken private by a US-private equity firm,[47] Just Eat plc, which is itself the subject of a takeover offer by the Dutch firm Takeaway.com,[48] is the only other technology company among the 200 largest premium-listed companies.[49] Companies from 'new economy' (mainly technology) industries that have listed between 2007 and 2017 on the LSE make up only 14 per cent of total market capitalisation, compared with 60 per cent and 47 per cent on NASDAQ and the NYSE, respectively.[50] The business community has identified a lack of replacement tech flotations for listed-technology companies that have been taken private as a big problem for the UK-economy and UK-tech sector.[51] The dearth of UK-technology firms on the market does not appear to lie in factors such as skills-gaps, infrastructure obstacles or local culture – as of January 2019, the UK was home to 21 private company start-ups with individual valuations of over $1 billion, nearly half of the European total,[52] and technology research company Megabuyte has identified 134 private UK-tech companies that could be prime candidates for large flotations.[53] If WVR-structure can encourage flotations of UK tech-companies on the LSE, it is a topic that bears serious consideration.

C. Zutter, 'Control as a motivation for underpricing: a comparison of dual and single-class IPOs' (2003) 69 *J. Financ. Econ.* 85, 98; I. Dittmann and N. Ulbricht, 'Timing and Wealth Effects of German Dual Class Stock Unifications' (2007) 14 *Eur. Financ. Manag.* 163, 191. Finding slightly less institutional ownership of WVR-firms: K. Li et al, 'Do Voting Rights Affect Institutional Investment Decisions? Evidence from Dual-Class Firms' (2008) 37 *Financial Management* 713, 720; J. Kim et al, 'Multi-Class Shares Around the World: The Role of Institutional Investors' (November 2018) *Unpublished* 1, 19.

[45] nn 136-137 Chapter 3, and accompanying text.

[46] Ibid.

[47] N. Fildes, 'Why the UK tech scene is disappearing into private hands' *Financial Times* (22 October 2019) <https://www.ft.com/content/27f48fac-f0f8-11e9-ad1e-4367d8281195>

[48] RNS 8669H: Announcement of Recommended All-Share Combination of Takeaway.com N.V. and Just Eat plc (5 August 2019).

[49] N. Fildes, 'Busy buyers leave only two UK tech giants standing' *Financial Times* (14 January 2018) <https://www.ft.com/content/39bc9b86-f464-11e7-88f7-5465a6ce1a00>.

[50] HKEX Concept Paper (2017) (n 24 above 11).

[51] n 47 above.

[52] CBInsights, 'The Global Unicorn Club: Private Companies Valued At $1B+' <https://www.cbinsights.com/research-unicorn-companies>

[53] n 47 above.

Of course, permitting WVR-firms on the premium-tier will not guarantee that a plethora of large technology firms will seek listings on the Main Market, but, as further set-out in Chapter 3, WVR-structure can support the listing of large technology companies by allowing founders to significantly diversify wealth and raise equity finance while retaining control upon IPO - this enables those founders to pursue long-term approaches to achieve their visions, promoting significant benefits, in particular, for high-growth technology firms which may require intensive research and development (R&D) spending and entail long product-cycles. Before the merits of WVR-structure are considered, though, a reasonable question is whether promoting listings is even necessary if large UK-technology companies already exist in the private company sphere. Three important rebuttals should be made.

Firstly, although a detailed consideration as to whether and how vibrant equity capital markets benefit the economy is beyond the scope of this thesis, encouraging founders to list their firms can create benefits. Permitting WVR-structure on the premium-tier could promote innovation,[54] an important quality of any stock market,[55] by creating a viable option for founders of technology companies. Supporting the growth of scale-up companies through the provision of public equity financing should benefit the economy as a whole, increasing economic growth and creating jobs.[56] Easing the path toward IPO opens-up a source of financing for founders seeking to grow their companies to the next level.

Second, a public-listing gives UK-individuals, or retail investors, the opportunity to share in the growth and success of the relevant company.[57] Detailed rules govern the promotion of investment products, meaning that private companies, unlike public companies, are not, subject to restricted exemptions, able to offer securities to the general public or proactively solicit such investments,[58] unless the promotor of the investment has been authorised by the FCA (or the contents of the relevant financial promotion has been approved by such an authorised person),[59] or if the potential investor is a 'high net worth individual'[60] or a 'sophisticated investor'.[61] US research has shown that the net gain of the US stock markets over time has been driven by only a handful of firms.[62] Missing-out on the British Google or British Facebook could be a significant loss to a UK investor's portfolio. British firms could float with WVR-structure on foreign markets that permit such structures, and it is accepted that UK-individuals could invest in those firms and therefore participate in their success. Manchester United, a mainstay of the English football leagues, is an example of a UK-based business that listed on the NYSE with WVR-structure, foregoing exchanges that did

[54] D. Cipollone, 'Risky Business: A Review of Dual Class Share Structures in Canada and a Proposal for Reform' (2012) 21 *Dalhousie J. Legal Stud.* 62, 69.
[55] K-H. Bae and J. Kang, 'Does the Stock Market Benefit the Economy?' (2017) EFMA Symposium: Finance and Real Economy Accepted Papers (March 2017).
[56] Ibid.
[57] Cipollone (2012) (n 54 above 69); S. Feldman, 'BNA Insights: IPOs in 2016 Increasingly Include Dual-Class Shareholder Voting Rights' (2016) *SRLR* 1, 3; A. Friedman, 'The Promise of Market Reform: Reigniting America's Economic Engine' *Harvard Law School Forum on Corporate Governance and Financial Regulation* (18 May 2017).
[58] CA 2006, s.755; Financial Services and Markets Act 2000 (FSMA 2000), Part II, and The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2000/1529) as amended (FPO).
[59] FSMA 2000, s.21.
[60] FPO, article 48.
[61] FPO, article 50.
[62] The net gain for the US stock markets between 1926 and 2016 can be attributed to only four percent of listed companies (H. Bessembinder, 'Do Stocks Outperform Treasury Bills?' (2018) 129 *J. Fin. Econ.* 440, 456)

not permit the structure.[63] However, in such cases, foreign exchanges and foreign-based advisors will garner the associated financial benefits of the listing, and UK-investors may still find it difficult to participate in the relevant flotation, often requiring foreign-based investment accounts and unfamiliar regulations. Even indirect exposure to foreign listed-companies through investments in UK-based pension plans, insurance products and investment funds which seek to be diversified amongst several jurisdictions, may be limited, since such UK-based institutional investors will retain a significant proportion of their investments in the UK.[64] In any event, several factors may deter UK-firms from listing abroad, further restricting the ability of UK-investors to participate in the growth of those companies. If there is an unfamiliarity in the foreign market with the brand and products of the UK-company, it will not be able to improve the success of the listing by capitalising on its reputation in its home product-market, and, from the opposite perspective, it may not be able to leverage the publicity of the listing into better sales in its main product-market.[65] Listing costs will also be more extensive for a UK-company listing abroad with requirements to instruct foreign as well as local advisors and ensure that accounts are compatible with the foreign jurisdiction's requirements.[66] The company will also need to accommodate the litigious culture of the foreign jurisdiction which may differ from the UK,[67] and it may be subject to greater ongoing regulatory compliance costs.

Third, it is pertinent to assess what happens to UK-technology companies that grow to a size where public equity finance would be beneficial to their growth, but determine not to pursue a UK-listing. UK-technology companies are disproportionately the subject of mergers and acquisitions (M&A) activity compared with their international peers.[68] In the US, rumours abound that the founders of Snap listed the company after turning down a takeover offer from Google that exceeded the IPO valuation of the company, after rejecting a smaller offer from Facebook in 2013.[69] Similarly, Groupon rejected a takeover offer from Google soon before its IPO.[70] However, in the UK, as shown in Figure 3, in the last five years, numerous examples exist of private UK-technology companies being acquired rather than listing on the UK-markets. Notably, this M&A activity is dominated by foreign acquirors. Although such companies may not be moving abroad wholesale in every case, foreign control not only takes such companies outside the ambit of investment possibilities for retail investors, but could also see the drip-feed of operations, jobs and talent to other jurisdictions. As an example, although Google is a large employer in the UK, after acquiring the British-based DeepMind, segments of its business, including units dedicated to the commercialisation of DeepMind's technology, have been moved to the US.[71] Therefore, the potential for WVR-structure to

[63] R. Chan and J. Ho, 'Should Listed Companies Be Allowed to Adopt Dual-Class Share Structure in Hong Kong?' (2014) 43 Comm. L. World Rev. 155, 168.
[64] Office for National Statistics (ONS), 'MQ5: Investment by insurance companies, pension funds and trusts: October to December 2018' (March 2019) at 26.
[65] M. Pagano et al, 'The Geography of Equity Listing: Why Do Companies List Abroad?' (2002) 57 *J. Financ.* 2651, 2658-9.
[66] J. Fanto and R. Karmel, 'A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing' (1997) 3 *SJLBF* 51, 66.
[67] Ibid 67.
[68] n 27 above 26.
[69] J. Constine, 'Google reportedly offered $30 billion to acquire Snapchat' *TechCrunch* (3 August 2017) <https://techcrunch.com/2017/08/03/google-buy-snap/>
[70] O. Thomas, 'Why Groupon Really Turned Down Google's $6 Billion Offer' *Business Insider* (2 June 2012) <https://www.businessinsider.com/groupon-google-deal-turn-down-2012-6?r=US&IR=T>
[71] M. Murgia, 'DeepMind co-founder's leave of absence signals transition' *Financial Times* (23 August 2019) <https://www.ft.com/content/45bb157a-c4f6-11e9-a8e9-296ca66511c9>

UK Private Company Target	Year of Acquisition	Acquiror	Jurisdiction of Acquiror	Acquisition Price
DeepMind	2014	Google	USA (NYSE-listed)	$650m
Vero Software	2014	Hexagon AB	Sweden (NASDAQ Stockholm-listed)	Unannounced
Swiftkey	2015	Microsoft Corporation	USA (NASDAQ-listed)	$250m
Onefinestay	2016	Accor	France (EURONEXT Paris-listed)	£177m
Skyscanner	2016	Ctrip.com International, Ltd	China (NASDAQ-listed)	$1.4b
Magic Pony Technology	2016	Twitter, Inc.	USA (NYSE-listed)	$150m
Shazam	2017	Apple Inc.	USA (NASDAQ-listed)	$400m
Momondo	2017	Booking Holdings	USA (NASDAQ-listed)	$550m
Silverrail	2017	Expedia	USA (NSADAQ-listed)	$148m
Vocalink	2017	Mastercard	USA (NYSE-listed)	$700m
Nyx Games	2018	Scientific Games	USA (NASDAQ-listed)	$626.5m
Callcredit	2018	TransUnion	USA (NYSE-listed)	$1.4b
Ziylo	2018	Novo Nordisk	Denmark (NASDAQ Copenhagen-listed)	$800m
Foundry	2019	Roper Technologies	USA (NYSE-listed)	$544m

Figure 3 - Large (over £100m) acquisitions of UK-private technology companies since 2014

(Sources: ONS, 'Mergers and Acquisitions Involving UK Companies' (publications from Q3 2014 to Q2 2019); A. Sword, '6 of the biggest UK tech acquisitions by overseas giants' *CBR* (18 July 2016) <https://www.cbronline.com/internet-of-things/6-of-the-biggest-uk-tech-acquisitions-by-overseas-giants-4952343/>; A. Hern, 'Is the global desire to buy British a bad thing for UK tech firms?' *Guardian* (16 December 2017) <https://www.theguardian.com/business/2017/dec/16/uk-tech-companies-bought-by-overseas-giants-apple-shazam>)

encourage UK-listings is pertinent, notwithstanding the existence of large private UK-tech companies.

4. Why are British Technology Companies Being Bought-Out?

Although venture capital (VC) financing may be available in the early stages of a start-up company, late-stage VC-funding deals are much larger in the US than in the UK,[72] and a gap has been identified in available financing in the 'scale-up' phase where start-ups seek to emerge as large, established businesses.[73] Such companies are often found within the science and technology industries and attain a size that is beyond

[72] n 27 above 26.

[73] ibid 26 - 'scale-up companies' are those with average growth in employees or turnover of more than 20% per annum over three years, with a minimum of 20 employees at the start. Also, see: HM Treasury (2017) (n 29 above 11); A. Bravo-Biosca, 'Firm Growth Dynamics across countries' (2016) *NESTA working paper* no.16/03 <https://media.nesta.org.uk/documents/wp16-03_firm_growth_dynamics-17.pdf>; S. Rigos, 'The UK equity gap, 'Why is there no Facebook or Google in the UK?'' (2011) *Greater London Authority* at 25. More recently, late-stage VC-funding has increased in the UK, which dominates the European market, but late-stage VC-funding in Europe generally lags behind the levels observed in the US (KPMG Enterprise, 'Venture Pulse Q2 2018: Global analysis of venture funding' (July 2018) at 2, 43 and 74).

further VC-funding.[74] Why are these companies foregoing UK-listings, and succumbing to buy-outs, when listing could be the evident next step in their evolution? At least with respect to the premium-tier, an aversion to losing control upon IPO to a disparate group of shareholders, the agenda and intentions of which may be completely unknown, could be deterring founders. With OSOV, a founder could retain control by continuing to own sufficient equity in the company post-IPO, but floating as a controlling shareholder-firm may be unrealistic - without sufficient equity funding (which dilutes the founder's control) the founder may not be able to fund its vision, and the founder may be averse to the risks implicit in a large proportion of its net worth bound to a single investment. As discussed in more detail in Chapter 3, the retention of control, and therefore insulation of the management team from removal, can be particularly crucial to founders of technology companies, with long product-cycles, that need to make long-term investments potentially at the expense of short-term profits.[75] Additionally, at IPO, as a result of commercial and competitive sensitivities, a technology company may not be able to disclose detailed long-term plans, nor elaborate on product direction and revenue generation. Consequently, the mismatch in information between the founder and potential investors can lead to the shares of the company being undervalued, and deter the founder from listing.[76] The founder may only be willing to accept such undervaluation if it is able to compensate itself through extracting other benefits post-IPO.[77] As detailed in Chapter 3, those benefits can only be extracted if the founder retains control - known in the common literature as 'private benefits of control', but referred to herein as 'controller benefits'. These concerns, which WVR-structure can alleviate, could be causing UK-technology companies from foregoing UK-listings.

Perhaps one could contend that the UK is already sufficiently permissive since WVR-structure is only proscribed on the premium-tier, and an issuer could list with WVR-structure on AIM or on the standard-tier of the Main Market, thereby negating many of the discouraging factors linked to OSOV-listings above. However, there are difficulties with this contention. Firstly, in comparison to the Main Market, AIM was established for smaller and growing companies,[78] with less onerous listing requirements,[79] and therefore embraces an investor-base reflective of the types of companies that list on the exchange. For a larger company, such as Google, it is unlikely that AIM would represent a suitable market to promote the levels of liquidity or raise the levels of finance required. Second, in relation to the Main Market, the LSE has marketed the premium-tier as its most prestigious tier, to which the highest standards of corporate governance are applicable.[80] More stringent admission requirements apply, including the need to appoint a sponsor, evidence a three-year revenue earnings track-record, have had control over the majority of its assets

[74] Ibid.
[75] See: '*Long-Termism*' in Chapter 3.
[76] M. Cremers et al, 'The Life-Cycle of Dual Class Firms: From IPO to Sunset' (2018) *ECGI Working Paper* No. 550/2018 1, 8; Bebchuk, 'Asymmetric Information and the Choice of Corporate Governance Arrangements' (2002) *Harvard Law School Discussion Paper* No. 398 1; Z. Goshen and A. Hamdani, 'Corporate Control and Idiosyncratic Vision' (2016) 125 *Yale L.J.* 560, 579.
[77] J. Gordon, 'Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice' (1988) 76 Cal. L. Rev. 1.
[78] White Page Ltd in association with the London Stock Exchange, 'A Guide to AIM' (2010) at 4.
[79] AIM companies are not subject to the Main Market's minimum capitalisation (£700,000), three-year trading record, nor free-float requirements (ibid 6).
[80] The premium-tier requires standards that are super-equivalent to the EU's minimum mandatory requirements, and therefore 'provides protection for investors, promotes shareholder confidence and acts as a badge of quality for companies' (FSA Consultation Paper 098/28, 'Listing Regime Review: Consultation on changes to the listing categories consequent to CP09/24' (November 2009) at 4).

for a three-year period, and evidence three-years of unqualified audited accounts. After listing, premium-listed companies are subject to more stringent requirements related to, for example, the implementation of large and related-party transactions, pre-emption rights, and minority investor protections in the presence of controlling shareholders, and are required to apply the UK Corporate Governance Code (UK CGC). The greater corporate governance standards associated with the premium-tier lends it prestige, attracting greater levels of investment by a larger number of sophisticated investors, and, consequently, attracts issuers, since such companies will be able to draw a greater level of investment at potentially a better price. The inferiority-complex associated with the standard-tier may have deterred large UK-firms from listing on that tier - even though WVR-firms, and the listing of inferior-shares, are permitted, as of December 2018, excluding preference shares, only three companies have standard-listed inferior-shares (and, in fact, their inferior-shares were previously premium-listed, but downgraded to the standard-tier after the FCA's formal prohibition of non-voting shares[81]). Two of those companies have premium-listed their superior-shares, and the other has not listed its superior-shares.[82] The FCA itself has admitted that a standard-listing is often considered unattractive for many potential issuers, with the very name connoting 'second-best' status.[83] Advisors often advise issuers not to list on the standard-tier,[84] and separating the Main Market into two-tiers has created a lack of clarity and uncertainty as to the purpose of the standard-tier.[85] A WVR-firm that would otherwise satisfy the premium-tier requirements would not be able to take advantage of the prestige attached to a premium-listing.

More crucially, non-premium-listed firms are excluded from the UK FTSE-indices, which comprise sub-categories of firms ranked on the basis of market capitalisation.[86] Even if the FCA could refine the framework around standard-listings to attenuate the 'second best' moniker attached thereto, as considered in its 2017 discussion paper,[87] a large WVR-firm would be considerably disadvantaged by a lack of access to the indices. Inclusion on the indices can improve liquidity and create a 'bump' in share price.[88] One reason for this is that certain investors, known as passive index trackers, slavishly track the performance of benchmark indices such as the FTSE-100 in the UK, and are therefore compelled to invest in their constituents.[89] Such passive investment funds represent significant assets under management,[90] from which

[81] See: Chapter 2.
[82] From a review of the FCA's 'The Official List' on 20 December 2018, excluding preference shares, only Schroders plc (Schroders) and Hansa Trust plc (Hansa) listed both non-voting shares and voting shares on the Main Market. Daily Mail & General Trust plc (Daily Mail) listed only non-voting shares.
[83] n 27 above 19.
[84] Ibid 19.
[85] Ibid 22.
[86] The FTSE-indices are maintained by a subsidiary of the LSE.
[87] n 27 above 14.
[88] B. Sharfman, 'A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs' (2018) 63 *Villanova Law Rev.* 1, 4; Anderson et al (2017) (n 44 above 7); D. Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanf. Law Rev.* 687, 711; S. Hirst and K. Kastiel, 'Corporate Governance by Index Exclusion' (2019) 99 *B.U. L. Rev.* 1229, 1253-4.
[89] For a more detailed description of index funds and the way in which they operate, see: L. Bebchuk and S. Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (November 2018) 1, 15 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3282794>; B. Cheffins, 'The Undermining of UK Corporate Governance (?)' (2013) 33 OJLS 503, 508; D. Solomon, 'The Importance of Inferior Voting Rights in Dual-Class Firms' (2017) 1, 27 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3179375>; Lund (2019) (ibid 732).
[90] In 2017, passive funds accounted for approximately 26% of all UK assets under management, rising from only 17% in 2008, with the upward trend appearing to continue (The Investment Association, 'Asset Management in the UK 2017-2018: The Investment Association Annual Survey' (September 2018) at 50).

standard-listed shares are completely excluded. Certain active funds will also be mandated to only invest in the shares of companies included in specific indices. Additionally, the performance of fund managers of non-index trackers may be assessed against the performance of indices, in which case, the fund managers are likely to invest a portion of assets under management in the indices in order to hedge risk.[91] Active investors that nonetheless track indices are sometimes referred to as 'closet indexers'[92] and indirectly represent another source of demand (increasing price and liquidity) for the shares of index constituents. Therefore, in practice, the prohibition of WVR-firms from the premium-tier represents an almost complete restriction on large WVR-listings in the UK, and this is reflected by the scarcity of firms adopting WVR-structure on the standard-tier.

Although other avenues of finance may be available to founders that would enable them to grow their companies without submitting to acquisitions, they all entail compromises. Debt-financing, for instance, allows the controller to retain overall control of day-to-day management and strategic decisions, but it constrains the actions of the company through debt covenants. Also, absent the close bank-ownership relationships found in jurisdictions such as Germany and Japan,[93] significant levels of debt-financing may not be available to start-up technology firms with little or no profits history. Pertinently, many recent US-listings have involved pre-profit companies, particularly in the high-growth technology sphere.[94] A lack of available debt-financing is especially acute in high asset specificity industries, again, like high technology industries which require investment in risky, long-term projects.[95] R&D spending can therefore be hampered where access to equity markets is more limited and firms are reliant on debt-financing.[96] Additionally, the incurrence of large amounts of debt, which is also a consequence of private equity funding, can lead to a firm shrinking to an inefficiently small size, with significant, regular interest payments throttling the ability of the company to invest and grow,[97] and, could discourage the pursuit of risky, potentially lucrative, projects, since the company will need to retain cash to pay-off debt withouth becoming insolvent. Furthermore, large levels of debt may be unserviceable by a growth-phase company making little in the way of profits. From the founder's perspective, debt also does not solve a desire of a founder to diversify wealth, since the founder is still retaining its equity.

If UK-companies are less able to tap late-stage VC-financing as compared to US-companies,[98] another option, at a later stage in the company's life-cycle, is to submit to a private equity buy-out. This still presents a dilemma for the controller, since it may involve the incurrence of significant debt, and is

[91] Cheffins (2013) (n 89 above 513); Hirst and Kastiel (2019) (n 88 above 1256).
[92] Hirst and Kastiel (2019) (ibid 1250).
[93] J. Franks and C. Mayer, 'Ownership and Control of German Corporations' (2001) 14 *Rev. Financial Stud.* 943, 948); J. Franks et al, 'The Ownership of Japanese Corporations in the 20th Century' (2014) 27 *Rev. Financial Stud.* 2580; E. Von Thadden, 'Long-term contracts, short-term investment and monitoring' (1995) 62 *Rev. Econ. Stud.* 557.
[94] In 2016, 68% of US IPOs involved pre-profit companies, rising to 75% and 92% of technology and biotechnology listings, respectively (HKEX Concept Paper (2017) (n 24 above 15).
[95] M. Maher and T. Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' (1999) *Organisation for Economic Co-Operation and Development* 1, 36.
[96] *Corporate Governance and Economic Performance*, ed. K. Gugler (Oxford: Oxford University Press (2001)) at 29; M. Bradley et al, 'On the Existence of an Optimal Capital Structure: Theory and Evidence' (1984) 39 *J. Financ. Econ.* 857, 874.
[97] L. Bebchuk et al, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in *Concentrated Corporate Ownership* (ed. R. Morck) Chicago: The University of Chicago Press (2000) at 309.
[98] nn 73-74 above.

traditionally conditional upon the ceding of extensive control, particularly over important strategic decisions, to the private equity firm. The sponsor, in a typical private equity deal, will own a majority, and usually a significant majority, of the shares in the company, will have enhanced board-voting rights, and will be able to compel the founders into a sale or listing of the company through the use of drag-along rights and demand registration rights. An alternative funding option to a private equity buy-out is minority investment by private equity investors. Such investments have become more common since 2008 (albeit forming only a significant minority of private equity transactions),[99] leading to a blurring of the line between VC and private equity. Such minority investments could allow a founder to procure significant financing (or liquidate wealth) without having to cede overall control of the company at a later stage than traditional VC-financing. Although perhaps preferable to debt-financing or a majority private equity buy-out, such transactions will still involve substantial minority shareholder protections in favour of the private equity firm, including possibly veto rights over major transactions and decisions of the company. The private equity investor may also be issued with instruments such as preference shares or convertible debt securities which will require the company to generate regular distributable profits.[100] Furthermore, the primary driver of the private equity investor will be to exit at a significant profit, and the focus of the company can shift from long-term success to ensuring a timely exit for the private equity firm. Although the success of any secondary buy-out or OSOV-IPO will be dependent upon the new investors determining that the business has encouraging growth prospects, *ceteris paribus*, the existing owners will likely have to show at least a degree of visible short-term progress in order to garner a profit on investment. In any event, such transactions still only form a minority pursuit of private equity firms, particularly in Europe,[101] and, therefore, currently, minority private equity investments can not be seen as a substitute for WVR-listings. Relatedly, though, minority private equity investment could become more prevalent if WVR-premium-listings were permitted, since such listings represent another avenue of exit for those investors which founders may be more likely to pursue if they could retain control. Similarly, larger traditional VC-investment may be promoted with the increased likelihood of a profitable exit.

All of which brings us to strategic M&A, where a founder may see growth potential by putting the company up for sale, and allowing a larger company, with greater resources, to acquire the firm. The consideration for the acquisition may also include the grant of a not insubstantial equity award in the acquiring entity. Although a takeover of the company implicitly involves the founder ceding authority to the acquiror, if that acquiror shares the vision of the founder and has a reputation for long-term decision-making, the founder may be content to sell-out with confidence that he/she will be given a degree of free-reign in continuing to manage the company without fear of dismissal on the basis of short-term considerations. With an acquisition, the acquiror will be known to the founder, whereas, with a listing where the founder does not retain control, the initial IPO-investors will not be certain, and, subsequently, such investors may regularly

[99] Globally, minority buy-outs by private equity firms rose from an average of 13% of all private equity deals between 2004 and 2007 to an average of 27% between 2008 and 2014 (A. Schneider and C. Henrik, Boston Consulting Group, 'Private Equity Minority Investments: Can Less Be More' (2 April 2015) <https://www.bcg.com/en-gb/publications/2015/private-equity-minority-investments-can-less-be-more.aspx>; Herbert Smith Freehills, 'European Private Equity Review' (Autumn 2017).

[100] It is likely that, in the private equity context, a sponsor will require the terms of preference shares to provide that distributions must be made in accordance with those terms whenever profits are available for the purpose.

[101] ibid.

change over time and are likely, in the UK, to be dispersed, each only holding a small interest.[102] The attraction of dealing with one known quantity as opposed to numerous unknown shareholders is obvious. With the latter, share price becomes a proxy for success.

In summary, given the options, it should be of no surprise that large UK-technology firms are eschewing listings in the UK, and, instead, seemingly selling-out to foreign acquirors. If Snap or Groupon were UK companies, the founders would perhaps have been more inclined to accept Google's respective rumoured offers.[103] Since WVR-structure can persuade founders to list their firms in the UK, an assessment as to whether there should be a thawing of relations between the premium-tier and WVR-structure is more topical than ever.

5. Contribution to the Literature and Structure of the Thesis

The benefits and detriments of WVR-firms have been debated for decades. Unsurprisingly, since the largest WVR-firms are listed in the US, the vast majority of evidence, in terms of theory, empiricism and anecdote, pertains to that jurisdiction. Although evidence from the US and other jurisdictions will be critically examined, this thesis presents a theoretical evaluation of WVR-structure in the public company sphere, primarily from a UK-perspective. As far as this author is aware, this is the first conceptual approach to the research of WVR-structure in the era of 'Big Tech',[104] that normatively assesses whether the UK should relax its rules prohibiting WVR-structure from the premium-tier, and, if such a relaxation were recommended, whether any restrictions should be imposed upon their operation. As discussed in Chapter 2, the UK-regulatory approach to WVR-structure has not necessarily been driven by careful scrutiny of the pros and cons, and the UK-regulators have not openly deliberated upon the specific consequences of proscribing or prescribing such structures from the premium-tier, nor the possibility of implementing inferior-shareholder protection mechanisms. Therefore, this thesis will gauge the literature, theory and empirical evidence on WVR-structure, while also considering the real-world consequences within the UK's regulatory and market milieu, with a view to forming normative policy.

The first part of this thesis sets the scene for an analysis of WVR-firms, and the remainder of this Chapter will delineate the scope of the thesis, and its theoretical basis. An open enquiry into WVR-structure would be exceedingly wide-ranging, and, therefore, on pragmatic grounds, as reasoned below, the scope of this thesis will be limited. Only controlling shareholder firms that implement WVR-structure as of IPO, with only one class of inferior-share publicly-listed, are considered. Such a stance would open-up the market to founders of non-listed companies desiring to grow their firms and/or diversify their wealth while retaining control; once such relaxations have been made, other structures and manners of adoption can be appraised by

[102] J. Franks and C. Mayer, 'Evolution of Ownership and Control Around the World: The Changing Face of Capitalism' (2017) *ECGI Finance Working Paper No. 503/2017* 1, 36 and 43; C. Holderness, 'Blockholders Are More Common in the United States Than You Might Think' (2010) 22 *J. Appl. Corp. Finance* 75, 79; G. Aminadav and E. Papaioannou, 'Corporate Control Around the World' (2016) *NBER Working Paper 23010* 1, 19 and Appendix Table 1.
[103] n 69-70 above.
[104] 'Big Tech' refers to the current trend in major technology companies with inordinate market, public and societal influence, particularly the companies Google, Apple, Facebook and Amazon (R. Foroohar, 'We need to talk about Big Tech' *Financial Times* (3 October 2017) <https://www.ft.com/content/64a20c34-a769-11e7-93c5-648314d2c72c>

further research. Chapter 2 chronicles the history of the UK's regulatory approach to WVR-firms. This background will be juxtaposed with the annals of the NYSE's attitude to such firms. Although the UK- and the US-markets should not be completely conflated, and analogies should be drawn carefully, a comparison of the jurisdictions can be reasoned on the basis that the NYSE provides the closest market to the LSE in terms of breadth, investment-base, maturity and ownership structure of publicly-listed firms.[105] Additionally, the majority of the existing literature on WVR-firms relates to, and the largest WVR-firms globally are based in, the US, and, consequentially, lessons learnt from the US could be pertinent in a UK context. Chapter 2 will show that both in the UK and the US, extraneous factors, rather than normative considerations, have principally influenced the approach to WVR-firms. Given the lack of a thorough theoretical and evidentiary approach by the regulators, this thesis will fill-the-gap with a detailed UK-focused analysis of WVR-structure.

The second part of this thesis will assess the evidence on WVR-firms. Generally speaking, the benefits and detriments of WVR-structure, and the empirical evidence in relation thereto, will be evaluated from the perspective of public investors. It is acknowledged that the adoption of WVR-structure could have much wider societal impacts, but since the provenance of WVR-restrictions in the UK relates to the protection of public shareholders,[106] the first persuasive argument to permit premium-listed WVR-firms should lie in ascertaining the consequences for public shareholders.[107] Chapter 3 notes that with OSOV-controlling shareholder firms, the potential conflict that concerns the regulators and the markets is between the controller and the minority shareholders, which is exacerbated with the addition of WVR-structure, since the incentive to disregard the interests of the inferior-shareholders is amplified where the controller owns disproportionately less of the cash-flow rights. However, the types of behaviour detrimental to public shareholders that may be incentivised by WVR-structure must be contrasted with the potential for the structure to enable the controller to operate the firm in a manner that is beneficial to all shareholders, not just the controller. A new formulation of the tradeoff between the detriments and benefits of WVR-structure will be constructed that involves an appraisal of controller benefits. Certain controller benefits will generate consequential benefits that are valuable to the outside shareholders, notwithstanding that the controller derives personal advantage. Regulators should focus on maintaining a balance such that those controller benefits that are benign outweigh those that are pernicious to public shareholders. Sufficient benefits exist to warrant WVR-structure being an option for firms seeking premium-listings, but regulators should be cognisant that the tradeoff for a specific firm could shift over time. The empirical evidence is critically reviewed in Chapter 4, with a view to establishing whether WVR-firms are, in truth, harmful to public shareholders. Existing studies are divided into those that assess market reaction to WVR-adoption, how the market values WVR-firms as compared to OSOV-firms, the returns earned by outside shareholders investing in WVR-firms, and how WVR-firms perform from the perspective of accounting measures. It will be shown that although the markets generally react negatively to the adoption of WVR-structure, and WVR-firms are mainly discounted by the market as compared to OSOV-firms, a majority of studies find that WVR-firms

[105] nn 66-68 Chapter 2.
[106] See: Chapter 3.
[107] Also, see: '*The Approach of this Thesis to the Purpose of the Firm*' below.

display real-world outperformance of OSOV-firms, and buy-and-hold investors do not earn lower returns by investing in portfolios of WVR-firms rather than OSOV-firms. In fact, a more nuanced picture may be emerging whereunder WVR-structure can generate substantive benefits for all shareholders under certain conditions and during specific firm life-cycle periods. It will be argued that WVR-firms do not, on average, harm public investors, since investors price-in the perceived risks of the structure. If anything, the discounts applied to WVR-firms by the market are not justified by the real-world performance of such firms, and the discussion should turn to reducing the cost of capital for WVR-firms.

Using the evidence gathered in the second part of this thesis, the final part of this thesis purveys the road ahead, embarking upon crafting a package of protection mechanisms for inferior-shareholders that limits the potential for the detriments of the structure to outweigh the benefits. In such a way, the cost of capital for WVR-firms, if permitted on the premium-tier, could be reduced. Chapter 5 sets-out the existing qualities of the UK-public markets and of UK-regulation that could operate to constrain potentially nefarious conduct by WVR-controllers. Chapter 6 critically analyses the protective measures subsisting in other jurisdictions, and other types of mechanisms that could possibly curtail the more egregious actions of WVR-controllers, in order to construct a package that will assuage some of the concerns of investors and regulators, and attenuate the discounts customarily applied to WVR-firms, smoothing the path toward the introduction of WVR-firms to the premium-tier. It will be argued that the package is a 'balanced package', such that protection of inferior-shareholders from the excesses of controllers is balanced against the desire to attract founders to the Main Market. The package aims to curtail the extraction of the most pernicious controller benefits, while permitting the more benign forms, since a total curb of controller benefit extraction will eliminate the reasons for founders adopting WVR-structure in the first place.

6. Scope and Assumptions

The WVR-world is broad and can encompass preference shares, golden shares and loyalty shares, as well as generating dispersed-ownership, controlling shareholder and multiple large blockholder structures. Such structures can also be adopted before, during or after IPO. Each type of capital or ownership structure, and adoption-method, presents a different set of considerations. However, to maintain the feasibility of this thesis, and to ensure that a manageable approach can be propositioned, the scope will be limited, and assumptions applied. It is submitted that the limited scope provides a focused route to an initial relaxation of the premium-tier prohibition of WVR-firms. After such a relaxation, subsequent research can be instructive as to whether the relaxation should be extended further to encompass other types of WVR-firms and methods of implementation.

Scope

This thesis only examines pure WVR-structure, being a structure where voting rights vary between different classes of shares, but otherwise the rights attached to those shares are equal. Companies issuing

preference shares are not, for the purposes of this thesis, included as WVR-firms. Preference shares are often non-voting, but compensate the holders of such shares by awarding them with preferential dividend rights and/or preferences in distributions upon a winding-up of the company. In such circumstances, the dynamics of the relationship are different from pure WVR-structure. The Listing Rules sourcebook (the Listing Rules) as published by the FCA, exercising its primary market functions,[108] recognises the possibility to list preference shares on the premium-tier.[109] Theoretically, preference shares could allow a controller to raise equity finance while maintaining control and also, if the preference shares additionally entitle the holders to share in dividends and distributions upon winding-up after they have received their preferences, create a Wedge. However, if the preference share terms provide that preferential distributions must be made whenever profits are available for the purpose[110] (and are cumulative to the extent that profits are not available), it would be unlikely that a controller could create a substantial disconnect between voting and cash-flow rights, since the more preference shares that are issued, the greater the burden on the business to service the preferential distributions from profits, potentially constraining the actions of the controller in a similar manner to debt-financing as described above.[111] Of course, the terms could be drafted to provide that preferential distributions are only payable upon the declaration of dividends to ordinary shareholders by the board (and affirmed by shareholder vote in the case of a final dividend) and are non-cumulative, but, in such a case, if preferential distributions are not paid regularly (even when profits are available), the price of those shares would decline as investors determine that the preferential rights are less valuable, and the FCA would likely deem such a structure to be a disguised WVR-structure that is prohibited from the premium-tier under the Listing Rules.[112] The issuer (and investors) would be treating such shares as straight non-voting stock in the knowledge that it is unlikely that preferential rights will be realised. If the spirit of the Premium Listing Principles is not being observed and preference shares are being issued in an attempt to create a Wedge through what is effectively a WVR-structure, the FCA will take action.[113] In particular, the FCA could question the motives of a company that floats and issues preference shares at a time when it is envisaged that it will remain as a pre-profit company for an extended period of time post-IPO. Preference shares are, therefore, not an adequate substitute for inferior-shares if the intention of the controller is to create a Wedge.

This thesis will also not delve into the concept of 'loyalty shares' in detail. Loyalty shares award greater voting rights to those shareholders who have held shares for a specified period of time. Any voting rights so awarded would only attach to the shares to the extent that they are held by the shareholder who initially received those rights. In France, loyalty share structures became the default mechanism for all

[108] The FCA will be retiring the name 'UK Listing Authority', and will instead refer to its 'primary market' functions (FCA, 'Primary Market Bulletin' (February 2019 / No. 20) at 1).
[109] Under the rules of the Listing Rules (LRs), in assessing whether the voting rights attaching to different classes of premium-listed securities are proportionate for the purposes of Premium Listing Principle 4, the FCA will consider, *inter alia*, dividend rights or entitlements to any surplus capital on winding up (LR 7.2.4G).
[110] CA 2006, s.830 – distributable profits must be available to make a distribution.
[111] Although, note that Lever Brothers, in the late-nineteenth and early-twentieth centuries, is an example of a UK-firm where the founder, William Lever, built the company into one of the largest in the world, while retaining control, by generating finance through the issuance of non-voting preference shares (n 6 Chapter 2 71 and 178).
[112] With little in the way of compensation rights for the lack of votes in the company, the preference shares begin to resemble inferior-shares. For details of the FCA's prohibition of WVR-structure from the premium-tier, see: Chapter 2.
[113] The purpose of the relevant Premium Listing Priciples is to 'prevent artificial structures involving multiple classes with different voting powers, which are designed to allow control to rest with a small group of shareholders' (n 60 Chapter 2, and accompanying text).

companies with registered stock from 3 April 2016, and any French company undergoing an IPO will be subject to a loyalty share structure unless otherwise disapplied.[114] Loyalty shares are also popular elsewhere in Europe, such as in Italy,[115] where public companies became permitted to issue loyalty shares in June 2014.[116] In the US, companies have been known to voluntarily adopt similar 'tenured voting' or 'time-phased voting' mechanisms, although the practice is not widespread.[117] Currently, issuers on the NYSE are permitted to undergo IPOs with time-phased voting systems, but can not adopt such plans mid-stream where the effect would be to disparately reduce or restrict the voting rights of existing public shareholders.[118] The principal intention behind the loyalty share concept is to ensure that voting control is in the hands of long-term shareholders with, presumably, the long-term interests of the company at heart.[119] Transitory shareholders, and those with more short-term inclinations, such as activist hedge funds, would be less able to exert influence. Such structures could give longer-term shareholders the opportunity to create a Wedge, since, after their shares receive the enhanced voting rights, they will be able to maintain control with a lower proportion of the equity than previously. However, with loyalty shares, it would not be abundantly clear, upon IPO, as to where voting control will lie down-the-line, since it can not be determined with certainty as to who will have held shares sufficiently long to receive enhanced voting rights. This makes it difficult for the market to 'price-in' the risks and rewards of the structure. Crucially, as discussed in Chapter 3, many of the arguments in favour of WVR-structure revolve around control being in the hands of specific individuals. Following on, it is not advocated, without substantial further research, that loyalty shares be permitted on the premium-tier, since if investors are not able to ascertain who the controllers will be at the time of investment, the ability of an investor to determine whether the structure is net-beneficial is curtailed. Loyalty share mechanisms can also be practically challenging to implement, since aspects such as being able to track beneficial ownership of shares can undermine the intended benefits.[120] Loyalty shares are a distinct sub-set of the WVR-realm, and this thesis will mainly examine the broader scenario where a Wedge is created immediately, rather than hard-wired to occur over time. If the rules on WVR-structure were to be relaxed, research on whether this should be extended to loyalty shares could, in the UK-context, form a productive space for further research.

If, as above, WVR-structure is 'all about control', this thesis is, equally, 'all about control'. The thesis primarily considers the scenario where a single shareholder (or connected shareholders) retains, through the use of WVR-structure, control of a publicly-listed company while holding a disproportionately smaller portion of the equity. Conversely, if both inferior-shares and superior-shares were listed and made freely available to public shareholders, a dispersed-ownership system for both classes of shares could

[114] M. Becht et al, 'Loyalty Shares with Tenure Voting – A Coasian Bargain? Evidence from the Loi Florange Experiment' (2018) *ECGI Law Working Paper* No. 398/2018 1, 4.
[115] A. Pacces, 'Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance' (2016) 4 ELR 199, 213.
[116] A. Santoro et al 'Deviations from the "one share – one vote" principle in Italy: recent developments – multiple voting rights shares and loyalty shares' (2015) 5 *Bocconi Legal Papers* 141, 143.
[117] D. Berger et al, 'Tenure Voting and the U.S. Public Company' (2016) Berkeley Center for Law, Business and the Economy and Wilson Sonsini Goodrich & Rosati 1, 16 <https://www.wsgr.com/publications/PDFSearch/tenure-voting.pdf>
[118] n 119 Chapter 2.
[119] Berger et al (2016) (n 117 above 20); L. Dallas and J. Barry, 'Long-Term Shareholders and Time-Phased Voting' (2016) 40 *DJCL* 541, 570.
[120] n 117 above 24.

develop where voting control is diffuse. The creation of Wedges on an investor-by-investor basis in a diffused-ownership WVR-firm can confuse the dynamics of a simple OSOV diffused-ownership system, and create a variety of consequences that diverge from those relevant to a WVR-firm where the superior-shares are not offered to the public and, instead, are owned by insiders. However, lessons from the US suggest that WVR-firms without controlling shareholders are rare.[121] This thesis focuses on WVR-firms with controlling shareholders and, accordingly, the proposals outlined in Chapter 6 practically prevent, and do not envisage, the development of dispersed-ownership WVR-systems.

The term 'controller' can also have different connotations. A vast gamut of literature exists in relation to the impact and consequences of large 'blockholders' in companies. The definition of 'blockholder' is often nebulous[122], and much of US-academia labels any shareholder owning more than 5 per cent of the voting rights in a corporation as a 'blockholder' on the somewhat arbitrary basis that such shareholdings in public corporations are required to be disclosed pursuant to Section 13d of The Securities Exchange Act of 1934 (1934 Act). However, a true 'controlling shareholder' is one that has the ability to replace the directors of the company,[123] and therefore able to have a fundamental influence on the appointment and removal of managers.[124] Such a 'controller' is also likey to be able to cause other simple-majority-vote resolutions to be passed, which brings with it a variety of powers.[125] As above, where WVR-structure has been implemented, a single shareholder or connected group of shareholders will usually hold substantial voting control. Therefore, the scope of this thesis resides in examining WVR-firms where such shareholder or shareholders hold sufficient voting rights to control the composition of the board, and the term 'controller' shall be used accordingly. The singular 'controller' will mainly be used herein, but the term should also be taken to comprise a group of connected controllers. Whether such a controller participates as part of the management team becomes a moot point, since even where third-party managers have been appointed, they will have been appointed at the behest of, and will owe their continued employment to, the controller. Controllers come in a variety of forms, whether individuals, companies or public bodies, management or non-management investors, or founders (included within the term 'family shareholders' in this thesis) or heirs.

Assumptions

(i) Assumption 1 – With respect to the UK, only the admission of firms that adopt WVR-structure at IPO will be considered.

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[121] L. Bebchuk and K. Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 *Geo. L.J.* 1453, 1496 found that 83.6% of Russell-3000 WVR-companies have a controlling minority shareholder (an earlier draft noted the figure as 96.7% of S&P-1500 WVR-firms).

[122] For a discourse in the inconsistencies in defining 'blockholder', see: A. Edmans, 'Blockholders and Corporate Governance' (2014) 6 *Annu. Rev. Financ. Econ.* 23, 35; A. Edmans and C. Holderness, 'Blockholders: A Survey of Theory and Evidence' in *The Handbook of the Economics of Corporate Governance*, eds. B. Hermalin and M. Wesibach (Elsevier (2017)) at 548.

[123] n 17 above.

[124] n 18 above.

[125] For example, under CA 2006, the ability to approve authorities to allot shares (s.551), approve executive remuneration (ss. 439 and 439A), approve loans to directors (s.197), approve substantial property transactions (s.190), appoint and dismiss the auditor (ss. 489(4) and 510(2)), and approve share buy-backs (ss. 694 and 701).

A distinction exists between IPOs and recapitalisations. As remarked in Chapter 2, the history of the US's approach to WVR-structure has flickered around such a distinction with the former viewed more favourably than the latter. The most severe objection to mid-stream (post-IPO) recapitalisations into WVR-structure is where the current shares held by outside shareholders are converted into inferior-shares, or those held by insiders are converted into superior-shares. In such cases, shares that outside shareholders already own are directly or indirectly disenfranchised. Even though such recapitalisations in the US may effectively require approval by the minority shareholders,[126] the dangers that shareholders could be coerced into approving the transaction[127] (through, for example, sweeteners, concerns that other shareholders will approve the transaction and benefit more extensively than those that do not, the ability of management to control the proxy agenda, and collective action issues hindering diffuse shareholders from acting together to ensure that they vote as a block in their interests), and that shareholders who voted against the transaction could still see their shares disenfranchised, have resulted in the NYSE continuing to maintain a prohibition against recapitalisations where shareholders are disenfranchised. English law imposes fairly stringent super-majority voting requirements to implement mid-stream recapitalisations,[128] and, therefore, in the context of the premium-tier, an argument could be made to replicate the NYSE and permit recapitalizations into WVR-structure where existing shareholders are not disenfranchised. However, foreign companies (which are listed on the Main Market) may be subject to laxer rules on recapitalisations. Moreover, OSOV-firms that subsequently recapitalise into WVR-structure can also be impugned on conceptual grounds. If a WVR-structure is adopted at the time of IPO, any potential investors, save for index tracker funds that would be required to invest in companies included in a relevant index, are able to assess the merits of the structure, the value of the controller and the other relevant qualities of the firm. For those investors with freedom of choice to invest in the company in the first place, it would be a step-change for them to be forced into a WVR-structure where the controller could create a Wedge when they invested on the basis of OSOV. As set-out in Chapter 3, the Wedge can create distortions in the incentives and motivations of a controller, and is therefore a significant change for an investor that backed a simple controlling shareholder structure in the first place. Furthermore, a mid-stream recapitalisation is likely to be implemented in response to specific events. This can be more pernicious than a WVR-structure being adopted at the start of the company's listed journey. Therefore, although recapitalisations will be referenced in the context of prior research, this thesis only specifically examines whether the UK should relax its rules to permit the IPO of new WVR-firms on the premium-tier, with the assumption that recapitalisations of existing OSOV-firms into WVR-structure will

[126] n 81 Chapter 4.

[127] See: R. Gilson and J. Gordon, 'Controlling Controlling Shareholders' (2003) 152 U Pa L Rev 785; R. Ruback, 'Coercive Dual-Class Exchange Offers' (1988) 20 *J. Financ. Econ.* 153; n 77 above 47; D. Ashton, 'Revisiting Dual-Class Stock' (1994) 68 *St. John's L. Rev.* 863, 912; S. Bainbridge, 'The Short Life and Resurrection of SEC Rule 19C-4' (1991) 69 Wash. U. L. Q. 565, 581.

[128] The articles must be amended to create a new class of shares, whether the recapitalisation is discriminatory or uniformly applied, requiring a super-majority special resolution vote of at least 75% (CA 2006, ss. 21 and 283). A discriminatory recapitalisation, though, is likely to require implementation through a scheme of arrangement (CA 2006, Part 26) – a procedure subject to Court-approval and the passing of class resolutions by members constituting a majority of members, and at least 75% of the votes exercised, at the meeting of the relevant class (CA 2006, s.899). With a discriminatory recapitalisation, it is likely that those members that would be effectively disenfranchised would be treated as a separate class (*Re Hawk Insurance Company Ltd* [2001] EWCA Civ 241).

continue to be restricted on the premium-tier. Additionally, elements of the protection package proposed in Chapter 6 are incompatible with mid-stream recapitalisations.

(ii) Assumption 2 – The mandatory offer rules under the Takeover Code will apply to all WVR-firms.

The mandatory offer rules of the UK's Takeover Code,[129] outlined in more detail in Chapter 5, require that any persons acting in concert acquiring 30 per cent or more of the voting rights in a relevant company must make an offer to all of its shareholders at a price no less than the highest price paid for shares by the offeror in the last 12 months.[130] As will be discussed throughout the thesis, the application of the mandatory offer rules has significant consequences in the context of WVR-structure, particularly in relation to curtailing the ability of a controller to abuse the structure in certain situations. The rules of the Takeover Code apply, in summary, to any UK, Isle of Man or Channel Islands public companies, and certain European Economic Area (EEA)-registered companies, with securities traded on, *inter alia*, the Main Market.[131] Although, after the UK leaves the EU, the Panel will no longer regulate EEA-registered companies,[132] EU countries have implemented broadly similar mandatory bid rules.[133] As of 31 December 2018, around 83 per cent of Main Market-listed companies were registered in the UK, the Isle of Man, the Channel Islands or another EEA member state,[134] and are therefore likely to be subject to mandatory offer rules. This thesis assumes that the mandatory offer rules of the Takeover Code apply to all premium-listed companies. Although it is accepted that a small proportion of WVR-firms registered in jurisdictions not subject to the mandatory offer rules could be admitted to the premium-tier if the Main Market relaxed its rules on WVR-structure, in Chapter 6, it will be discussed that other protective mechanisms can, to an extent, replicate certain of the benefits of the mandatory offer rules.[135]

7. The Purpose of the Firm and WVR-Structure

The 'purpose' of the firm has been debated for over 200 years,[136] and it is not intended that a thorough delineation of the history of that debate be included here. However, a brief overview of the continuing dialectic, and the approach taken by this thesis, will benefit the discussion to follow. Although somewhat of a simplification, broadly, the contemporary debate has fluttered between two concepts – 'shareholder

[129] The Takeover Code as published by the UK's Panel on Takeovers and Mergers (Takeover Code).
[130] Ibid, Rule 9.
[131] See: Chapter 5 for full details.
[132] The Takeover Panel, Code Committee Response Statement RS2018/2, 'The United Kingdom's Withdrawal from the European Union' (6 March 2019) at 10.
[133] For example, 30% thresholds apply in Germany, France, the Netherlands and Spain, with a 25% threshold applying in Italy (Bonellierede, Bredin Prat, De Brauw, Hengeler Mueller, Slaughter and May and Uría Menéndez, 'Guide to Public Takeovers in Europe' (June 2016)).
[134] From 1161 companies listed on the Main Market, 852 companies were registered in the UK, the Channel Islands or the Isle of Man, and 107 were registered in another EEA country (LSE, 'Company List' (31 December 2018) <https://www.londonstockexchange.com/statistics/companies-and-issuers/companies-and-issuers.htm>).
[135] See: '*Transfer-Driven Sunset Clauses*' and '*Takeover Code*' in Chapter 6.
[136] A. Page, 'Has Corporate Law Failed? Addressing Proposals for Reform' (2009) 107 *Mich. L. Rev.* 979, 979 (f/n 1).

primacy' and 'stakeholder pluralism'. Shareholder primacy asserts that managers should manage corporations primarily in the interests of its shareholders.[137] In contrast, stakeholder pluralism can be associated with 'managerialism', where managers have the discretion to manage companies in the interests of their stakeholders as they see fit, rather than merely prioritising shareholder value.[138] The 'purpose' of the firm, or, more appropriately, in "whose interests should firms be managed?" is a live debate, with academic and cultural discourse on the topic enlivened in recent years.[139] Managerialism, and its connection with stakeholder pluralism, has spilled into the real world with the recent pronouncements by the Business Roundtable, an association of US company CEOs, that companies should not be required to prioritise short-term shareholder profits over all other stakeholder interests,[140] swiftly followed by a denouncement of that view by institutional investors through the CII.[141]

Shareholder Primacy v Stakeholder Pluralism

Various theories of the firm have been used to justify both shareholder primacy and stakeholder pluralism. Early theoretical arguments regarding the theory of the firm mainly revolved around the essence of the company itself, and considerations as to its 'corporate personality'.[142] That debate, however, had dissipated by the 1930s with recognition that the company had a legal form beyond a mere amalgamation of contracts between shareholders. Reflections on the functional basis of the company began to dominate over determinations of its abstract conception.[143] A corollary to accepting that the company has legal form with its own interests, is that the 'interests of the company' must be defined. The early 1930s saw a popular academic discourse between two prominent lawyers. In one corner, Dodd (1932) tackled the challenge of defining the interests of the company by espousing that the managers of a company are fiduciaries for the company rather than for its individual members.[144] Dodd argued that, as a legal person, a company should be equated to any professional person, and, therefore, "employ its funds in a manner appropriate to a person practising a profession and imbued with a sense of social responsibility".[145] In the other corner, Berle (1932)[146], although he had sympathy for Dodd's views, rejected what was essentially a stakeholder pluralism

[137] C. Smith and D. Rönnegard, 'Shareholder Primacy, Corporate Social Responsibility and the Role of Business Schools' (2016) 134 *J. Bus. Ethics* 463, 465.
[138] For a description of managerlaism, see: *The Globalization of Corporate Governance*, eds. A. Dignam and M. Galanis (Surrey: Ashgate Publishing Limited (2010)) at 25 *et seq*. Managerialism does not sit completely comfortably with stakeholder pluralism, however, since managers could act in their own self-serving interests in a manner that does not benefit any other stakeholders (see: n 166 below, and accompanying text, and n 168 below).
[139] For example, see: *Better Business Makes the Greater* Good, ed. C. Mayer (Oxford: Oxford University Press (2018)) at 37-40; L. Stout, 'New Thinking on Shareholder Primacy' (2012) 2 *Account. Econ. Law* 1; *Corporate Duties to the Public*, eds. B. Choudhury and M. Petrin (Cambridge: Cambridge University Press (2018)) at 41-46; J. Fisch and S. Solomon, 'Should Corporations Have a Purpose' (2020) <https://ssrn.com/abstract=3561164>
[140] n 42 above. From a UK perspective, also see: The British Academy, 'Principles for Purposeful Business' (2019) <https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business>
[141] n 43 above.
[142] For a more detailed overview of the early theoretical underpinnings of corporate form, including the contractual, concession, legal fiction, aggregate and corporate realism theories, see: n 138 above 9-14.
[143] B. Cheffins, 'The Trajectory of (Corporate Law) Scholarship' (2004) 63 *CLJ* 456, 479. However, the debate on 'corporate personality' was resurrected in a different context in the US Supreme Court's judgment in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010).
[144] E. Dodd, 'For Whom Are Corporate Managers Trustees' (1932) 45 *HLR* 1145, 1160.
[145] Ibid 1161.
[146] A. Berle, 'For Whom Corporate Managers Are Trustees: A Note' (1932) 45 *HLR* 1365.

paradigm on pragmatic grounds. Berle believed that the shareholder wealth-maximisation purpose of the corporation can not be abandoned without first determining the accountability of managers.[147] Building upon his earlier seminal work on the separation of ownership from control where, in a dispersed ownership system outside managers control firms,[148] Berle determined that the pluralist approach extolled by Dodd would give managers free-reign to make self-serving decisions.[149] Although Berle was attracted to the social responsibility aspects of Dodd's articulation, he felt, at least in his early work,[150] that non-shareholder stakeholder interests were better served by legal developments, rather than assuming that managers will act in the most socially optimal matter.[151] Shareholder primacy was the most prudent course.[152]

The legal debate between Dodd and Berle gave way to an economic formulation of the theory of the firm. An early protagonist was Coase (1937) who based his theory upon a transaction costs rationale.[153] He built upon the economic theory that the market operates through a pricing mechanism which automatically allocates resources efficiently, by continually matching supply to demand,[154] but deduced that transaction costs are inherent in the contracts entered into by market participants.[155] Those transaction costs could be mitigated through "a system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur".[156] Although such an approach could invoke stakeholder pluralism, since the entrepreneur is responsible for directing all stakeholder relationships in an efficient manner,[157] economists in the 1970s began to use Coase's theorem as a foundation to describe the firm as being a market in and of itself within which contracts are continually renegotiated by management.[158] The firm was designated as a 'nexus of contracts',[159] and 'contractarians'[160] took corporate purpose roundly in a shareholder primacy direction. The rationale was underpinned by the position of shareholders as the residual claimants in the company.[161] The shareholders, as residual claimants, would be incentivised to monitor the other contracting parities, whose performance may otherwise be difficult to discern, in the interests of the company's success, and should, therefore, be granted voting rights and the ability to change management to undertake such monitoring efficiently.[162] Furthermore, stakeholders, such as creditors, suppliers and employees, are able to

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[147] Ibid 1367.
[148] *The Modern Corporation and Private Property*, eds. A. Berle and G. Means (New York: World, 1932).
[149] n 146 above 1368.
[150] Berle, in his later work, embraced more of a pluralist approach (for example, see: *Power without Property*, ed. A. Berle (New York: Harcourt, Brace and Company (1959)).
[151] n 146 above 1372.
[152] Ibid 1368.
[153] R. Coase, 'The Nature of the Firm" (1937) 4 *Economica* 386.
[154] F. Hayek, 'The Trend of Economic Thinking' (1933) 40 Economica 121, 129.
[155] n 153 above 390-391.
[156] Ibid 392-393.
[157] n 143 above 484.
[158] A. Alchian and H. Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 *The American Economic Review* 777. The authors rejected Coase's description of the existence of an authority relationship between the entrepreneur and stakeholders.
[159] For example, the term 'nexus of contracts' was used by: M. Jensen and W. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *J. Financ. Econ.* 305, 310.
[160] Under the economic nexus of contracts model, the company can be considered to be an "association of people formed to carry on business" (*Company Law: Theory, Structure and Operation*, ed. B. Cheffins (Oxford: Oxford University Press (1997)) at 32).
[161] n 143 above 484.
[162] Alchian and Demsetz (1972) (n 158 above 788). In the US context, the authors noted that the right to change management in a dispersed ownership firm is more correctly a manifestation of the shareholder's right to sell its shares - management can be replaced through the operation of the market for corporate control (see: nn 86-90 Chapter 3, and accompanying text), and that threat influences management to act in accordance with shareholder objectives. See also, Easterbrook and Fischel (1983) (n 24 above 403).

contract for a fixed sum, whereas shareholders, particularly in the context of a dispersed-ownership system, can not contractually protect themselves, and, therefore, their interests should be prioritised in the manner in which companies are managed.[163] The discourse naturally led to the pathbreaking work of Jensen and Meckling (1976).[164] The authors, focused on the 'contract' between the owners of the firm (or, from a legal perspective, the owners of the residual cash-flow rights of the firm) and management, and framed it in the context of an 'agency relationship' - "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent."[165] In this case, the agents are the managers, and the principals the shareholders. It was noted that the agents will not always act in the best interests of the principals, and may, instead, pursue their own wealth-maximisation, leading to 'agency costs', which increase as the residual ownership rights of management decline.[166] An implication is that efficiency is fostered by implementing mechanisms that ensure that management operates the company to pursue the best interests of the shareholders.[167]

Although shareholder primacy, accordingly, dominated much of the literature in the 1980s and 1990s, the concept did not have it all its own way. Theorists were able to justify stakeholder pluralism on contractarian grounds, rationalising that, due to divergences in market power, non-shareholder stakeholders are not able to negotiate their contracts in an optimal manner and are, therefore, as deserving of protection as shareholders.[168] Emphasising the vicissitudes of the debate, arguments for shareholder exceptionalism on the basis that, unlike non-shareholder stakeholders who can constantly renegotiate their contracts, shareholders invest for the life of the firm [169] have been disputed through the identification of stakeholder interdependencies that can render the renegotiation power of non-shareholder stakeholders ineffective in certain scenarios.[170] Contemporary theoretical studies have developed variations of existing themes,[171] with one recent study looking at the debate from the opposite angle, recognising that giving shareholders too much

[163] F. Easterbrook and D. Fischel, 'The Corporate Contract' (1989) Columbia Law Rev. 1416, 1447.
[164] n 159 above. Jensen and Meckling, and Alchian and Demsetz, were likely influenced by an influential article by Milton Friedman: M. Friedman, 'The Social Responsibility of Business is to Maximise its Profits' *New York Times Magazine* (13 September 1970) (although, it has also been commented that Friedman's influence on the shareholder primacy debate has been overblown – B. Cheffins, 'Stop Blaming Milton Friedman!' (2020) <https://ssrn.com/abstract=3552950>).
[165] n 159 above 308.
[166] Ibid 312-330. The authors defined agency costs to be the aggregate of monitoring costs, costs expended in aligning the interests of the agents to the principals, and any losses incurred by the agents nevertheless pursuing their own interests over those of the principals (Ibid 308).
[167] F. Easterbrook and D. Fischel, 'The Corporate Contract' (1989) Columbia Law Rev. 1416, 1421.
[168] C. Hill and T. Jones, 'Stakeholder-Agency Theory' (1992) 29 *J. Manag. Stud.* 131, 136-139. The authors noted that non-shareholder stakeholders suffer 'utility losses' in the same way that shareholders suffer agency costs, and, therefore, mechanisms should be implemented to align the interests of the company with all stakeholders, not just shareholders. Also, see: A. Licht, 'The Maximands of Corporate Governance: A Theory of Values and Cognitive Style (2004) 29 *Del. J. Corp. Law* 649, 652 – the claims of non-shareholder stakeholders are not necessarily fixed, and, therefore, it could be argued that those stakeholders also have residual claims.
[169] O. Williamson, 'Corporate Governance' (1984) 93 *YLJ* 1197, 1202 and 1204.
[170] R. Freeman and W. Evan, 'Corporate Governance: A Stakeholder Interpretation (1990) 19 *J. Behav. Econ.* 337, 353. Also, see the 'team production' formulation used to justify a pluralist approach by M. Blair and L. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Va. L. Rev.* 247, 292.
[171] Contemporary theories of the firm have generally used Coase's theorem as an initial foundation, although some have deviated into new territory, such as the 'adaptation costs' theorem proposed by Wernerfelt, 'The Comparative Advantages of Firms, Markets and Contracts: a Unified Theory' (2015) 82 *Economica* 350; an 'asset partitioning' model developed by H. Hansmann and R. Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *YLJ* 387; and the 'director primacy' concept of *The New Corporate Governance in Theory and Practice*, ed. S. Bainbridge (Oxford: OUP (2008)) at 66.

power can itself create costs for companies.[172] The theory of the firm has not solved the conundrum of shareholder primacy versus stakeholder pluralism, and, largely similar theories of the firm can be adopted to justify both ideologies.[173] Therefore, since the aim of this thesis is not to develop a new theory of the firm, placing WVR-structure squarely within a particular 'theory of the firm' is not practically necessary to progress the assessment of WVR-firms. However, given that the discussion between shareholder primacy and stakeholder pluralism is a hot button issue in corporate governance literature, establishing the footing on which WVR-firms will be assessed is expedient.

The Dominance of Shareholder Primacy and the Application to WVR-Firms

Although academics and economists have long debated the shareholder primacy/stakeholder pluralism juxtaposition, it would appear that, legally, in the UK, shareholder primacy has won the day. Under CA 2006, s.172, in satisfying their duty to act in the interests of the company, directors must, as a default,[174] "promote the success of the company for the benefit of its members as a whole". Although directors must also have regard to various non-stakeholder interests, those considerations must be made in the context of acting to benefit the shareholders.[175] This 'enlightened shareholder value' concept recognises that by taking into account the interests of non-shareholder stakeholders, long-term profits for shareholders can also be enhanced. Furthermore, shareholders possess the underlying right to change the board of the company (and, therefore, indirectly, the management team).[176] The intervention rights of shareholders in this regard underpins a shareholder primacy approach.

However, with WVR-structure, the dynamics shift to such an extent that one could challenge whether in such circumstances shareholder primacy remains extant. As referenced in the scope, this thesis assumes that the controller has voting control of the company.[177] As such, if the controller has divested of a majority of the equity, the majority equity-holders of a WVR-firm can not remove the managers, who therefore remain insulated from those equity-holders, and the accountability of those managers to the public shareholders will be significantly undermined. Economically, decision-making authority has been delegated to the managers (which will generally include the controller) by the equity-holders, and those managers may pursue self-serving (or, more appropriately, controller-serving) actions to the detriment of the equity-holders. The controller, with voting control in the company, has little in the way of personal economic incentive to desist from such behaviour if its equity-holding is small, and the economic incentives to pursue shareholder wealth-

[172] See: the discussion on 'principal costs' in Goshen and Squires (2017) (n 150 Chapter 3). For further discussion, see: nn 251-253 Chapter 3, and accompanying text.
[173] It was once said with respect to the analysis by Berle and Means that it was a "gun on a rotating platform that could be pointed in more than one direction". (J. Hetherington, 'Redefining the Task of Corporation Law' (1985) *19 U. San. Fran. L. Rev.* 229, 235, as cited in n 143 above 480). The same could be said of the theory of the firm generally as to whether a specific theory is used to justify shareholder primacy or stakeholder pluralism).
[174] A company is free to express in its articles a purpose other than the benefit of its members (CA 2006, s.172(2)).
[175] CA 2006, s.172(1)(a)-(f). However, note recent efforts to require certain companies to disclose how directors have considered the interests of non-shareholder stakeholders in their decision-making (CA 2006, ss.414CZA and 414C(1); and UK CGC provision 5).
[176] nn 17 and 18 above.
[177] See: '*Scope*' above.

maximisation progressively diminish as the controller's equity-holding declines.[178] Is WVR-structure therefore managerialism in disguise, and therefore potentially a route toward stakeholder pluralism?

From an economic and control perspective, where the controller leads the management team, clearly managers have discretion to take decisions for the benefit of non-shareholder stakeholders. The law does, though, effectuate a realignment of WVR-structure with shareholder primacy. In Chapter 5, the various legal and regulatory measures that could protect the interests of inferior-shareholders in WVR-firms are outlined. In particular, CA 2006, s.172 still applies to directors of WVR-firms in the same way as it does to directors of OSOV-firms, requiring them to promote the success of the company for the benefit of its members as a whole (not just the superior-shareholders). Other regulatory measures, such as related-party transaction regulations, also prevent certain actions being taken by management without the consent of the inferior-shareholders. Although the efficacy of those protections can, to a degree, be doubted,[179] WVR-firm managers do not have complete free-reign to make decisions as they see fit. Therefore, WVR-firms sit somewhere between shareholder primacy and stakeholder pluralism in their form. Managers of WVR-firms have practical discretion to make decisions that do not prioritise shareholder wealth-maximisation, but can not completely ignore the interests of the public shareholders due to constraints that exist under law and regulation (and, to a lesser degree, through the application of other psychological and market forces[180]).

The Approach of this Thesis to the Purpose of the Firm

The debate on the purpose of the firm has long fluttered between shareholder primacy and stakeholder pluralism,[181] and it is not intended that this thesis should present a normative appraisal of the purpose of the firm. Moreover, the purpose of this thesis is to explicate the merits of WVR-stock with a view to developing a framework within which the LSE's premium-tier prohibition of WVR-structure can be relaxed. However, it is expedient to outline whether, in this thesis, the merits of WVR-firms are to be assessed on the basis of shareholder primacy or stakeholder pluralism. The recent discord between the Business Roundtable and CII indicates that this is a topical issue.[182] Although that debate was not specifically related to WVR-structure, *per se*, it involved contentions as to the degree to which shareholder democracy can influence management to prioritise short-term shareholder interests; clearly WVR-structure is relevant in this regard, since it gives management a level of insulation from the influence of public shareholders. An argument in favour of, or in opposition to, WVR-structure can be made on both shareholder primacy or stakeholder pluralism grounds, and the approach of this thesis will straddle elements of both.

From a stakeholder perspective, as discussed in this Chapter 1, there is a scarcity of high-growth, especially tech-sector, firms listing on the UK equity markets. WVR-structure can encourage founders to list

[178] In relation to the shifting conflict dynamics as capital structure changes, see: nn 9-14 Chapter 3, and accompanying text.
[179] See: Chapter 5.
[180] Ibid.
[181] It has also been labelled 'cyclical' (n 143 above 498). Even the Business Roundtable has flipped-flopped between shareholder primacy and stakeholder pluralism, often influenced by the prevailing economic winds (Cheffins (2020) (n 164 above 25)).
[182] n 140-141 above, and accompanying text.

their firms in the UK, and, although strictly outside the scope of this thesis, some of the broader economic benefits of fostering flotations and retaining British companies in Britain have been broached.[183] These stakeholder considerations are not stakeholder pluralism in the pure sense, though, since pluralism relates to the actions of the boards of those companies. From a stricter stakeholder pluralism standpoint, this author accepts that WVR-structure enables managerial decision-making on a broader stakeholder friendly basis. For instance, as discussed in more detail in Chapter 3, the ability to take a long-term approach to the company's business, and the incentive to take risks that could result in innovative products, are facilitated by WVR-structure. Consequentially, such approaches could be beneficial for many non-shareholder stakeholders, such as employees, suppliers, customers and society generally, and a justification for WVR-structure could be made on stakeholder pluralism grounds.[184] Such considerations should also be weighed against the proposition asserted by Berle that giving management discretion to take actions that benefit all stakeholders does not necessarily result in those managers taking those actions.[185] However, a detailed elaboration of the benefits (or otherwise) of long-termism and risk-taking for all stakeholders, and an evaluation of the evidence pertaining thereto, could easily subsume the entire subject matter of a dissertation, and is therefore not contemplated by this thesis.

Although this thesis will not be assessing WVR-firms on the basis of their potential to benefit non-shareholder stakeholders from a stakeholder pluralism perspective, what about the potential to harm those stakeholders? Another area of topical concern is the propensity for large, financially dominant companies to act contrary to the public interest. Some of the most successful tech-firms have adopted WVR-structure, and the pseudo-monopolies within which such firms operate can give the founders of those firms far-reaching powers. Some may argue that giving WVR-founders access to vast economic resources, and granting them wide and unaccountable power, may have exacerbated some of the recent controversies in Big Tech, including Google's anti-trust violations and Facebook's misuse of data.[186] It is hereby submitted, though, that corporate controversies are prevalent in OSOV- as well as WVR-firms,[187] and disquiet regarding the disproportionate market power of large tech-firms are aspects that should be reflected and balanced through legal and regulatory methods. It is not within the purview of this thesis to determine whether further regulations are required to temper the success of Big Tech (and it could, in fact, be argued that encouraging the growth of more tech-firms, and giving them options beyond being acquired by large foreign tech-

[183] Also, see: B. Reddy, 'Finding the British Google: Relaxing the Premium-Tier Prohibition of Dual-Class Stock' (2020) *CLJ Forthcoming*.
[184] Additionally, advancing high-growth firms (by, for example, a WVR-path to flotation) could prospectively, due to growth-phase economics, benefit customers and employees through their desire to pursue market share and increase workforce.
[185] n 151 above, and accompanying text.
[186] A. Hern and J. Jolly, 'Google fined €1.49bn by EU for advertising violations' *The Guardian* (20 March 2019) <https://www.theguardian.com/technology/2019/mar/20/google-fined-149bn-by-eu-for-advertising-violations>; J. Wong, 'Facebook expects FTC fine of up to $5bn in privacy investigation' *The Guardian* (24 April 2019) <https://www.theguardian.com/technology/2019/apr/24/facebook-ftc-fine-first-quarter-financial>
[187] For example, continuing in the tech-context, Amazon and Apple, OSOV-firms, have also been the subject of recent controversies (S. Butler, 'Amazon accused of handing over 'diddly-squat' in corporation tax *The Guardian* (3 September 2019) <https://www.theguardian.com/technology/2019/sep/03/amazon-accused-of-handing-over-diddly-squat-in-corporation-tax-despite-tripling-payment>; M. Murphy, 'Apple agrees to pay $500m over "iPhone slowdown" lawsuit' *The Telegraph* (2 March 2020) <https://www.telegraph.co.uk/technology/2020/03/02/apple-agrees-pay-500m-iphone-slowdown-lawsuit/>).

companies, promotes greater competition), although there are fundamentally sound arguments that regulation in that ambit, not necessarily restricted to WVR-firms, should be effectuated.[188]

Therefore, although this thesis is founded on public benefit grounds – the potential for WVR-structure to encourage more flotations – after establishing that footing earlier in this Chapter, the primary focus shifts to the effect of WVR-structure on the interests of public shareholders. This author is not advocating that shareholder primacy should be the centre of attention for companies and regulators, but there are three main reasons for taking a public shareholder-focused approach. Firstly, the law pertaining to directors' duties endorses shareholder primacy, with directors of WVR-firms required to promote the success of the company for the benefit of its members as a whole, and, therefore, the predilection for WVR-directors to comply with that duty in practice should be gauged. CA 2006, s.172 does encompass an enlightened shareholder value prospect, though, and it will be argued that WVR-structure, in fact, promotes compliance with that concept, since it is easier for WVR-managers to have regard to the interests of non-shareholder stakeholders, with a view to creating long-term success for shareholders, if those managers are not slavish adherents to short-term share price. Second, as discussed in Chapter 2, the UK's prohibition of WVR-structure stems from an institutional bias against WVR-structure, and an assumption that the structure harms public shareholders. Accordingly, whether WVR-structure does in fact harm public shareholders should be scrutinised. Conceptually, it will be discussed, in Chapter 3, that actions taken by WVR-controllers ostensibly in the interests of the controller are not necessarily harmful to public shareholders – the outcomes may be shared with, or generate separate consequential benefits for, public shareholders. Empirically, in Chapter 4, it will be shown that WVR-structure is not financially harmful to public shareholders. Third, the ideological distaste of institutional investors against WVR-firms can not be completely ignored. That distaste is not reflected by those institutional investors shunning WVR-firms on exchanges where they are permitted,[189] but, as will be outlined in Chapter 4, the cost of capital for WVR-issuers is increased due to institutional investor discounting of WVR-firms. To win the argument that WVR-firms should be permitted on the premium-tier, it is necessary to show that such a relaxation will not harm public shareholders, and, to reduce the cost of capital for such firms (and to smooth the path toward such a relaxation), mechanisms need to be developed to give institutional investors greater comfort that WVR-managers will not egregiously act against their interests. In summary, for pragmatic reasons, a thesis that evaluates a relaxation of the premium-tier's prohibition of WVR-structure must assess WVR-firms from the perspective of shareholder primacy. If or when WVR-firms are accepted on the premium-tier, future research could shift to determining whether OSOV- or WVR-structure is more conducive to other stakeholder interests, and, correspondingly, whether issuers should choose OSOV- or WVR-structure in specific contexts.

Since this thesis will not be engaging with the 'theory of the firm' or a normative assessement of the 'purpose of the firm' in relation to its assessment of WVR-firms, the references throughout this thesis to 'theory' do not implicate an evaluation based upon the theories delineated above. 'Theory' will be used in

[188] There are currently no UK-based tech-firms operating on the scale of Google or Facebook (or, indeed, the OSOV-firms Amazon or Apple), and, therefore, it could be argued that any desire for regulatory steps to constrain overreaching powers of UK tech-firms should not, at this stage, delay encouraging UK tech-firms to grow.
[189] See: n 44 above.

the colloquial sense, and, throughout this thesis, unless otherwise expressed, ‘theory’ will denote an analytical or conceptual evaluation of the hypothetical pros and cons of WVR-structure as a contrast to the real-world empirical evidence.

CHAPTER 2:
A TALE OF TWO CITIES - THE HISTORY OF ONE-SHARE-ONE-VOTE IN LONDON AND NEW YORK

The history of OSOV in the UK, and the path taken toward the premium-tier's prohibition of WVR-firms, is chronicled in this Chapter. It will be explained that OSOV was not always the norm in the listed-company sphere, but it came to the fore as a result of the influence of institutional investors that began to dominate the UK-markets. The LSE's history will be juxtaposed with that of the NYSE, a jurisdiction that, based upon its similar market profile and position as the world's premier stock exchange, serves as the best experimental laboratory for the UK. It will be shown that in the US, when the NYSE was debating whether to relax its own prohibition on WVR-firms, issuers and their managers had a greater degree of influence than in the UK, and were therefore able to impel the NYSE's direction of travel, particularly at a time when various US-exchanges were competing for issuers between themselves, and the NYSE was facing significant pressure from a large existing issuer openly flouting the exchange's rules. It would appear that the regulators of both the LSE and the NYSE have been reactionary over time, and have been largely compelled by the viewpoints of the dominant factions in each market, rather than being proactive in rigorously scrutinising the merits of WVR-structure with a view to justifying their approaches on normative grounds.

1. The UK and the Institutional Investor Effect

A detailed exposition of the history of OSOV in the UK and elsewhere could easily subsume the entirety of a legal historian's magnum opus, and this thesis does not allude to such delusions of grandeur. However, a brief elucidation of the progression toward a formal OSOV-criterion for premium-listed companies would be conducive to fully understanding the impetus and motivation leading to the FCA's position.

It would be remiss not to commence with the late-nineteenth century case of *Birch v Cropper*,[1] which involved the unlisted private company, The Bridgewater Navigation Company Limited. The Court assessed whether the company's assets, upon winding-up, should be distributed equally to all ordinary and preference shareholders based upon capital subscribed rather than capital paid-up. The Court determined that since any shareholder who has subscribed to the same amount of capital must meet losses equal to such subscribed capital, in relation to the distribution of assets, after the return of all capital to all classes of shareholder, the surplus assets should be distributed equally between all shareholders holding equal shares in the company's equity.[2] Lord Macnaghten[3], and Lord Fitzgerald[4] recognised, on the basis of equality and justice, that, unless otherwise provided in the articles of association of the company (articles) or renounced by a shareholder, every holder of shares of equal amount is entitled to an equal proportion in the capital and property of the company per share. Although this case concerned the application of surplus assets upon a winding-up rather

[1] *Birch v Cropper and Others In re The Bridgewater Navigation Company Limited* (1889) 14 App. Cas. 525.
[2] Ibid at 538.
[3] Ibid at 543 and 546.
[4] Ibid at 542.

than voting rights *per se*, it is acknowledged as the launching point for the assertion that absent any specific regulation (of the company or the law) each shareholder is entitled to equal rights in the company proportional to its subscribed capital, including the right to vote.[5]

Prior to the case of *Birch v Cropper*, OSOV was not the most common policy for UK-companies. In particular, joint stock banks, railway companies and canal companies often implemented voting schemes that prevented investors acquiring voting control simply by making large capital investments.[6] Voting rights were either capped or were determined pursuant to schemes where those voting rights would increase at a slowing rate with greater investment.[7] The intention was to prevent company policy being dominated by a small cabal of wealthy investors, and the voting-system was included as a provision in the default articles for companies.[8] Such structures, sometime labelled 'prudent-mean voting', began to become less popular in the early twentieth century, as OSOV began to dominate,[9] and the default articles for companies was amended in 1905 to reflect OSOV.[10]

Notwithstanding the aspirations toward equality, the case of *Birch v Cropper* is clear that OSOV is not a mandatory prerequisite. Although OSOV constitutes the default position, and this has been ingrained statutorily,[11] a company is free to deviate from such a construction through provisions set-out in its articles.[12] Even the entitlement of shareholders holding a majority of the votes in a company to remove the directors under s.168 of CA 2006, which is expressed to be non-waivable,[13] is not precluded by the use of WVR-structure.[14] From a purely legislative basis, companies are therefore ascribed a degree of flexibility in the rights attached to their capital structures; but, taking the trajectory of the history of OSOV into the listed-company realm, other factors will also influence the ability of companies to implement WVR-structure. For example, permission to list on the Main Market must be obtained from the FCA, which will, amongst other things, insist on compliance with the Listing Rules. Additionally, the exigencies of investors will also pressure companies to structure capital rights in a manner that attracts maximum investment. As such, the rules and customs of the stock exchange itself, and market forces, are wholly relevant to a discourse on the path of the UK's premium-tier toward OSOV.

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[5] It should also be noted that, in the normal course, it is likely that potential investors in companies would expect voting and cash-flow rights to be allocated on a OSOV–basis, and so, as a matter of practicality, the decision in *Birch v Cropper* represents a 'presumptive' approach to company law which reduces the transaction costs of companies in having to specifically implement rules that would be expected by the vast majority of investors (see: Chapter 6 on the 'presumptive' approach).
[6] *Corporate Ownership and Control: British Business Transformed*, ed. B. Cheffins (Oxford: Oxford University Press (2008) at 32.
[7] Ibid 33.
[8] C. Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 Wash. & Lee L. Rev. 1347, 1360.
[9] n 6 above 33.
[10] n 8 above 1360.
[11] CA, s 284. Although where voting is conducted by way of a show of hands, each member is entitled to one vote notwithstanding the extent of its shareholding, the chair of a shareholders' meeting can call a 'poll' (counting votes-per-share), and is required to do so where demanded by not less than 5 shareholders, or by shareholders representing not less than 10% of the voting rights or paid up share capital with voting rights attached (CA 2006, s 321).
[12] *Bushell v Faith* [1970] AC 1099.
[13] n 17 Chapter 1.
[14] n 12 above.

At the listed-company level, deviations from OSOV were not always restricted in the UK. Indeed, deviations from OSOV were not uncommon during the nineteenth and twentieth centuries.[15] It has been supposed that one reason for deviations from OSOV was due to the imposition by the LSE, from the mid-nineteenth century to the late 1940s,[16] of a rule requiring that at least two-thirds of securities the subject of a public offering be allotted to the public.[17] Although there were a number of potential loopholes to the rule, including through arranging for shares to be traded on the LSE by way of special settlement,[18] for a company owner seeking an orthodox LSE-quotation of OSOV-stock, majority control could not be retained at the time of IPO. Although the relevant owner could subsequently re-acquire further shares on the public markets after the IPO in order to, once again, build-up a controlling position, an obvious approach to avoid the transaction costs inherent therein would be to only float non-voting shares and retain voting stock, since the rule only applied to the class of shares being listed.[19] Although the application of the two-thirds rule will have influenced some issuers to adopt WVR-structure, in fact, WVR-structure began to grow more rapidly after the rule was repealed.

The emergence of hostile takeover activity[20] was the true precursor to a rapid growth of WVR-structure, which appeared in a different form, whereby inferior- and superior-shares were listed. In response, companies, and their boards, began issuing WVR-stock, whereby a discrete set of shareholders would acquire the vast majority of superior-shares.[21] In this way, boards were able to insulate themselves from hostile predators who would otherwise be able to secure control by acquiring shares from public shareholders. Franks et al (2005)[22] estimated that in a fifteen year period from 1953, 7.5 per cent of listed-companies issued WVR-shares of this nature.[23] However, an advance toward an equity-capital market composed of numerous companies controlled by small groups of voting-privileged shareholders came to a screeching halt. Three crucial qualities of the corporate governance environment in the 1960s instigated the handbrake.

Firstly, the rise of the institutional shareholder in the UK in effect cut WVR-structure off-at-the-knees. In the 1950s and 1960s, after World War II, the proportion of listed-company shares owned by institutional shareholders rose significantly, as the proportion held by individual investors fell.[24] Institutional investors were averse to WVR-structure generally.[25] WVR-structure gave insiders the ability to block

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[15] By 1958, the proportion of listed industrial and commercial OSOV-companies in the UK was only 41%, having reduced steadily from 55% in 1896 (F. Braggion and M. Giannetti, 'At the Origins of the Non-Voting Shares' Discount: Investor Preferences vs. Fundamentals' (2012) 1, 32 <https://pdfs.semanticscholar.org/a48e/53a18141d21de29615ed9cdc4e472c6e2c5a.pdf>).
[16] n 6 above 76.
[17] L. Hannah, 'The "Divorce" of ownership from control from 1900 onwards: Re-calibrating imagined global trends' (2007) 49 *Bus. Hist.* 404, 416; Cheffins et al, 'Ownership dispersion and the London Stock Exchange's 'two-thirds rule': an empirical test' (2013) 55 *Bus. Hist.* 670, 686.
[18] Cheffins et al (2013) (ibid 673).
[19] n 6 above 226-227.
[20] The first UK hostile takeover was launched in 1953 for the shoe chain J. Sears Holdings (J. Franks et al, 'Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom' in R. Morck (ed), *A History of Corporate Governance Around the World: Family Business Groups to Professional Managers* (Chicago: NBER and University of Chicago Press (2005)) at 584); A. Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 *CLJ* 422, 427.
[21] Franks et al (2005) (ibid 584 and 604).
[22] Franks et al (2005) (ibid 584).
[23] n 6 above 31 – 'During the mid-1950s some 7 per cent of the market value of the industrial and commercial sector of the UK equity market took the form of 'non-voting' ordinary shares…'.
[24] n 6 above 88 and 244-245; Franks et al (2005) (n 20 above at 585); *The Pattern of Ordinary Share Ownership: 1957–1970*, ed. J. Moyle (Cambridge: Cambridge University Press (1971)).
[25] Franks et al (2005) (n 20 above at 584 and 604); J. Armour and D. Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation' (2007) 95 *Geo. L.J.* 1727, 1736; F. Braggion and M. Giannetti,

takeovers, which institutional investors cherished for their potential to generate windfall returns,[26] and, to the extent that takeovers did proceed, insiders could garner a control premium from a potential offeror on the basis that such offeror would be able to acquire voting control merely by acquiring the insiders' superior-shares. Institutional investors were also concerned, to a lesser extent given the passivity of institutional investors during this period,[27] that their powers to influence the composition of the board,[28] and therefore discipline managers, would be curtailed. The clear distaste by institutional investors for WVR-structure, and the ensuing increases in cost of capital, led to a number of existing WVR-firms reunifying into OSOV in order to raise equity finance at a commercially practical price.[29] High profile companies such as Burton Group, Marks & Spencer, Ranks and House of Fraser all experienced enfranchisement of existing non-voting shares between 1959 and 1979.[30]

Second, with institutional investor domination of the London capital markets came increased influence. In relation to an individual investment, the axiomatic remedy for an institutional investor is to exit, but in relation to market-wide rules, customs and regulations, exiting the entire market as a whole was not really an option for domestic institutional investors; this led to collaborative lobbying of the regulators by institutional investors for shareholder-friendly regulations beneficial to them.[31] Although, institutional investors could simply factor the risks inherent in investing in WVR-firms into the price they were willing to pay for inferior-shares, the clear preference was to avoid the transaction costs intrinsic to making such assessments. This could be ensured by pressing for uniform levels of corporate governance across all companies, including harmonised voting structures geared toward OSOV.[32] It is not surprising, therefore, that institutional investors heavily petitioned the regulators against the issue of restricted-voting rights shares by listed-companies.[33] The views of the Jenkins Committee[34] of 1960, which was charged with reviewing the adequacy of corporate legislation, were also germane. Although it concluded that an outright prohibition of non-voting stock would be 'too drastic a step' and would 'encourage alternative methods of vesting control in the holders of particular shares or classes of shares',[35] the report was marked by substantially divergent

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'Changing Corporate Governance Norms: Evidence from the Dismissal of Dual Class Shares in the U.K.' (2016) 1, 9 <https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id2138949.pdf> Also, n 6 above 317 outlines the proclamations of the British Insurance Association eulogising the importance of OSOV to insurance companies, pension funds and investment trusts.

[26] n 6 above 360.

[27] B. Cheffins and S. Bank, 'Corporate Ownership and Control in the UK: The Tax Dimension' (2007) 70 *MLR* 778, 808.

[28] The Companies Act 1948 (s.184) introduced the non-waivable right of shareholders to remove directors from the board by ordinary resolution (now reflected in CA 2006, s 168).

[29] Franks and Mayer (2017) (n 102 Chapter 1 13) noted that, in 1965, approximately 15% of LSE-listed companies had WVR-shares, but nearly all of these companies had enfranchised their non-voting shares by the 1990s.

[30] n 6 above 309 and 317.

[31] Armour and Skeel (2007) (n 25 above 1771); L. Enriques et al, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies' in *The Anatomy of Corporate Law*, eds. R. Kraakman et al (Oxford: Oxford University Press (2017)) at 104.

[32] W-G. Ringe, 'Deviations from Ownership-Control Proportionality - Economic Protectionism Revisited' in *Company Law and Economic Protectionism: New Challenges to European Integration*, eds. U. Bernitz and W-G. Ringe (Oxford: Oxford University Press (2010)) at 229.

[33] Armour and Skeel (2007) (n 25 above 1771) noted that institutional investors had significant influence over an assortment of other corporate governance measures, such as pre-emption rights, shareholder consent for major corporate transactions under the Listing Rules, and the Combined Code on Corporate Governance, as well as being 'involved at every stage of the drafting of the [Takeover] Code'; S. Wei and A. Young, 'Dual share plan in context: making sense of Hong Kong's decision not to embrace Alibaba's listing' (2015) I.C.C.R.R. 4, 7.

[34] The Report of the Company Law Committee presented to Parliament in June 1962, chaired by Lord Jenkins (the Jenkins Report).

[35] Ibid 48.

opinions amongst the witnesses to the committee, and a robust dissenting opinion by a minority of the committee.[36] The dissenting element noted in particular that objection to the use of non-voting shares was strongest in the ambit of publicly quoted companies,[37] but, importantly, further noted that it was open to the British stock exchanges to refuse new issues of non-voting shares on their markets, which would negate the requirement to legislate in this area.[38] In fact, this is exactly the process that entailed. In response to pressure from powerful institutional investors, the LSE made it clear that it discouraged the quotation of inferior-shares; although there was no outright prohibition on their issuances, the LSE would use its discretionary powers to refuse applications to list inferior-shares on its market in the majority of cases.[39] This curbed the listing of new WVR-firms.

The third change in the corporate governance environment deterring the use of WVR-structure was the emergence of rules governing the conduct of public company takeovers. In 1959, guidance on takeovers was published through a collaborative effort between the Bank of England and the LSE known as the Notes on the Amalgamation of British Business.[40] Ensconced within the principles was the genesis of a concept of equality of treatment during takeover offers as between all shareholders.[41] This concept was elaborated and reinforced when it was more formally ingrained into the City Code on Take-Overs and Mergers (the Takeover Code) in 1968.[42] The new Takeover Code was administered by a Takeover Panel promoted by institutional investors and issuing houses as well as the original backers of the principles.[43] It has occasionally been stated that the UK formally prohibited the listing of WVR-structure in 1968,[44] but, in fact, the relevant change in that year was the introduction of certain Takeover Code rules that diluted their utility rather than a formal prohibition. The new Takeover Code specified that partial bids for shares were unwelcome, and to the extent a partial offer was made, a *pro rata* offer would have to be made to all shareholders unless otherwise agreed by the Takeover Panel,[45] and the same price offered to all shareholders of the same class of shares in the company.[46] These equality provisions were further supplemented by a 1971 revision to the Takeover Code that first implemented a mandatory bid provision whereunder any person acquiring 40 per cent (subsequently reduced to 30 per cent in 1974) or more of the company's shares would be required to make a bid for the remaining shares in the company.[47] Two consequences of the new Takeover Code were that it prohibited discriminatory price offers, and deterred post-IPO stake-building of large blockholdings, since acquirors would be wary of being required to make a full takeover offer for all the

[36] Ibid 207.
[37] Ibid 208.
[38] Ibid 209.
[39] Franks et al (2005) (n 20 above 604); n 6 above 317 and 32; Ringe (2010) (n 32 above 223); n 160 Chapter 1 472 and 475; M. Brennan and J. Franks, 'Underpricing, ownership and control in initial public offerings of equity securities in the UK' (1997) 45 *J. Financ. Econ.* 391, 395.
[40] Armour and Skeel, (2007) (n 25 above 1759); n 6 above 334; Franks et al (2005) (n 20 above at 604).
[41] Armour and Skeel, (2007) (ibid 1760); n 6 above 334.
[42] Armour and Skeel, (2007) (ibid 1759); n 6 above 335; Franks et al (2005) (n 20 above at 604); J. Franks et al, 'Ownership: Evolution and Regulation' (2009) 22 *Rev. Financial Stud.* 4009, 4045.
[43] Armour and Skeel, (2007) (ibid 1760); n 6 above 335.
[44] For example, see: K. Rydqvist, 'Dual-Class Shares: A Review' (1992) 8 *Oxf. Rev. Econ. Policy* 45, 45; M. Faccio and L. Lang, 'The ultimate ownership of Western European corporations' (2002) 65 *J. Financ. Econ.* 365, 386.
[45] R. Pennington, 'Takeover Bids in the United Kingdom' (1969) *Am. J. Comp. Law* 159, 174.
[46] Ibid 175.
[47] Armour and Skeel, (2007) (n 25 above 1764).

shares in the company upon surpassing the mandatory bid threshold.[48] The requirements outlined therein gradually morphed into the detailed takeover conduct provisions contained in the modern day Takeover Code, as outlined in Chapter 5. Turning back to the effect on WVR-structure, it is clear that the Takeover Code can have indirect deterrence effects on their employment. Upon a takeover offer, within classes of shares, the same price must be offered to all shareholders, and between classes, comparable offers must be made, and, therefore, the ability of a holder of superior-shares to garner a significant premium on the sale of those shares in necessarily limited. Although 'comparable' is not precisely defined, in effect, the offeror can not offer a disproportionate premium over market-price to superior-shareholders as opposed to inferior-shareholders.[49] Of course, the superior-shares and inferior-shares may be trading at different prices on the market, meaning that the offer price for each will not be identical, but the percentage premium over market-price for each would likely have to be identical,[50] reducing the ability of the superior-shareholders to generate a substantial control premium. Thus one of the incentives for insiders to adopt or retain WVR-structure was eliminated.

Through a combination of institutional shareholder apathy, LSE discouragement, and rules governing takeovers, listed-companies with WVR-structure became rare in the UK,[51] with new listings of WVR-firms almost completely extinguished by the 1980s.[52] By the early 1990s, only three FTSE-100 companies retained two-tier voting structures, and two of those, Great Universal Stores plc and Whitbread plc, unified their share voting rights in 1993.[53]

The *status quo* which effectively deterred WVR-structure without imposing a formal prohibition remained in place until the situation was finally set-in-stone for premium-listed companies. In 2010, the two tiers of the Main Market were re-labelled the premium-tier and the standard-tier, and non-voting shares were prohibited from the premium-tier.[54] In 2014, the Listing Rules were further amended to include two new high-level principles with which premium-listed companies must comply (Premium Listing Principles) were introduced – (i) 'All equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote';[55] and (ii) 'Where a listed company has more than one class of equity shares admitted to premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company.'[56] Therefore, for a premium-listed company, all premium-listed shares must carry votes proportional to their cash-flow rights in the company, in effect prohibiting the premium-listing of more than one class of shares with diverging voting rights, assuming that such shares only differ by way of voting rights.[57] Theoretically, it

[48] Franks et al (2005) (n 20 above at 585).
[49] Takeover Code, Note 1 to Rule 14.1.
[50] Although the position is not free from doubt, where the superior-shares are not listed, the ability to offer divergent prices for inferior-shares and superior-shares will likely be limited even further (see: Chapter 3).
[51] n 6 above 32; Ringe (2010) (n 32 above 223); Franks (2005) (n 20 above 604).
[52] Franks et al (2005) (ibid 585).
[53] Practical Law Company, 'Whitbread equalises shares' (1993) *Practical Law UK Articles* 2-100-444. The third company was Schroders (also see: n 61 below).
[54] Financial Services Authority, 'Listing Regime Review: Feedback on CP09/24 and CP09/28 with final rules' (February 2010).
[55] Listing Rules, Premium Listing Principle 3.
[56] Listing Rules, Premium Listing Principle 4.
[57] If other compensatory enhanced rights are attached to inferior-shares, such as with preference shares, they may be admitted to a premium-listing (n 109 in Chapter 1).

would be possible to list inferior-shares with superior-shares remaining unlisted in the hands of, for example, the founders. However, it is unlikely to be palatable to founders to pursue this avenue due to the introduction of a rule providing that, for premium-listed companies, certain matters that are required to be approved by a shareholder vote under the Listing Rules must be decided by a resolution of the holders of the premium-listed shares;[58] the significance of this is that in many instances where the Listing Rules require a shareholder vote,[59] the votes of the unlisted shares will not be counted, negating the very advantage sought by the founders. It is also unlikely that the FCA would admit such a structure to a premium-listing, considering it to be contrary to the spirit of the Premium Listing Principles. The FCA noted that 'the purpose of Premium Listing Principle 4 is to prevent artificial structures involving multiple classes with different voting powers, which are designed to allow control to rest with a small group of shareholders'.[60] Premium-listed WVR-firms with non-voting stock that were admitted prior to the 2010 prohibition had to move their inferior-shares to the standard-tier, resulting in them not enjoying the greater liquidity and price premium ascribed by a premium-listing.[61]

Unsurprisingly, as discussed above, the UK's approach to WVR-structure has been strongly influenced by the dominant stakeholders in the market – the institutional investors. That approach has emerged without any public consultations on WVR-structure, and without any formal research into the benefits and detriments of WVR-structure and whether they are, in fact, harmful to public shareholders. However, the UK's story with respect to WVR-firms does not halt here. The debate is ongoing, and contemporary dialogue has raised the topic once again. Both the UK-Government and the FCA have recently noted the potential value of WVR-structure, and have acknowledged the subject as an area for debate.[62] As further noted by both the Government and the FCA though, institutional shareholders are still generally averse to WVR-structure,[63] and, recently, in relation to the US-listing of Lyft, institutional investors, including a number of UK-led organisations, flexed their muscles by publicly decrying the proposed WVR-structure.[64] However, the fact that the use of WVR-structure is being raised yet again, and so soon after the FCA's 2014 amendments to the Listing Rules, is indicative of the subject's divisiveness and that, perhaps, the UK's adherence to OSOV is not as inexorable as recent history seemingly suggests.

[58] LR 9.2.21R.
[59] For example: cancellation of listings, certain transfers between listing categories, establishment of employee share schemes, long-term incentive plans and discounted share options, implementation of deep discount open offers, vendor consideration placings, share issues out of treasury and equity share subscription offers, undertaking of significant transactions or related-party transactions, certain repurchases of securities, and material changes to investment policy or conversion of listed equity shares of closed-end investment funds.
[60] FCA Policy Statement PS14/8, 'Response to CP13/15 – Enhancing the effectiveness of the Listing Regime' (May 2014) at 31.
[61] The route was taken by Schroders, Hansa and Daily Mail.
[62] nn 26-27 Chapter 1, and accompanying text.
[63] n 26 Chapter 1 67; n 27 Chapter 1 8.
[64] Letter to the board of Lyft, Inc. (14 March 2019) <http://ctwinvestmentgroup.com/wp-content/uploads/2019/03/Lyft-IPO-dual-class-sign-on_Final.pdf> The signatories were institutional investors with over $3.2 trillion assets under management, including the UK-led institutions Legal and General Investment Management, Hermes Equity Ownership Services, and the Local Authority Pension Fund Forum.

2. The US Context

As of the end of 2016, the largest stock market on the basis of total market capitalisation was the NYSE.[65] Given its significance, an examination of OSOV as it pertains to the LSE would be facilitated by briefly traversing the historical course of OSOV on the NYSE. Additionally, it is often remarked that the character of the US-stock exchanges parallels that of the LSE, in terms of a dispersed-ownership structure,[66] whereunder the majority of companies lack a dominant blockholder or controlling shareholder, resulting in equity ownership being dispersed amongst numerous small shareholders. Also, the majority of publicly-listed stock in both the UK and the US is held by institutional investors,[67] although it appears that such investors dominate the UK-markets to an even greater extent.[68] Furthermore, the vast majority of the existing literature and academic discourse on the merits of WVR-structure was published in the mid-1980s in relation to a proposed controversial relaxation by the NYSE of its OSOV-requirements,[69] and a subsequent attempt by the Securities and Exchange Commission (SEC) to harmonise voting rights across all US-exchanges.[70] A consideration of the US's experience is therefore felicitous.

The course of voting standards of corporations in the US initially followed a similar track to the UK, interestingly, also driven by those stakeholders holding the greatest influence at the time. Historically, one-share-per-shareholder was the prevalent voting norm in the US, developing into a OSOV-standard toward the end of the eighteenth century and beginning of the nineteenth century, following pressure from large existing and potential shareholders.[71] However, Alexander Hamilton, who, prior to his stint on Broadway, was better known as the father of the first National Bank of the US, in conceiving of the bank's voting structure, was hesitant to settle on OSOV on the basis that it would allow just a few shareholders to 'monopolize the power and benefits of the bank'.[72] He also acknowledged that one-vote-per-person would not give sufficient deference to the investments made by large shareholders and the protection that they required, so advocated for 'prudent-mean voting rights' which, as above, essentially, placed a cap on the votes exercisable by

[65] As of the end of February 2019, the total market capitalisation of the NYSE was US$23.055 trillion, comfortably exceeding the market capitalisation of NASDAQ, the second largest exchange (data from the World Federation of Exchanges <https://www.world-exchanges.org/our-work/statistics?activate=26639!jQI5eS1SeJ2ICiQTyczGO7jIVWQkVX4CFWgEld1SIM>).

[66] n 102 Chapter 1; OECD Corporate Governance Factbook 2017 at 11; R. Daniels and P. Halpern, 'Too Close for Comfort: The Role of the Closely Held Public Corporation in the Canadian Economy and the Implications for Public Policy' (1996) 26 Can. Bus. L.J. 11, 12; R. Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 *Harv. Law Rev.* 1642, 1645; Franks et al (2009) (n 42 above 4009); Cheffins, (2013) (n 91 Chapter 1 505 and 509); Ringe (2010) (n 32 above 221); R. La Porta et al, 'Corporate Ownership Around the World' (1999) 54 *J. Finance* 471, 492. Although some commentators have speculated that the characterisation of the ownership of equity on US markets as being predominantly dispersed is somewhat of a myth, the contention is generally based upon a prevalence of blockholders at the 5% level, rather than true controlling shareholders (C. Holderness, 'The Myth of Diffuse Ownership in the United States' (2009) 22 *Rev. Financial Stud.* 1377, 1378 and 1394; A. Shleifer and R. Vishny, 'Large Shareholders and Corporate Control' (1986) 94 *J. Political Econ.* 461, 462; Edmans and Holderness (2017) (n 122 Chapter 1 551)).

[67] Chan and Ho (2014) (n 63 Chapter 1 176); D. Langevoort, 'The SEC, Retail Investors, and the Institutionalization of the Securities Markets' (2008) *Georgetown Law, Faculty Working Papers* 1, 1; ONS, 'Ownership of UK quoted shares: 2018' at 4.

[68] The ONS assessed that as at 31 December 2018, the proportion of UK-quoted shares beneficially owned by individuals was only 13.5% (ibid 8). However, the Securities Industry and Financial Markets Association 2019 Fact Book (at 60) showed that, in 2018, 'households' owned 37.6% of US-equities. However, the figure for the US may be overstated, by including holdings by non-profit organisations, and presumably certain indirect retail ownership through institutional funds, and the percentage of US-equities held directly by individuals (pure retail investors) may be closer to that of the UK (Chan and Ho (2014) (ibid 175).

[69] n 108 below and accompanying text.

[70] n 115 below and accompanying text.

[71] D. Ratner, 'The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote"' (1970) 56 Cornell L. Rev. 1, 6.

[72] Ibid 6; n 8 above 1356.

individual shareholders.[73] Accordingly, as with the UK, the prudent-mean system became somewhat of the norm in the US in the early nineteenth century,[74] driven by public concerns as to the concentration of control of large corporations by a small number of financial institutions.[75] Prudent-mean voting, though, soon came under pressure from large shareholders, and, by the end of the nineteenth century, corporations were struggling to raise capital without appeasing shareholders with full compensation in terms of voting power for their investments.[76] The situation therefore evolved and it became rare for statutory rules to mandate such restraints, and, as such, OSOV without restrictions became the default rule in most States, and once again became the voting standard followed by the majority of US-corporations.[77]

Since OSOV was only a default, and not mandatory, in the absence of federal encroachment, the ability for listed-companies to issue shares that deviated from this standard was a function of the rules of the relevant stock exchange. In the early twentieth century, the NYSE permitted WVR-structure. The first known instance of a US-listed company issuing true WVR-stock was when International Silver Company issued non-voting stock in 1898.[78] As listed-corporations thrived, it became more common for them to begin issuing WVR-shares, since, amongst other things, additional finance could be raised without diluting existing large shareholders.[79] The attitude of investors had shifted as such corporations became more profitable, with them seeing the benefits in investing in successful companies notwithstanding that shares carried restricted voting rights.[80] The situation, though, came to a head in the mid-1920s, after two high profile listings on the NYSE adopting extreme WVR-structures. In 1925, the controllers of Dodge Brothers, Inc. (Dodge)[81] and Industrial Rayon Corporation[82] listed non-voting common stock, while retaining control through holding voting stock. Strikingly, the controller of Dodge, the investment bank, Dillon, Read and Company, was able to retain 100 per cent control while holding less than 2 per cent of the equity.[83] These listings resulted in a great deal of adverse publicity and academic criticism. Professor William Ripley, at the time a professor of political economy at Harvard University, in particular, railed against the notion that banks were acquiring private businesses, and recouping the purchase price, and more, through subsequent issues of stock to the public without relinquishing any semblance of control.[84] Through a series of public addresses, articles and texts, Ripley's influence grew, with his diatribes against the use of WVR-stock entering the public conscience, leading to a discussion with President Calvin Coolidge on the subject.[85] Adolf Berle, a noted

[73] Ibid.
[74] n 8 above 1358.
[75] n 71 above 6; T. O'Neil, 'Rule 19c-4: The SEC Goes Too Far in Adopting a One Share, One Vote Rule' (1989) 83 Nw. U. L. Rev. 1057, 1062.
[76] O'Neil (1989) (ibid 1063).
[77] n 71 above 8; O'Neil (1989) (ibid 1063); J. Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' (1985-1986) 54 Geo. Wash. L.R. 687, 693; Ringe (2010) (n 32 above 224); n 8 above 1359.
[78] J. Howell, 'The survival of the U.S. dual class share structure' (2017) 44 *J. Corp. Finance* 440, 444.
[79] Ashton (1994) (n 127 Chapter 1 892).
[80] O'Neil (1989) (n 75 above 1063).
[81] Seligman (1985-1986) (n 77 above 694 and 700); P. Loomis and B. Rubman, 'Corporate Governance in Historical Perspective' 8 *Hofstra Law Rev.* (1979) 141, 152; M. Warren III, 'One Share, One Vote: A Perception of Legitimacy' (1988) 14 J. Corp. L. 89, 92.
[82] Seligman (1985-1986) (ibid 694).
[83] n 81 above.
[84] W. Ripley, 'Two Changes in the Nature and Conduct of Corporations' (1926) 11 Proc. Acad. Pol. Sci. 695, 696. As to concerns relating to the powers and potential abuses of the banking houses through the use of dual-class stock, also see: A. Berle, 'Non-Voting Stock and "Bankers' Control"' (1926) 39 Harv. L. Rev. 673, 676; *Main Street and Wall Street*, ed. W. Ripley (Boston: Little, Brown, and Company (1927)) at 77.
[85] Seligman (1985-1986) (n 77 above 695).

lawyer who later published a ground-breaking text on company governance and the separation of ownership from control,[86] also joined the pantheon of preeminent academics criticising non-voting stock, stressing that 'power without responsibility is, philosophically, a perilous matter'.[87]

The escalating public anxiety led to the NYSE, in 1926, adopting an informal policy which, even though cast in opaque terms, in effect established an assertion not to permit the listing of non-voting stock. The NYSE publicly stated, 'Without at this time attempting to formulate a definite policy, attention should be drawn to the fact that in the future the committee, in considering applications for the listing of securities, will give careful thought to the matter of voting control.'[88] Although many reasons, treading the topography of the academic arguments, were tendered as to the reasons for the policy, it is clear that the primary impetus was the emergent public hysteria, and the NYSE's fear that it would lead to unwelcome top-down regulation.[89] It was even pointed out that the informal policy was 'devoid of content', and '[not] based…on a principle or theory that could clarify the ambiguities in the policy'.[90] The policy was formalised in 1940 with the publication of the NYSE's 'Statement of Listing Requirements as to Preferred Stock Voting Rights', which stated: 'Since 1926, The New York Stock Exchange has refused to list non-voting common stock.'[91] WVR-structure was also subject to scrutiny by way of a requirement that 'any allocation of voting power under normal conditions to classes of stock other than common stock should be in reasonable relationship to the equity interests of such classes'.[92] It should be noted, though, that in enforcing this policy, the NYSE still showed a degree of pragmatism, much in the same way as the LSE displays in exercising its discretion as to whether to waive its free-float requirement that at least 25 per cent of listed-shares be in public hands in one or more EEA states.[93] In particular, in 1956, the Ford Motor Company was permitted to issue stock with disproportionate voting rights – evidently the prestige of the company and the benefit to the NYSE of admitting the company's listing outweighed a strict adherence of the exchange to OSOV.[94]

The NYSE's policy on WVR-structure continued, albeit with the occasional exception as referenced above, until the mid-1980s, when, as with the UK in the 1950s,[95] there was a rash of hostile takeover activity.[96] Corporations saw the issue of WVR-stock as an effective takeover defence. A review of policy was again elicited by a burst of pragmatism when confronted with divergence by another large corporation, more significantly in this case, by a corporation already listed on the NYSE. In 1984, General Motors issued

[86] n 9 Chapter 3.
[87] Berle (1926) (n 84 above 674).
[88] Seligman (1985-1986) (n 77 above 697); Loomis and Rubman (1979) (n 81 above 152); O'Neil (1989) (n 75 above 1064); n 79 above 893.
[89] Loomis and Rubman (1979) (n 81 above 153). Also, see: Seligman (1985-1986) (n 77 above 698) quoting a 1953 memorandum from the vice-president to the president of the NYSE referencing the reason for the prohibition as being the political reaction to the notion of 'banker control' and specifically referred to Ripley's criticism.
[90] Seligman (1985-1986) (n 77 above 700).
[91] Seligman (1985-1986) (ibid 699)).
[92] Seligman (1985-1986) (ibid 690); Warren III (1988) (n 81 above 92); R. Gilson, 'Evaluating Dual Class Common Stock: The Relevance of Substitutes' (1987) 73 Va. L. Rev. 807, 808.
[93] LRs 6.14R, 9.2.15R and 14.2.2R. The FCA has used its discretion to lower the threshold for a number of controlling shareholder companies, such as Eurasian Natural Resources Corporation plc (ENRC), Ferrexpo and Fresnillo, in the past.
[94] Seligman (1985-1986) (n 77 above 700).
[95] n 20 above.
[96] n 77 Chapter 1 4; Ringe (2010) (n 32 above 225); Bainbridge (1991) (n 127 Chapter 1 571).

restricted voting stock[97] in conjunction with its acquisition of Electronic Data Systems Corporation (EDS).[98] The significance of General Motors already being NYSE-listed is that the NYSE's only means of recourse would have been to delist General Motors, a perceptibly more severe corollary than merely rejecting a corporation's IPO. The NYSE did not delist General Motors, and, as a result, many other NYSE-listed corporations subsequently issued stock with disproportionate voting rights.[99] Consequentially, the NYSE declared a moratorium in 1984 on enforcement against divergences from OSOV.[100] Some have speculated that it was happenstance that prompted the NYSE to modify its position on WVR-structure,[101] in that it was such a high profile corporation challenging the *status quo* through the issue of WVR-stock for what was, at the time, an unorthodox purpose rather than for a more commonly castigated purpose such as entrenchment. Indeed, the NYSE had in the past delisted smaller firms for breaches of its listing-standards.[102] However, another element was also at play; competition from other domestic stock exchanges. Historically, the NYSE could rely upon its position of prestige and enhanced liquidity to attract listings, but this competitive advantage was gradually eroded through uniformly applicable federal regulations and better use of technology throughout the capital markets, and sponsors began to recognise the American Stock Exchange (AMEX) and the National Association of Securities Dealers (NASD), including its computerised trading system, NASDAQ, as viable alternatives.[103] At the time, the NASD had not instigated any constraints on the listing of WVR-structure.[104] Although AMEX had prohibited the listing of pure non-voting stock in 1972, it permitted the listing of stock with disproportionate voting rights, subject to prescribed requirements.[105] These competitive pressures, further underscored by the General Motors' issuances, resulted in the NYSE, in 1984, forming a subcommittee[106] to review its policy on WVR-structure.[107] The subcommittee recommended an amendment to the NYSE's listing standards, subject to certain safeguards, following which the NYSE, in 1986, proposed a relaxation to its rules on OSOV.[108]

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[97] The restricted voting stock carried only half the votes of the common stock, justified on the basis that the new class of stock would be tied to the performance of the acquired company, and, therefore, had lesser entitlement to voting rights over the whole, larger, enterprise.

[98] O'Neil (1989) (n 75 above 1064); n 79 above 894; Warren III (1988) (n 81 above 93).

[99] In a three-year period ended June 1987, more than 46 corporations listed on the NYSE had either issued inferior-shares or had restricted the voting power of large shareholders (Warren III (1988) (ibid 93)). General Motors itself also issued further inferior-shares in conjunction with a second acquisition.

[100] Warren III (1988) (ibid 93).

[101] n 79 above 895.

[102] The NYSE delisted Cannon Mills in 1962 superficially as a result of a breach of its proxy solicitation rules, but the underlying polemic was the distribution of non-voting stock by the corporation; in many other cases, the NYSE used the threat of delisting to dissuade corporations from issuing non-voting stock (Seligman (1985-1986) (n 77 above 699-700)).

[103] n 77 Chapter 1 6; Warren III (1988) (n 81 above 92); Seligman (1985-1986) (ibid 701); Bainbridge (1991) (n 96 above 576-577)).

[104] Warren III (1988) (n 81 above 92); Gilson (1987) (n 92 above 807).

[105] AMEX implemented, *inter alia*, a voting ratio maximum of 10:1 between superior- and inferior-shares, and a rule requiring that inferior-shareholders be able to elect not less than 25% of the board (Seligman (1985-1986) (n 77 above 704-705); Warren III (1988) (ibid 92); n 79 above 896; Gilson (1987) (ibid 807)).

[106] The NYSE's Subcommittee on Shareholder Participation and Qualitative Listing Standards.

[107] Seligman (1985-1986) (n 77 above 700); Warren III (1988) (n 81 above 93); Bainbridge (1991) (n 96 above 577).

[108] The NYSE proposed that any WVR-stock outstanding at the time of a corporation's IPO would be permitted to listing. However, any such stock either issued at a later date, or created by way of the modification of existing stockholder rights, would be required to be approved by a majority of independent directors and public stockholders. The prohibition of purely non-voting stock would remain in place (Gilson (1987) (n 92 above 807); Warren III (1988) (ibid 93); n 79 above 898). The subcommittee had in fact proposed even greater protections than finally published by the NYSE, including approval by two-thirds of all stockholders, a maximum voting ratio of 10:1, and a requirement that, other than voting rights, all classes of common stock should have equivalent rights attached (Warren III (1988) (ibid 94)).

Given the history of the UK's journey to OSOV, one may ask where were the institutional investors in the US during this period? However, during the period when the NYSE was considering a relaxation of its OSOV-rules, institutional investor influence was not at the levels seen in the UK.[109] Although the holdings of institutional investors were rising dramatically, they did not account for a majority of equity holdings on the NYSE.[110] With issuers holding sway, the period was labelled 'managerialism'.[111]

Since the change to NYSE's listing-standards required SEC approval,[112] it triggered federal reaction. The SEC endeavoured to broker an agreement between the main national exchanges – the NYSE, the NASD and AMEX – in an attempt to seek voluntary adoption of a uniform voting standard on WVR-stock.[113] However, the efforts were unsuccessful, leading to the SEC, in 1988, influenced again by public and academic opprobrium toward the proposed NYSE reforms,[114] enacting a federally mandated listing requirement – the infamous Rule 19c-4.[115] Rule 19c-4 provided that US-exchanges would be required to delist any corporation that 'issues any class of security, or takes other corporate action, with the effect of nullifying, restricting or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock of such issuer'.[116] Although Rule 19c-4 restricted deviations from OSOV in certain circumstances, it is often overlooked that the rule did not go as far as to mandate a OSOV-requirement for issuers. Rule 19c-4 essentially only prohibited post-IPO recapitalisations that had the effect of disenfranchising existing public stockholders by converting their stock into stock with lesser-voting rights, or converting insiders' stock into stock with superior-rights. The significance that Rule 19c-4 would still permit the exchanges to determine the validity of WVR-firm IPOs should not be neglected; notwithstanding all the previous public excoriation regarding WVR-stock, the SEC was willing to tacitly approve their existence. In 1989, as a consequence of Rule 19c-4, the NYSE abandoned the proposed amendment to its listing requirements, and, instead, adopted requirements that mirrored the SEC's new rule. However, the SEC's efforts spawned controversy, and a representative organisation for large publicly-listed corporations, the 'Business Roundtable', no doubt motivated by the interests of its members who would have been predisposed toward flexibility to issue WVR-stock as a takeover defence, filed a lawsuit against the SEC. In 1990, the Court of Appeals for the District of Columbia struck down Rule 19c-4, rendering it invalid, on the basis that the SEC had exceeded the powers that had been imbued by Congress.[117] The resultant scenario was that voting right requirements would remain purely in the hands of the individual exchanges. In 1993, the SEC suggested that the main exchanges should follow a uniform policy, which reflected the spirit of Rule 19c-4

[109] A. Gurrea, 'Theory, Evidence, and Policy on Dual-Class Shares: A Country- Specific Response to a Global Debate' (2019) *Ibero-American Institute for Law and Finance Working Paper Series* 3/2019 para. 6.1; J. Coffee, 'Liquidity Versus Control: The Institutional Investor as a Corporate Monitor' (1991) 91 *CLR* 1277, 1310.
[110] Institutional investors held 28.2% of the equity of NYSE-listed corporations in 1970, rising to 41.4% in 1990 (NYSE Factbook data as published by NYXdata <http://www.nyxdata.com/factbook>).
[111] A. Sorkin, 'How Shareholder Democracy Failed the People' *New York Times* (20 August 2019) <https://www.nytimes.com/2019/08/20/business/dealbook/business-roundtable-corporate-responsibility.html?smid=nytcore-ios-share>
[112] n 77 Chapter 1 7; Bainbridge (1991) (n 96 above 577).
[113] Gilson (1987) (n 92 above 808); n 77 Chapter 1 7; Bainbridge (1991) (ibid 577).
[114] For example: n 77 Chapter 1 4.
[115] Code of Federal Regulations, Title 17, Chapter 2, Part 240 § 240.19c-4 'Governing certain listing or authorization determinations by national securities exchanges and associations'. The short-lived Rule 19c-4 was promulgated by the SEC and adopted in 1988 under Section 19(c) of the 1934 Act.
[116] Ibid, subsection (a).
[117] *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990).

while incorporating a greater deal of flexibility.[118] AMEX and NASD quickly adopted this policy, followed by the NYSE in 1994. The rule still exists today and, in tribute to Rule 19c-4, gives greater attention to post-IPO disenfranchisements of existing stockholders, while broadly permitting other issuances of WVR-stock.[119]

Without outlining the background of OSOV amongst the US-public markets, history may, on first sight, suggest that, eventually, through a careful progress of normative and empirical analysis over the course of decades, the NYSE determined that capital flexibility rather than OSOV was the most beneficial system for modern-day equity markets. However, as the background shows, the reasons and reactions to OSOV over the years were not so much governed by judicious scrutiny of the pros and cons of WVR-structure, but more through a combination of public reaction, competitive pressure, the influence of the primary stakeholders of the relevant times, and the serendipity of a mammoth corporation flouting the listing requirements. The controversy relating to WVR-structure does not seem to have been tempered over time. Prior to settling on the suggestion of a uniform policy amongst the exchanges in 1993, the SEC had sought, again, to negotiate a OSOV-standard.[120] More recently, politicians have criticised the concept of WVR-stock,[121] and institutional shareholders, through the representative body, the Council of Institutional Investors (CII), have intensified their lobbying efforts with the regulators and private-sector indices.[122] Individual and groups of institutional investors have consistently disparaged WVR-structure, influencing proxy advisors and the development of voluntary corporate governance principles.[123] The efforts were not in vain. S&P Dow Jones, in 2017, declared that it would not include any potential new entrants to its S&P Composite 1500 indices with WVR-structure.[124] Existing constituents of the indices would remain as members however. FTSE Russell, also, since 2017, omits any new entrants of WVR-stock from its indices unless at least 5 per cent of the voting rights are freely available to the public.[125] Existing constituents of the indices are grandfathered until September 2022. For new entrants, although FTSE Russell's transmutation was not as severe as S&P Dow Jones, the decision rules-out index-inclusion for firms only issuing non-voting stock to the public (as Snap has done) or from implementing an extreme voting ratio. After a long consultation, MSCI narrowly declined

[118] n 78 above 447.

[119] The current version of the NYSE Listed Company Manual states in § 313.00 (A): 'Voting rights of existing shareholders of publicly traded common stock…cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of time phased voting plans, the adoption of capped voting rights plans, the issuance of super voting stock, or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer.' Of further note, §313.40 gives a greater degree of flexibility to foreign issuers where the issuer's capital structure is in compliance with its local laws stating that, 'The Exchange will accept any action or issuance relating to the voting rights structure of a non-U.S. company that is in compliance with the Exchange's requirements for domestic companies or that is not prohibited by the company's home country law.'

[120] V. Goldwasser, 'Differential Voting Rights and the Super Share – In Search of an Accommodation on the Merits (1994) 7 Corp. & Bus. L.J. 215.

[121] On 5 June 2013, Senator Elizabeth Warren (D-MA) sent a letter to the vice-presidents of the NYSE and NASDAQ urging them to consider rules mandating OSOV <https://www.warren.senate.gov/files/documents/Senator%20Warren%20letter%20to%20NYSE,%20Nasdaq%20-%206-5-2013.pdf>

[122] Sharfman (2018) (n 88 Chapter 1 3); 259; Lund (2019) (n 88 Chapter 1 709).

[123] n 23 Chapter 1 597-599; A. Winden, 'Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures' (2018) 3 *CBLR* 852, 856; B. Nicholas and B. Marsh, 'Dual-Class: The Consequences of Depriving Institutional Investors of Corporate Voting Rights' (May 17, 2017) Harvard Law School Forum of Corporate Governance and Financial Regulation; n 41 Chapter 1.

[124] S&P Dow Jones Indices, 'S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rights' (31 July 2017) <https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf?force_download=true>

[125] FTSE Russell, "Voting Rights Consultation – Next Steps' (July 2017) <https://www.ftse.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf>

to omit WVR-firms from its regular indices; instead, it resolved to launch new benchmark indices that would either only comprise OSOV-firms, or weight firms for voting rights.[126] MSCI was no doubt influenced by the machinations of the leading asset manager, BlackRock, Inc. (BlackRock). In an open letter by the Vice-Chairman of BlackRock, the firm underlined its preference for OSOV, but conveyed its opinion that corporate governance standards should be set by regulators and exchanges.[127] BlackRock acknowledged that in certain instances, at least for limited periods of time, WVR-structure could be beneficial, and, therefore, its preference, as eventually followed by MSCI, was for the maintenance of broad indices covering the entire investable universe, with separate bespoke indices that screen-out specific corporate governance traits. Clearly, even in the US, which is often held-out as the paragon of successful companies utilising WVR-structure, the debate on OSOV has not yet been decisively won.

3. Making sense of UK and US history

Attitudes in the UK and the US have seemingly flip-flopped between favouritism toward OSOV and WVR-structure, although the course of history of the two jurisdictions has settled on opposite sides of the argument. The exchanges in both jurisdictions were influenced by the dominant stakeholders at the relevant times. The UK's passage toward a OSOV-standard at its highest listing-level was steered by the aspirations of institutional investors, the foremost players in the UK capital markets at the time.[128] In the US, the critical juncture of General Motors disregarding the OSOV-requirement in 1984[129] occurred at a time when institutional investors did not quite have the sway that they had in the UK at the time the UK adhered to OSOV, and, as such, in the US, managers of corporations were able to be more assertive.[130] It is unlikely that, present-day, in the UK, a current premium-listed company would test the determination of the LSE to enforce its rules on OSOV, or that a group of large listed-companies would challenge any such regulatory requirements in the manner that the Business Roundtable proceeded in the US in the late 1980s. The influence of institutional shareholders is too strong in the UK, and, given the need to raise capital, UK-companies would not wish to 'bite the hand that feeds them'. Also significant, in the US, was the competition that the NYSE faced from other US-exchanges that were more amenable toward WVR-firms. The LSE did not face the same levels of domestic competition, with regional exchanges effectively merging

[126] MSCI Press Release, 'MSCI Will Retain the MSCI Global Investable Market Indexes Unchanged and Launch a New Index Series Reflecting the Preferences of Investors on Unequal Voting Structures' (30 October 2018) <https://www.msci.com/documents/10199/0b548379-fbe7-71c7-b392-7140b2215cc9>; MSCI, 'MSCI Voting Rights-Adjusted Indexes Methodology' (March 2019) <https://www.msci.com/eqb/methodology/meth_docs/MSCI_Voting_Rights_Adjusted_Indexes_Methodology_Mar2019.pdf>

[127] BlackRock, 'Open Letter Regarding Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes' (19 April 2018) <https://www.blackrock.com/corporate/literature/publication/open-letter-treatment-of-unequal-voting-structures-msci-equity-indexes-041918.pdf> Other large passive fund asset managers Vanguard and State Street have subsequently expressed similar sentiments (Hirst and Kastiel (2019) (n 88 Chapter 1 1234)).

[128] It has been said that the influence of institutional shareholders stretches to such extent that their 'interests dominate the institutions of lawmaking and enforcement' (Enriques et al (2017) (n 31 above 104).

[129] n 98 above and accompanying text.

[130] The ability of managers to be more assertive may also have been a factor of the more 'manager-friendly' corporate legislative environment in the US (n 32 above 230; *Strong Managers, Weak Shareholders: The Political Roots of American Corporate Finance*, ed. M. Roe (Princeton: Princeton University Press (2004))).

into the LSE in 1965,[131] and, even pre-1965, those regional exchanges determined not to deviate from the LSE's position on OSOV.[132] Furthermore, now, with responsibility for the Listing Rules being in the hands of a government regulator since 2000, the FCA will be less concerned with competition for listings than a self-regulatory exchange.[133]

The positions in both jurisdictions may not yet be settled, as evidenced recently by the UK's re-examination of whether WVR-structure may be appropriate in certain circumstances, and the US's relaxed policy being subject to criticism from politicians and institutional investors, and re-assessment by certain indices. However, it is worrying that the policy decisions in both the UK and US have been directed quixotically rather than based upon a clear assessment of the benefits and burdens of WVR-structure, and how they relate to existing ownership, regulatory and shareholder-protection factors. It is also concerning that, recently, in the US, the treatment of WVR-firms is being impacted by the decisions of, broadly unregulated, for-profit index providers rather than by regulators or exchanges. Therefore, with respect to the UK, this thesis seeks to reassess the UK-policy based upon normative considerations and evidence, with a view to ascertaining whether the UK's current policy is fit-for-purpose and, if reforms are appropriate, whether existing related laws and regulations should be attuned accordingly.

[131] n 6 above 75.
[132] Ibid 317.
[133] n 160 Chapter 1 378.

CHAPTER 3:
THE NEW TRADEOFF - THE PROS AND CONS OF WVR-STRUCTURE

As briefly remarked in Chapter 1, part of the distrust that the regulators exhibit toward WVR-structure stems from a fear that the controller will utilise its power to extract personal benefits that are detrimental to shareholder wealth-maximisation. However, it is not a *fait accompli* that a controller will use its power to take actions that are detrimental to other shareholders. This Chapter commences with a discussion of the provenance of the FCA's distrust of WVR-structure, being concerns related to the actions of controlling shareholders generally, followed by a discussion of the structure's benefits and detriments. Certain of the pros and cons will be common to both OSOV-controlling shareholder and WVR firms, but WVR-structure modulates the dynamics of the relevant factor. The balance between the benefits and detriments, to public shareholders, of WVR-structure results in a tradeoff. Although such a tradeoff has been previously noted in the literature, it is discussed in new terms in this Chapter - it will be argued that, in fact, the tradeoff represents a balance between different types of controller benefits. It is not inevitable that the extraction of controller benefits will be detrimental to inferior-shareholders. As will be discussed, the description of controller benefits in the common literature as *private* benefits of control may be a misnomer - the exercise of control in a manner that benefits a controller personally, can, in certain cases, have consequential effects that are also beneficial for all shareholders. Where those controller benefits that are benign outweigh those controller benefits that are pernicious to public shareholders, the tradeoff can be tilted into a net-beneficial position. Whether that tradeoff is likely to be tilted in a positive direction is firm-specific, and may shift over time. WVR-structure, like OSOV, will be optimum for some firms (at least for part of their life-cycles), but not for others. Taking WVR-structure off-the-table prevents those firms for which the structure is beneficial from realising the locus that is optimal for public shareholders. The discussion below sets the tone for the next Chapter, in which the empirical evidence on WVR-firms will be assessed to determine how, in fact, the WVR-tradeoff is generally tilted.

1. The Provenance of the UK's Regulatory Attitude to WVR-Structure

Although WVR-structure is permitted as a matter of company law in the UK, the FCA has created an exception to this *prima facie* position by proscribing such structures from the premium-tier, which embraces the highest standards of corporate governance, suggesting that the structure is not completely without merit, but, with certain companies, shareholders should be shielded from some perceived menace against which they are unequipped to protect themselves. Why is WVR-structure, in particular, not correlated with the highest standards of corporate governance? The underpinning of the distrust of WVR-structure can be traced to concerns that controllers of listed-companies will exercise their powers in a manner that benefits them personally to the exclusion of the public shareholders. This harks back to the statement by Holderness and Sheehan (1988): '…although the reasons for the public's hostility are seldom specified, there is a vague

notion that the voting power of large-block shareholders somehow harms small shareholders'.[1] Such personal benefits are often referred to as 'private benefits of control'. For reasons that will become clear in the discussion on the WVR-Tradeoff at the end of this Chapter, throughout this thesis, private benefits of control are labelled 'controller benefits'. One may assume that controller benefits will be more voraciously pursued where the controlling shareholder either serves, or has representatives, on the board,[2] but, even where the controller is not itself represented on the board, it may collude with management for its benefit to the detriment of the company as a whole.[3] The provenance of the premium-tier prohibition of WVR-firms, which are generally associated with incumbent controlling shareholders,[4] stems from a cynicism of controlling shareholders.

'With great power comes great responsibility' – although attributed to comic book lore,[5] the quote is also apt in the corporate governance sphere. With OSOV, controlling shareholders are incentivised, to a degree, to exercise responsibility, since actions that are detrimental to shareholder wealth-maximisation will also have a considerable impact upon the controller's wealth – sometimes referred to the controller having 'highest use value'.[6] However, even with OSOV, there is not complete equivalence between actions taken by the controller that are detrimental to shareholder-wealth, and the impact felt by the controller – the controller receives 100 per cent of the controller benefits resulting from its actions, but only suffers pain equivalent to the ownership percentage that it holds in the company. Ratner (1970) stated that a controlling shareholder structure is akin to 'putting the lions in the same cage with the rabbits at the zoo, on the assumption that the lions will represent the rabbits' interests in negotiating with the keepers for food.'[7] The situation is further exacerbated with WVR - the controller is able to progressively abrogate responsibility, since its financial exposure to the well-being of the company declines as its cash-flow rights fall. The Wedge, which, as shown in Figure 1 of Chapter 1, may in practice be sizeable, taints the motives and incentives of the controlling shareholder. Those in control of the company fail to fully feel the consequences of their actions,[8] and, therefore, WVR-structure incentivises the extraction of controller benefits.

2. Theoretical Detriments to Inferior-Shareholders of WVR-Structure

Prior to a granular outline of the theoretical detriments of WVR-structure, at a higher-level, the shifting nature of conflicts should be discussed. In any publicly-listed firm, conflicts in interest can arise between

[1] C. Holderness and D. Sheehan, 'The Role of Majority Shareholders in Publicly Held Corporations: An Exploratory Analysis' (1988) 20 *J. Financ. Econ.* 317, 318.
[2] La Porta et al (1999) (n 66 Chapter 2 500) showed that 69% of large companies in wealth economies that are controlled by individuals or families also have board representation by such controllers at CEO or chair level. More recently, in a random sample of 375 US-listed firms, in cases where the largest blockholder was an individual, a named representative served on the board in 91% of the cases, and 62% of individual blockholders were both directors and officers (Edmans and Holderness (2017) (n 122 Chapter 1 553)).
[3] In continental Europe it is not unusual for blockholders to either force management to pursue actions that augment blockholder value rather than shareholder value generally or to support management-sponsored proposals in return for compensatory side payments (n 95 Chapter 1 25).
[4] nn 121, 20 and 21 Chapter 1.
[5] The quote has been attributed to S. Lee and S. Ditko, 'Amazing Fantasy #15, "Spider-Man!"' (August 1962).
[6] P. Flocos, 'Toward a Liability Rule Approach to the "One Share, One Vote" Controversy: An Epitaph for the SEC's Rule 19c-4?' (1989–1990) 138 *U Pa L Rev* 1761, 1797; Gilson (2006) (n 66 Chapter 2 1651); Dammann (2015) (n 24 in Chapter 1 481).
[7] Ratner (1970) (n 71 Chapter 2 20).
[8] n 24 Chapter 1.

various parties. The nature of these conflicts can vary between OSOV dispersed-ownership, OSOV-controlling shareholder, and WVR firms. Essentially, in the context of a corporate structure where ownership and control are separated, such as in a OSOV dispersed-ownership firm,[9] the potential conflict lies between management and shareholders, and, in the absence of adequate monitoring by shareholders, managerial-agency costs may be incurred as a result of self-serving, underperforming or indolent managers not acting in the best interests of the company, nor its shareholders.[10] The separation of ownership and control develops in a dispersed-ownership structure, since no individual shareholder holds a sufficiently large stake in the company to motivate it to expend significant cost and effort in monitoring management;[11] such a shareholder will only garner a small proportion of the benefits (benefits which could equally be enjoyed simply by 'free-riding' on the back of another shareholder's monitoring efforts).[12] When combined with the collective action issues inherent in the shareholder having to corral a significant cabal of dispersed-shareholders in order to ensure that they possess sufficient aggregate voting power to pressure management in the event that monitoring unearths poor performance, dispersed-shareholders can become 'rationally apathetic'.[13] In contrast, in a OSOV-controlling shareholder firm, due to the substantial equity ownership of the controller, it is sufficiently incentivised to rigorously monitor management, and management misbehaviour can be moderated. Better monitoring by a controlling shareholder, free from the rational apathy tainting disparate shareholders, therefore solves the managerial-agency costs dilemma. However, due to the incentive on the controlling shareholder to extract controller benefits, the primary conflict shifts from that between the management team and the shareholders, to that between the majority shareholder and the minority shareholders. With WVR-structure, the dynamic may be distorted further. If a large Wedge is implemented and the controller only holds a small level of equity, the incentive to monitor the management team in the interests of shareholder-wealth is diminished, yet the incentive to extract controller benefits is enhanced. The conflict, now between the superior-shareholders and the inferior-shareholders, sees a re-emergence of managerial-agency costs with little incentive on management to pursue shareholder wealth-maximisation. Some have therefore opined that WVR-firms embrace the risks of OSOV-controlling shareholder firms without the benefits, thereby combining the worst qualities of controlling shareholder and dispersed-ownership constructs.[14]

It has been mathematically modelled that the incentivisation to extract controller benefits escalates at a sharply increasing rate as the controller's cash-flow rights decrease.[15] One model calculates the maximum decrease in firm value, caused by the controller extracting controller benefits, that the controller would accept, based upon its equity proportion of the delta between firm value before and after the controller benefit

[9] n 148 Chapter 1.
[10] Jensen and Meckling (1976) (n 159 Chapter 1 308); D Fischel, 'The Corporate Governance Movement' (1982) 35 *Vand L Rev* 1259, 1263. For further discussion on 'agency costs', see: nn 164-166, and accompanying text.
[11] Although note the rise of hedge fund activists who may intervene while owning equity well below controlling interest levels – however, traditionally, this is not managerial monitoring as such, and more the instigation of wholesale change in pursuit of a short-term profit-seeking agenda.
[12] For a succinct description of the free-riding issue, see: n 77 Chapter 1 44.
[13] Ibid 43.
[14] Bebchuk et al (2000) (n 97 Chapter 1 295).
[15] Ibid 295; n 121 Chapter 1 1473.

extraction.[16] The model predicts that the increase in such delta that would be accepted as a controller moves from 30 per cent to 25 per cent of equity ownership is much less than the increase apparent as the controller moves from 10 per cent to 5 per cent of equity ownership.[17] For example, if controller benefit extraction is $100 million, a 30 per cent equity owner would accept a decrease in firm value of up to $333.3 million (the controller's proportion of that decrease is $100 million, so the controller will not be compensated for the decrease in firm value by the extraction of controller benefits for any decrease in firm value above that sum). For the same value of controller benefits, a 25 per cent owner would accept a decrease in firm value of $400 million, a 10 per cent owner of $1 billion, and a 5 per cent owner of $2 billion. Therefore, the decrease in firm value that the controller would accept increases between a 30 per cent and 25 per cent equity owner by $66.6 million, but by $1 billion as the controller moves from 10 per cent to 5 per cent.

Therefore, as the Wedge increases, the incentive to ensure that management prioritises shareholder wealth-maximisation decreases, but the incentive to extract controller benefits that could be detrimental to the inferior-shareholders increases. The manner in which such incentives may manifest themselves in a WVR-firm are discussed below:

Tunnelling

Perhaps the most egregious form of controller benefit extraction is through what is euphemistically labelled 'tunnelling'.[18] This is 'the transfer of assets and profits out of firms for the benefit of those who control them'.[19] The most common form of tunnelling is where the relevant company enters into transactions with other entities, in which the controller usually owns a greater proportion of the cash-flow rights than in the relevant company, on non-arm's length terms unfavourable to the relevant company. In effect, the controller is diverting cash-flow from one controlled entity to another, thereby expropriating the inferior-shareholders in the first entity.[20] Sweetheart deals or the simple withdrawing of corporate funds,[21] as well as the appropriation of corporate opportunities[22] have been noted as forms of tunnelling in WVR-firms. Additionally, a controller may divert resources from a company by entering into a merger with, or acquiring, a weaker firm in which the controller has a greater ownership stake, then 'bailing-out' the weaker firm using the assets of the first company.[23] Tunnelling can, of course, also occur in OSOV-controlling shareholder firms, but, with WVR, the conflict of interest between the controlling and public shareholders is more acute due to the disproportionately low equity interest held by the controller. From a theoretical perspective, the

[16] n 121 Chapter 1.
[17] Ibid 1473.
[18] For example, Gilson and Gordon (2003) (n 127 in Chapter 1) favour laws that place limits on tunnelling by way of deviation of a corporation's ongoing earnings to controlling shareholders, but are more sanguine as to the extraction of other controller benefits such as the extraction of control premia.
[19] S. Johnson et al, 'Tunneling' (2000) 90 *AEA Papers and Proceedings* 22, 22. The authors attribute the genesis of the term to the expropriation of minority shareholders in the Czech Republic ('as in removing assets through an underground tunnel').
[20] Ibid 7; M. Bertrand et al, 'Ferreting Out Tunneling: An Application to Indian Business Groups' (2002) 117 *Q. J. Econ.* 121, 139.
[21] Ashton (1994) (n 127 Chapter 1 916).
[22] Solomon (2017) (n 89 Chapter 1 15 and 16).
[23] Dammann (2015) (n 6 above 494).

incentives to engage in tunnelling, and the temptation to use voting power to heighten personal interests, increase with the Wedge[24] - the 'self-perpetuation of corporate princes'.[25]

It is interesting to note that although examples of tunnelling through egregious self-dealing are prevalent in weak investor protection jurisdictions,[26] in commonly perceived strong investor protection jurisdictions, such as the UK and the US,[27] it has been stated that: 'At major companies with two classes of stock, horror stories are rare; champions of uniform voting rights can't cite a single example.'[28] Although that quote was made in 1985, at a time when the NYSE was just opening-up to WVR-firms once again, even since 1985, at least in relation to extreme tunnelling, only two obvious US-examples have emerged. In 2001, the founder of Adelphia Communications Corporation (Adelphia) (a WVR-firm where the family of the founder held at the time around 63 per cent of the voting rights but only 26 per cent of the cash-flow rights[29]) and his son were convicted of obscuring liabilities, inflating earnings to meet market expectations, engaging in concealed self-dealing, and using corporate funds for personal purposes,[30] which led to bankruptcy proceedings of the company in 2002. Similarly, Conrad Black was convicted of expropriating more than $400 million from Hollinger International (Hollinger) using his controlling position and roles as CEO and chair.[31] Black held, directly or indirectly, 73 per cent of the voting rights in the company, but only 30 per cent of the cash-flow rights.[32] The dearth of anecdotal evidence may be due to the fact that regulations in strong investor-protection jurisdictions, such as related-party transaction regulations in the UK, apply to curtail the most extreme forms of self-dealing. Such regulations prevent the relevant company from entering into transactions with, *inter alia*, the controller, or 'associates' of the controlling shareholder, unless specific conditions are fulfilled. As described further in Chapter 5, in the UK, such transactions, if they exceed certain thresholds, are only permissible if confirmed by the company's sponsor that the terms are fair and reasonable to the shareholders, or, if the transaction is large, after the approval of the independent shareholders. The scope for tunnelling is therefore limited in the UK,[33] although it is conceivable that, given

[24] Hu and Black (2006) (n 24 Chapter 1 851); Jensen and Meckling (1976) (n 10 above 313); n 22 above 13.
[25] Warren III (1988) (n 81 Chapter 2 104).
[26] See the examples in: Johnson et al (2000) (n 19 above 7); S. Johnson, 'Corporate governance in the Asian financial crisis' (2000) 58 *J. Financ. Econ.* 141, 144. In Korea, it was found that an increasing Wedge is associated with greater levels of related-party-transactions, which were likely to have been implemented for the benefit of the controller (in effect, tunnelling), although the correlations were less significant for high-growth firms and those firms with strong governance where related-party-transactions would be closely monitored (M. Kang et al, 'The association between related-party transactions and control-ownership wedge: Evidence from Korea' (2014) 29 *Pac-Basin. Financ. J.* 272, 285).
[27] The strength of investor protection in the UK and US was deduced by an influential series of studies by La Porta et al (R. La Porta et al, 'Legal Determinants of External Finance' (1997) 52 *J. Financ.* 1131; R. La Porta et al, 'Law and Finance' (1998) 106 *J. Political Econ.* 1113; R. La Porta et al, 'Investor Protection and Corporate Valuation' (2002) 57 *J. Financ.* 1147). In relation to the US, some doubt was subsequently raised as to the strength of investor protections (for example: S. Djankov et al, 'The law and economics of self-dealing' (2008) 88 *J. Fin. Econ.* 430; H. Spamann, 'The "Antidirector Rights Index" Revisited' (2010) 23 *Rev. Fin. Studies* 467). However, further studies have explained this by suggesting that the strength of US-protections lies in the accessibility and prevalence of private enforcement rather than the strength of the legal protections themselves (D. Katelouzou, and M. Siems, 'Disappearing Paradigms in Shareholder Protection: Leximetric Evidence for 30 Countries, 1990-2013' (2015) 15 *J. Corp. Law Stud.* 127).
[28] Hector, 'The Flap Over Super-Shares' *Fortune* (16 September 1985) 114, 116, as cited in Flocos (1989-1990) (n 6 above 1778).
[29] S. Gilson and B. Villalonga, 'Adelphia Communications Corp.'s Bankruptcy' (2010) *Harvard Business School Case 208-071* 1, 17.
[30] Ibid 6.
[31] Cipollone (2012) (n 54 Chapter 1 75).
[32] Nicolas and Marsh (2017) (n 123 Chapter 2).
[33] Although, in relation to potential flaws in the UK's related-party regime, see: Chapter 5.

the power and information advantages instilled in a controller, clandestine or subtle, even fraudulent, tunnelling could occur in contravention of the regulations which may only be discovered after the event.[34]

High Executive Remuneration

The extraction of excessive managerial remuneration could be considered to be a form of tunnelling, and generally would not be covered by related-party transaction regulations.[35] If a WVR-controller is involved in management, this can be associated with higher levels of executive compensation,[36] and some have opined that this is one of the primary channels of controller benefit extraction.[37] Theoretically, the incentive on the WVR-controller to extract significant sums through this method is greater through a combination of suffering a smaller downside as a result of its smaller equity holding, and receiving lower regular equity income. However, although, in individual cases, there may be instances of astonishingly high levels of executive pay, across the board, the higher levels of pay in WVR-firms are insignificant compared to market capitalisation.[38] In high investor-protection jurisdictions, requirements for public companies to disclose substantial details of executive pay[39] mean that outrageously high levels of pay would likely attract significant shareholder, public and media opprobrium, which, notwithstanding isolated instances of excessive compensation, should, when purveying the overall picture, act as a moderating mechanism in this regard.[40] It is therefore not inevitable that a controller will extract high levels of remuneration. A prominent example is that of Google, where the founders famously annually only pay themselves $1 in salary.[41] Therefore, although a controlling shareholder has the legal power to pay itself any sum by way of executive compensation, other constraints may curtail this power.

[34] Hollinger is a felicitous example from an international perspective.
[35] It is likely that the payment of directors' remuneration would be considered to be a transaction in the ordinary course of business which is excluded from the related-party transaction regulations (LR 11.1.5R). Payments under long-term incentive schemes are also excluded from the regulations (LR 11.1.6R and LR 11 Annex 1.1R).
[36] R. Masulis et al 'Agency Problems at Dual-Class Companies' (2009) 64 *J. Financ.* 1697, 1703, 1708; S. Tinaikar, 'Executive compensation disclosure and private control benefits: A comparison of U.S. and Canadian dual class firms' (2017) 29 *J. Int. Account. Aud. Tax.* 32, 41; S. Tinaikar, 'Voluntary disclosure and ownership structure: an analysis of dual class firms' (2014) 18 *J. Manag. Gov.* 373, 394; B. Amoako-Adu et al, 'Dual class discount, and the channels of extraction of private benefits' (2013) 16 *Adv. Financ. Econ.* 165, 195; Smart and Zutter (2003) (n 44 Chapter 1 104).
[37] Amoako-Adu et al (2013) (Ibid 195).
[38] For example, for the fiscal years ended 2000 and 2001, the average total annual compensation for managers of US WVR-corporations was only $154,000 more than those of OSOV-corporations (Tinaikar (2014) (n 36 above 394)), and between 2001 and 2007, the average CEO compensation for WVR-firms was $5.2m compared to $4.7m for matched OSOV-firms (Amoako-Adu et al (2013) (ibid 183). Although Masulis et al (2009) found more striking results showing that average US-CEO total compensation between 1995 and 2003 increased by $1.054m as the ratio of insiders' voting rights to cash-flow rights rose by one standard deviation (n 36 above 1707), and Smart and Zutter (2003) (n 36 above 104) found average US-CEO pay of WVR-firms between 1990 and 1998 to be $905,649 (about twice as much as the figure for OSOV-firms), this should be considered in the context of average market capitalisation - in 2017, the average market capitalisation of a US-listed company was $7.3bn, and even in 2001, the average was above $3bn (Ernst & Young, 'Looking behind the declining number of public companies' (May 2017) at 3 and 2).
[39] In relation to the UK, quoted companies must prepare a directors' remuneration report (CA 2006, s.420) which must disclose detailed information relating to directors' remuneration (CA 2006, s.421 and The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013). The contents must be publicly disclosed on the company's website (CA 2006, s.430).
[40] The term 'outrage costs and constraints' was coined in this context in *Pay Without Performance*, eds. Lucian Bebchuk and Jesse Fried (Cambridge, MA: Harvard University Press (2004)) at 5. By way of analogy, in a OSOV-context, the loss of a UK advisory say-on-pay vote can lead to substantive changes being made to executive remuneration (nn 238-239 Chapter 6).
[41] Proxy Statement Schedule 14(A) of Alphabet Inc. (30 April 2019) at 43.

Inefficient Decision-Making

The pursuit of controller benefits, which, as above, is incentivised in WVR-firms, can also lead to management making inefficient decisions.[42] The seminal study by Bebchuk et al (2000) showed that controllers can 'externalise progressively more of the costs of their moral hazards' as the Wedge expands.[43] For example, when presented with two competing projects, one of which is better for the company, a controller may still procure that the company choose the more inefficient option if the controller benefits accruing to that project outweigh the downside risk associated with the controller's equity holding; with WVR-structure, if the controller has significantly reduced its equity holding, the likelihood of choosing inefficient projects of this nature increases.[44] The authors also show that 'decisions of scope' are influenced by WVR-structure - decisions as to whether to distribute cash-flows or expand the firm. If the firm owns an asset that generates controller benefits, a controller may cause the firm to hold on to the asset rather than sell it and distribute the profits, even though the sale price for the asset exceeds the benefits derived by the company from retaining it. Additionally, if the firm can acquire an asset that creates controller benefits for the controller, the firm may acquire that asset with free cash rather than distribute that cash to the shareholders. The controller benefits that lead to the making of inefficient decisions can be related to tunnelling, as above, but could also be more subtle and, for example, correlated with the extraction of non-pecuniary controller benefits (as described below). The authors opine that inefficient decisions can unintentionally result in WVR-firms becoming inefficiently large and evolving into unwieldy conglomerates[45] (although, as discussed below, other factors that drive diversification, and therefore the creation of conglomerates, by OSOV-controlling shareholder firms may be dampened by WVR[46]).

The equity markets appear to acknowledge that inefficient decision-making could be taking place, notwithstanding the existence of regulations aimed at curtailing related-party transactions. Taking the US, Masulis et al (2009) found that the value given by outside investors to cash holdings of WVR-firms is decreasing with the size of the Wedge.[47] The reasoning is that such excess cash holdings give the controllers the opportunity to use firm cash in a way that extracts controller benefits. Additionally, chiming with the theoretical analysis of Bebchuk et al (2000), as the Wedge increases, the authors found that acquisition decisions were greeted with greater negative market reactions, firms were less likely to withdraw from acquisitions that the market deemed as negative, and capital expenditure contributed less to shareholder value.[48] This suggests that, with WVR-structure, the market perceives that acquisition decisions are being driven by the level of controller benefits that may be generated, and that capital expenditure is being used to 'empire-build' rather than for the benefit of the company.[49] Amoako-Adu et al (2013) also found that the

[42] Also, see, from a normative perspective, the classic robust defence of OSOV in Easterbrook and Fischel (1983) (n 24 Chapter 1 409).
[43] n 14 above 301.
[44] n 14 above 302.
[45] Ibid 303.
[46] See: '*Diversification*' below.
[47] Masulis et al (2009) (n 36 above 1703).
[48] Ibid 1713-1715.
[49] n 22 above 16; H. Kim and R. Michaely, 'Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures' (2018) 1, 5 <https://ssrn.com/abstract=3145209>

higher the cash holdings of a WVR-firm, the greater the valuation discount attributed to such firm by outside investors compared to OSOV-firms,[50] but, unlike Masulis et al and Bebchuk et al, did not find that capital expenditure by WVR-firms was discounted more in WVR-firms, suggesting that investors did not view capital expenditure as a means of controller benefit extraction.[51] Beyond market perception, though, other empirical studies that assess operating performance of WVR-firms suggest that controller benefit extraction does not prejudice the performance of those firms to the extent that they perform worse than OSOV-firms.[52] Therefore, even though theory suggests that tunnelling and inefficient decision-making will be excessive in WVR-firms, this is not conclusively backed-up by the empirical evidence. Indeed, the propensity for inefficient decision-making should be balanced against the enhanced ability for WVR-firm managers to make efficient project choices as described under the benefits of WVR-structure below.

Management Team Entrenchment

In the UK, the shareholders of a company are able to remove the directors by way of majority-vote.[53] This is an important and non-waivable requirement of company law, since, in the normal course, the board has the right to remove and replace management,[54] giving the shareholders an indirect method of expressing their views on management and effectively instigating change in the management team. With the controller of a WVR-firm holding a majority of the votes, inferior-shareholders are unable to exercise this right without the support of the controller, who may well also be a manager. Management is completely insulated from removal by the public shareholders.[55] So long as the managers are acting in a manner that is satisfactory to the controller, possibly even in priority to the interests of the shareholders as a whole, they will not have any fear of losing their employment.[56] The inability to cause the removal of managers is a key detriment of, and significant risk to minority shareholders in, even OSOV-controlling shareholder firms, since without the deterrent of removal, the risk persists that the managers may not perform efficiently or diligently, or, worse, act in a self-serving manner. With WVR-structure, though, the risks are amplified, since, as the Wedge expands, the less the incentive on the controller (as a, potentially, well-diversified, minority investor) to ensure that management maximises shareholder-wealth, and the greater the incentive on the controller to, instead, procure that management serves the interests of the controller.

The impact of management entrenchment on shareholder-value could transmute over time. For example, a founder may hang-on as a manager even though his/her skills and abilities have significantly waned over time and the company would be better served with fresh leadership. Even though the founder would benefit from handing-over day-to-day management to a new CEO through an increase in share price

[50] Amoako-Adu et al (2013) (n 36 above 196).
[51] Ibid 197.
[52] See: Chapter 4.
[53] n 17 Chapter 1.
[54] n 18 Chapter 1.
[55] n 12 above 61; Cipollone (2012) (n 31 above 65); M. Moore and E. Walker-Arnott, 'A Fresh Look at Stock Market Short-termism' (2014) 41 *J. Law Soc.* 416, 440; A. Anand, 'Offloading the Burden of Being Public: An Analysis of Multiple Voting Share Structures' (2016) 10 *Va. Law Bus. Rev.* 395, 400.
[56] Although such behaviour could constitute a breach of directors' duties, as discussed in Chapter 5, difficulties persist in the enforcement of such duties which blunt the deterrence effect.

(although of course, as the Wedge increases, the share value benefits to the founder decrease), a combination of a desire to avoid the loss of controller benefits, endowment effects[57] and a reticence to accept that the interests of the company would be further promoted by new management can lead to the founder continuing as a manager.[58] A further aspect connected with management entrenchment rears its head when the original founder does resolve that there should be a change in day-to-day management. Rather than instigating an open-recruitment process, the founder may determine that managerial control should be transferred to an heir or another family member. Although the original manager is no longer entrenched, family entrenchment continues, even though the new manager may not be well-suited or the best candidate for the role.[59] The change in management may also be concomitant with a transfer of the controller's superior-shares to the family member. Studies have shown that, on average, transfers of control to heirs or other family members are associated with worsening performance.[60] This has been termed the 'gravity of generations'.[61] As discussed in Chapters 4 and 6, dwindling management team efficacy could explain one of the reasons why certain studies have shown that the performance of WVR-firms declines over time. An analogy can be drawn to the fictional, dysfunctional Roy-family in the television show 'Succession'.[62] Public shareholders were concerned that the patriarch had outstayed his welcome as CEO of the family-controlled company, and were ill-disposed to succession by family members. The producers of the drama conceded that they used the WVR-firms CBS Corporation (CBS) and News Corporation (News Corp.), with their controlling families, the Redstones and Murdochs, respectively, as inspiration.[63]

The entrenchment of management is further exacerbated by the fact that the internal monitoring mechanism provided by independent directors in dispersed-ownership firms is substantially lacking in the presence of a controlling shareholder,[64] such as found in most WVR-firms. Non-executive directors in UK listed-companies have traditionally had two roles – an advisory role in developing strategy, and a supervisory role in monitoring and scrutinising the performance of management.[65] Although WVR-firms can, and do, appoint independent directors, from a UK-perspective, the controller would dictate the relevant appointments,

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[57] n 80 below, and accompanying text.
[58] H. Cronqvist and M. Nilsson, 'Agency Costs of Controlling Minority Shareholders' (2003) 38 *J. Financial Quant. Anal.* 695, 715; n 72 below and accompanying text. Also see the discussion of Viacom, Inc. in Bebchuk and Kastiel (2017) (n 23 Chapter 1 588) where the controller has retained control well into his nineties.
[59] Bebchuk and Kastiel (2017) (ibid 606); Holderness and Sheehan (n 1 above 318).
[60] Anderson et al, 'Founding-Family Ownership and Firm Performance; Evidence from the S&P 500' (2003) 58 *J. Financ.* 1301, 1321; R. Morck et al 'Inherited Wealth, Corporate Control, and Economic Growth: The Canadian Disease' in *Concentrated Corporate Ownership*, ed. R. Morck (Chicago: The University of Chicago Press (2000)); N. Bloom and J. Van Reenen, 'Why Do Management Practices Differ Across Firms and Countries?' (2010) 24 *J. Econ. Persp.* 203, 218; M. Bennedsen et al, 'Inside the Family Firm: The Role of Families in Succession Decisions and Performance' (2007) 122 *Q.J. Econ.* 647, 669; F. Pérez-González, 'Inherited Control and Firm Performance' (2006) 96 *Am. Econ. Rev.* 1559, 1574; B. Villalonga and R. Amit, 'How Do Family Ownership, Control and Management Affect Firm Value?' (2006) 80 *J. Fin. Econ.* 385, 403; N. Bloom and J. Van Reenen, 'Measuring and Explaining Management Practices Across Firms and Countries' (2007) 122 *Q.J. Econ.* 1351, 1383; R. Barontini and L. Caprio, 'The Effect of Family Control on Firm Value and Performance: Evidence from Continental Europe' (2006) 12 *Euro. Financ. Manag.* 689; M. van Essen et al, 'How does Family Control Influence Firm Strategy and Performance? A Meta-Analysis of US Publicly Listed Firms' (2015) 23 *Corp. Gov.* 3, 18; Adams et al, 'Understanding the relationship between founder-CEOs and firm performance' (2009) 16 *J. Empir. Finance* 136, 149.
[61] Gilson (2006) (n 6 above 1668).
[62] J. Armstrong, 'Succession' *HBO* (2018-2019).
[63] A. Hill, 'The plague of long-running feuds in family businesses' *Financial Times* (19 August 2019) <https://www.ft.com/content/f5d1b782-bf3f-11e9-89e2-41e555e96722>
[64] Cipollone (2012) (n 31 above 75).
[65] UK CGC, Principle H. Also, see: *Re Continental Assurance Company of London plc* [2007] 2 BCLC 287, 443; and *Equitable Life Assurance Society v Bowley* [2004] BCLC 180, 189.

and it can be doubted as to whether those directors are truly independent, and whether they will be particularly adroit in monitoring the management team.[66] If the relevant director attaches prestige, pride or financial benefits to the role, there is a possibility that such director's independence could display a level of obsequiousness to a controller who has appointed the director and controls his/her removal,[67] and who could also appoint compliant 'independent' directors to further positions at other companies under its control.[68] Although, as discussed in Chapter 5, the Listing Rules grants minority shareholders in controlling shareholder firms voting rights, in the first instance, in relation to the appointment or re-election of independent directors, ultimately, the controlling shareholder possesses the power to finally compel any such appointment or re-election.[69] Concerns with regards to the independence of independent directors (and their ability to act, in the interests of the public shareholders, as a check-and-balance on the managers) would not be any different in a WVR-firm as compared to a OSOV-controlling shareholder firm, but the consequences of the independent directors being ineffective or impotent will be more keenly felt where the management team is even less incentivised to act in the interests of the outside shareholders.

Therefore, in summary, if the inferior-shareholders are displeased with the performance of management, they will have no power to change the management team, and will not be able to rely upon the controller to make the relevant change if such performance results in a decrease in share price. With controller benefits dictating over share value, the consequences of the inferior-shareholders not being able to remove underperforming management become more acute. High profile managerial failures have occurred in US WVR-firms, and inferior-shareholders were not able to replace management. For example, the executives of Groupon survived after its auditor discovered material weaknesses in its internal controls which precipitated a decline in share price, and, at News Corp. in the wake of the phone-hacking scandal, even after non-controlling shareholders voted against Rupert and James Murdoch remaining on the board, they were protected by their own majority-control through the ownership of superior-stock.[70]

Non-Pecuniary controller benefits

Most studies into controller benefits focus on the extraction of financial benefits by the controller, ignoring the numerous non-pecuniary benefits.[71] Reputation and prestige, as well as the simple psychological

[66] Seligman (1985-1986) (n 77 Chapter 2 722); Daniels and Halpern (1996) (n 66 Chapter 2 16); P. Halpern, 'Systemic Perspectives on Corporate Governance Systems' in *Corporate Governance and Globalization: Long Range Planning Issues*, eds. S. Cohen and G. Boyd (Northampton: Edward Elgar Publishing Inc. (2000)) at 29; N. Kumar and J. Singh, 'Outside Directors, Corporate Governance and Firm Performance: Empirical Evidence from India' (2012) 4 *AJFA* 39, 44; L. Bebchuk and A Hamdani, 'Independent Directors and Controlling Shareholders' (2017) 165 *U. Pa. L. R.* 1271, 1287; L. Lan and U. Varottil, 'Shareholder Empowerment in Controlled Companies: The Case of Singapore' in *The Research Handbook of Shareholder Power*, eds. Randall Thomas and Jennifer Hill (Cheltenham: Edward Elgar (2015)) 572, 577; J. Erickson et al, 'Board Composition and Firm Value under Concentrated Ownership: The Canadian Evidence' (2005) 13 *Pac-Basin. Financ. J.* 387, 400; C. Chen et al, 'Board Independence as a Panacea to Tunneling? An Empirical Study of Related-Party Transactions in Hong Kong and Singapore (2018) 15 *J. Empir. Leg. Stud.* 987, 1017; A. Gurrea, 'Towards a credible system of independent directors in controlled firms' *Ibero-American Institute for Law and Finance Working Paper* 1/2019 1, 15.

[67] B. Reddy, 'The Fat Controller: Slimming Down the Excesses of Controlling Shareholders in UK Listed Companies (2018) 38 OJLS 733, 754.

[68] D. Lin, 'Beyond Beholden' (2019) 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3335195>

[69] nn 77-79 Chapter 5, and accompanying text.

[70] T. Wen, 'You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchanges' (2014) 162 *U. Pa. L. R.* 1495, 1502.

worth of being in control[72] are obvious non-pecuniary benefits. Certain industries also lend themselves to specific non-pecuniary benefits; such as the influence accrued through control of the media or newspapers, and the sense of achievement through success of sports teams,[73] which may explain why such firms, even when they float, often retain concentrated ownership or adopt WVR-structure.[74] Being the controller of a large or influential company can breed further commercial, political or reputational opportunities, unrelated to the business of the company. Although often academically neglected, from the perspective of outside shareholders, non-pecuniary controller benefits can be particularly insidious, since there may be large incentives for controllers to sacrifice firm value in their pursuit,[75] especially where a WVR-controller only owns a small level of equity, and therefore only has minimal economic concern as to the effect that such pursuit will have on the value of the company.

Further examples of the extraction of non-pecuniary controller benefits include empire-building and instigating pet projects for personal satisfaction.[76] A controller could cause the company to pursue a project purely due to it being personally interesting to the controller, or may decline an otherwise profitable project or changes to the strategy of the business due to apathy or simply due to an inclination to work less assiduously or prefer the 'easy-life' rather than making difficult decisions that cause strife but are in the interests of the company.[77] A theoretical propensity for WVR-firms to make inefficient decisions, as discussed above, could well be driven by the controller prioritising the extraction of non-pecuniary controller benefits, rather than driven by an engagement in related-party transactions or the extraction of other pecuniary controller benefits. Of course, a management team in a OSOV-controlling shareholder firm, or even a OSOV dispersed-ownership firm, could take similar approaches. However, in a OSOV-controlling shareholder firm, the incentive to do so is reduced due to the controller's large equity interest in the company, and, in a OSOV-dispersed ownership firm, the outside shareholders can, at least in the UK, change the board with a view to constituting a more diligent management team. This is a crucial consideration for outside investors in WVR-firms – not only will they be concerned by the potential for controllers to extract pecuniary benefits that expropriate the public shareholders, but also that a management team led by the controller will underperform yet remain in place since the controller derives personal satisfaction from managing the company. Another consideration, as will be detailed next, is that non-pecuniary controller benefits can also have a bearing on takeover activity.

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[71] Gilson (2006) (n 6 above 1665) made a similar critique.
[72] P. Aghion and P. Bolton, 'An Incomplete Contracts Approach to Financial Contracting' (1992) 59 *Rev. Econ. Stud.* 473, 476; A. Dyck and L. Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 *J. Financ.* 537, 540; Gilson (2006) (ibid 1664).
[73] H. Demsetz and K. Lehn, 'The Structure of Corporate Ownership: Causes and Consequences' (1985) 93 *J. Political Econ.* 1155, 1162; Smart and Zutter (2003) (n 36 above 105).
[74] Demsetz and Lehn (1985) (ibid 1167 and 1171).
[75] n 21 Chapter 1 1085 – 'A Majority owner…can rationally…sacrifice firm value…to maintain [non-pecuniary] private benefits of control.'
[76] n 49 above.
[77] M. Bertrand and S. Mullainathan, 'Enjoying the Quiet Life? Corporate Governance and Managerial Preferences' (2003) 111 *J. Political Econ.* 1043, 1047; Kim and Michaely (2018) (n 49 above 5).

Takeover Probability

With WVR-structure, there is the potential that controlling shareholder structures could lead to value-enhancing takeovers being blocked. Clearly an offeror can not take control itself without acquiring, in a consensual manner, the controlling stake of the controller, which will not occur unless it is compensated for the loss of its controller benefits.[78] Moreover, the mathematical model determines that such behaviours increase sharply with the ability of the controller to externalise the costs of controller benefits (as is possible with WVR-structure), which is inversely proportional to the level of equity owned by the controlling shareholder.[79] Equally, a bidder will not compensate an incumbent controller for controller benefits, unless such bidder can accrue equivalent (or, in the case of jurisdictions with mandatory bid rules that require equality of treatment of all shareholders, enhanced) controller benefits after completion, or such bidder believes that it can drastically improve firm performance to a level that outweighs the compensation paid. The relevant controller benefits may encompass pecuniary or non-pecuniary benefits. An example of non-pecuniary benefits deterring a takeover is the endowment effect that is particularly applicable to individual or family controlling shareholders where sentiment, loyalty or paternalistic considerations dominate pure economic considerations;[80] a takeover otherwise profitable and advantageous to public shareholders (either in terms of sale price, or in terms of appreciation of share price post-completion under new control) is blocked by the controlling shareholder. It should be noted that such considerations only apply where a controller (or persons acting in concert to exercise control) exists; in rare situations where a dispersed-ownership WVR-firm prevails, since the superior-shares are owned by multiple unrelated parties, each individual holder of superior-shares will not possess control and will not therefore be able to extract controller benefits. In such a case, in relation to the potential for efficient takeovers to be blocked, WVR-firms will be no different from OSOV-firms.[81]

A number of theoretical US-studies have also suggested that WVR-structure is not as 'socially optimal' as OSOV from a takeover perspective, since not only will efficient takeovers be blocked, but inefficient takeovers may also be promoted, which leave the inferior-shareholders subject to the control of a new, worse controller (and management team) that portends poorer firm performance.[82] These studies are not discussed in depth in this thesis, since the studies do not fully contemplate the UK's mandatory bid rule which would not allow a bidder to acquire control by simply acquiring only the superior-shares, and, instead, would require a control-seeking bidder to make an offer for all the shares in the company. Assuming that the Takeover Code applies to the relevant company,[83] within a mandatory bid regime, all shareholders have the

[78] M. Barclay and C. Holderness, 'Private benefits from control of public corporations' (1989) 25 *J. Financ. Econ.* 371, 380; E. Schuster, 'The Mandatory Bid Rule: Efficient, After All? (2013) 76 MLR 529, 547; Gilson (2006) (n 6 above 1672).
[79] n 14 above 304; Also, see: Easterbrook and Fischel (1983) (n 42 above 409); Ruback (1988) (n 127 Chapter 1 153); n 25 above 99.
[80] Daniels and Halpern (1996) (n 66 above 20). For an economic description of the term 'endowment effect', see: *Thinking, Fast and Slow*, ed. D. Kahneman (Farrar, Straus and Giroux (2011)) at 289-299.
[81] Noted briefly in: M. Burkart and S. Lee, 'One Share – One Vote: The Theory' (2008) 12 *Rev. Financ.* 1, 11.
[82] For example: ibid; M. Harris and A. Raviv, 'Corporate Governance: Voting Rights and Majority Rules' (1988) 20 *J. Financ. Econ.* 203 and S. Grossman and O. Hart, 'One Share-One Vote and the Market for Corporate Control' (1988) 20 *J. Financ. Econ.* 175; n 14 above 295; R. Stulz, 'Managerial Control of Voting Rights: Financing Policies and the Market for Corporate Control' (1988) 20 *J. Financ. Econ.* 25, 32.
[83] As discussed in Chapter 1, it is assumed that Rule 9 of the Takeover Code will apply.

opportunity to sell their stock, and notions of inferior-shareholders being lumbered with a worse management team due to the nature of the capital structure are therefore less relevant. From the bidder's perspective, since the bidder will have to make an offer for all the shares which could, potentially, lead to it owning 100 per cent of the company, it will not be able to guarantee that it will own a majority of the votes and only a sliver of the equity post takeover – this will deter the bidder from making an offer for greater than the post-acquisition security benefits (the bidder will not be able to recompense itself for overpaying for the shares by expropriating inferior-shareholders post-acquisition if there are no or very few inferior-shareholders post-acquisition). This makes it less likely that the inferior-shareholders could become beholden to a new controller that extracts greater levels of controller benefits than the previous controller. The US-models also assume that dispersed inferior-shareholders will make an assessment as to whether to sell to a large extent based upon the potential for share-appreciation post-acquisition. In practice, with Takeover Code and UK-law being applicable, if the offer price is substantially above the market price of the shares, there is a good chance that individual shareholders will decide to sell. The post-acquisition share value would only be relevant to a target shareholder to the extent that such shareholder remains as a shareholder post-takeover. This is a challenging and risky assessment for a shareholder to make, since it is likely that the bidder will be at least outwardly indicating that it will only proceed with the takeover if it acquires full ownership.[84] Although the bidder could waive that condition if the bid is structured as a takeover offer, it would be completely in the hands of the bidder. The consideration of a target shareholder would be whether the offer price is more than the benefits the shareholder will receive going forward if the takeover does not succeed, rather than a consideration of the benefits received if the takeover does succeed and the shareholder remains as a shareholder post-acquisition.

Therefore, in the UK, if WVR-firms were permitted on the premium-tier, in theory, takeovers that could be beneficial to inferior-shareholders (in that they will receive a windfall on their original investments) may well be blocked; however, the likelihood of 'inefficient' takeovers occurring which result in public shareholders being trapped in a WVR-firm with a worse controller in place should be no greater than would be the case with a OSOV-firm.[85]

A consequence of takeover probability being reduced is that the market for corporate control, a valuable constraining mechanism on management, is attenuated. 'A well-functioning takeover market subjects firms to a continuous auction process. In principle, firms should therefore be ultimately owned and managed by those who maximize their value.'[86] The notion propounded by the quote correlates with the seminal work of Henry Manne. Manne noted that the market for corporate control provides a valuable check-

[84] If structured as a scheme of arrangement, which is more usually the case with respect to recommended offers, in effect, the bid is 'all-or-nothing'; either the bidder acquires 100% of the shares or, unless the bid is converted into a takeover offer, the bid is unsuccessful. A scheme requires the approval of a majority of shareholders by number attending a class meeting, holding at least 75% of the voting rights of the shareholders of that class attending such class meeting (CA 2006, s.899). If structured as a straight takeover offer, usually the bidder will include as an offer condition that acceptances from shareholders holding at least 90% of the votes must be received, since this is the threshold at which the bidder can subsequently 'sweep-up' the remaining minority shareholders (CA 2006, s.979). Although, the bidder will inevitably reserve the right to waive the condition, this will be entirely at the discretion of the bidder. In 2018, of 23 takeover bids on the Main Market, 18 were structured as schemes of arrangements and only 5 were takeover offers. In 2017, the numbers were 19 and 6, respectively (Practical Law What's Market, 'Public M&A: Trends and highlights 2018: What's Market data - Structure of deal').

[85] In fact, it has been noted that mandatory bid and coat-tail requirements should block all inefficient transfers (n 81 above 18).

[86] Ibid 5.

and-balance on managerial conduct, assuring competitive efficiency among managers and protecting small shareholders.[87] If managers are not performing adequately, share price will fall, leading to it becoming easier and cheaper for a third party to acquire control of the company and install a new, more efficient, management team, thereby incentivising managers to perform to the best of their abilities.[88] Since courts usually apply the 'business judgment rule' in the US, and therefore rarely second guess the business decisions of managers, Manne remarked that the market for corporate control also had a role in encouraging directors to comply with their fiduciary duties which would otherwise be difficult to enforce by the shareholders.[89] Additionally, the market for corporate control can be viewed as a mechanism that enables alternative management teams to compete for the right to manage corporate resources, thereby incentivising shareholder wealth-maximisation.[90] With the market for corporate control significantly curbed in WVR-firms, the management team, which may overlap or be associated with the controller, will only be concerned with the aspirations of the controller, rather than the threat of a takeover caused by deteriorating share price.

The deduction of takeover probabilities is not a simple task though. For instance, notwithstanding the model described above, takeovers of WVR-firms, with controller consent, do occur,[91] and empirical evidence is mixed as to whether WVR-firms are subject to fewer takeovers in the US than OSOV-firms.[92] A plethora of external economic and non-economic considerations, unrelated to the pure economics of the offer price, could affect a controller's decision to exit; the mathematical models rarely acknowledge the possible existence of such considerations. For example, a determination to seek new challenges, a desire to retire from the business, or a simple desperation to liquidate assets may weigh heavily on the decision-making of an incumbent controller. Also, the theoretical studies do not fully contemplate the existence of non-pecuniary controller benefits, and the fact that these may well vary significantly between different controllers – in jurisdictions where mandatory bid requirements do not apply, a bidder for a company may rationally over-pay for shares from a financial perspective if it values non-pecuniary controller benefits higher than the existing controller.

[87] H. Manne, 'Mergers and the Market for Corporate Control' (1965) 73 *J. Political Econ.* 110, 113; Cipollone (2012) (n 31 above 77).
[88] n 3 above 39.
[89] Although the business judgment rule does not formally apply in the UK, the Courts have generally shown a deference to managerial decisions and will not look upon them with the benefit of hindsight (*Smith v Fawcett* [1942] Ch. 304, 306; *Burland v Earle* [1902] AC 83, 93). Additionally, the ability of shareholders to assert breaches of fiduciary duties through derivative claims may be practically limited (see: Chapter 5).
[90] M. Jensen and R. Ruback, 'The Market for Corporate Control: The Scientific Evidence' (1983) 11 *J. Financ. Econ.* 5, 6.
[91] D. Fischel, 'Organized Exchanges and the Regulation of Dual Class Common Stock' (1987) 54 *U. Chi. L. Rev.* 119, 150; A. Khachaturyan, 'Trapped in Delusions: Democracy, Fairness and the One-Share-One-Vote Rule in the European Union' (2007) 8 *EBOR* 335, 351.
[92] Finding WVR-takeovers to be as, or more, prevalent than OSOV-takeovers: S. Bauguess et al, 'Shareholder diversification, corporate risk taking, and the benefits of changing to differential voting rights' (2012) 36 *J. Bank Finance* 1244, 1249; S. Bauguess et al, 'Recontracting shareholder rights at closely held firms' (2007) unpublished working paper, Arizona State University) cited in R. Adams and D. Ferreira, 'One Share-One Vote: The Empirical Evidence' (2008) 12 *Rev. Finance* 51, 64; O. Arugaslan et al, 'On the decision to go public with dual class stock' (2010) 16 *J. Corp. Finance* 170, 175. Finding that the probability of an acquisition was less for WVR-firms: Smart and Zutter (2003) (n 36 above 102); Cremers et al (2018) (n 76 Chapter 1 21); W. Mikkelson and M. Partch, 'The consequences of unbundling managers' voting rights and equity claims' (1994) 1 *J. Corp. Finance* 175, 197; Cronqvist and Nielsen (2003) (n 58 above 712); B. Jordan et al, 'Growth opportunities, short-term market pressure, and dual-class share structure' (2016) 41 *J. Corp. Finance* 304, 310.

Control Premia

Outside the UK, a WVR-controller can benefit from control premia in two manners – (i) an acquiror solely acquires the superior-shares, thereby acquiring control without the inferior-shareholders receiving any consideration; or (ii) the acquiror acquires all the shares in the company but pays a larger price for the superior-shares as compared to the inferior-shares. The first scenario is potentially more egregious, and some have criticised such control premia of being, in effect, a transfer of the value of the firm from the inferior-shareholders to the exiting controller.[93] Even in the second scenario, although it is widely recognised that a controller may retain a premium for the sale of its controlling block (and is therefore expected by investors),[94] the inferior-shareholders could be regarded as having been prejudiced if the difference in offer prices for inferior- and superior-shares is greater than merely the value of the controller benefits held by the controller.

In the UK, the ability to extract control premia is significantly mitigated by the mandatory bid regime and comparable treatment requirements.[95] With regards to the first scenario, a potential acquiror will not be able to acquire control of the company merely by making an offer for the superior-shares; an offer for all the shares in the company, no matter the class or voting rights attached, must be made pursuant to the Takeover Code's mandatory offer requirements.[96] With regards to the second scenario, with multiple classes of shares, a bidder must pay to each class of shareholder at least the highest price paid by the bidder for shares of that *class* during the 12 months prior to the announcement of the offer,[97] and offers made for each class of shares must be 'comparable'.[98] 'Comparable' does not necessarily mean 'identical', and the Takeover Panel must be consulted,[99] but, *prima facie*, the Takeover Panel will insist that the ratio of the offer values be equal to 'the average of the ratios of the middle-market quotations taken from the Daily Official List over the course of the six months preceding the commencement of the offer period'.[100] Therefore, if superior- and inferior-shares were listed in the UK,[101] it is unlikely that control premia would be large (and even if it were, investors would not be caught off-guard, since it would be based upon prevailing market prices). Although, the Main Market listed-companies Schroders and Hansa show non-trivial price differentials between superior- and inferior-shares,[102] a large slice of such differentials is driven by the fact that the superior-shares are premium-listed and the inferior-shares only standard-listed.[103] If both classes of shares were premium-listed the price

[93] Control has been described as a 'corporate asset', and accordingly should benefit all shareholders in proportion to their ownership (M. Barclay and C. Holderness, 'The Law and Large-Block Trades' (1992) 35 *J. Law Econ.* 265, 268).
[94] ibid 267.
[95] See: Chapters 1 and 5 for further details.
[96] If the bidder acquires 30% or more of the voting rights, a mandatory offer will be required (Takeover Code, Rule 9; see: Chapter 5).
[97] Ibid, Rule 9.5.
[98] Ibid, Rule 14.1.
[99] Ibid, Rule 9.5.
[100] Ibid, Notes to Rule 14.1.
[101] Note, though, that it is proposed in Chapter 6 that upon any relaxation of the UK's rules, the superior-shares should remain unlisted.
[102] n 61 Chapter 2. On 18 December 2018, the closing share price (as published by the LSE) for (i) Schroders was £23.85 for voting shares and £20.30 for non-voting shares; and (ii) Hansa was £10.10 for voting shares and £9.73 for non-voting shares.
[103] As previously discussed (nn 89-92 Chapter 1, and accompanying text), certain passive investors will be required to, and certain active investors will customarily, invest in the premium-listed superior-shares, since they are part of an index, which will drive the price differential (the comparative influence would be greater for Schroders since the voting shares are part of the FTSE-100 index). See: D. Lobo, 'Crux: Schroders is a "no brainer" investment opportunity' *Citywire Wealth Manager* (12 July 2017)

differential would likely be much smaller, since where a controller holds a majority of the voting rights through holding a significant majority of the superior-shares (which is usually the case based upon the US-experience[104]), a minority holding of superior-shares is unlikely to be of substantially greater value to a third party as compared to a minority interest in the inferior-shares,[105] and a potential offeror would not be able to acquire substantive voting rights in the company merely by acquiring the superior-shares – an offer for the inferior-shares would also be required pursuant to the mandatory offer requirements of the Takeover Code. It should be noted that with Google, where the non-voting and OSOV-shares are both listed, and the company has voluntarily adopted an equal treatment clause such that both classes of shares will receive the same sum on any takeover,[106] the voting premium between the two classes is only around 2 per cent.[107]

Of course, in most cases, the superior-shares will not be listed[108] (and in some jurisdictions, such as Hong Kong and Singapore, the superior-shares are not permitted to be listed). In the case of a UK-mandatory bid, where the superior-shares are not listed, the Takeover Panel would not be able to apply the voting premium formula in assessing 'comparable' price, if, for instance, a bidder triggers the Takeover Code's mandatory offer requirements by acquiring unlisted superior-shares. In such circumstances, it is difficult to envisage that the Takeover Panel will not insist that the same price be paid for equal equity interests, requiring that the price paid per listed inferior-share be the same as the highest price paid per unlisted superior-share. However, as discussed in Chapter 6, it would be helpful for the Takeover Panel to clarify the meaning of 'comparable' in a WVR-context. An important factor to note, though, is that with control premia bearing little relevance in the UK, takeovers will be even less likely to occur, since controllers can consume controller benefits but not sell them separately.[109]

An analogy can be drawn to Canada where, since 1987, new WVR-firms floating on the TSX must implement 'coat-tail' provisions which require, subject to certain exemptions, inferior-shares to receive the same price per superior-share upon a takeover bid.[110] This can eliminate control premia, and allow all shareholders to participate in the potentially higher takeover premia (as discussed in benefits of WVR-firms below) generated by WVR-firms when takeovers do occur. It has also had the effect of voting premia (the difference between the price of superior- and inferior-shares) in Canada being 'some of the smallest premiums in the world'.[111] Even in the US, notwithstanding some instances of control premia,[112] on acquisitions, studies have found that often the price paid for inferior-shares is identical or similar to the price

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<https://citywire.co.uk/wealth-manager/news/crux-schroders-is-a-no-brainer-investment-opportunity/a1032675>; Dittmann and Ulbricht (2007) (n 44 Chapter 1 185).

[104] n 4 above.

[105] A. Stumpf and A. Cline, 'Price Differentials Between Voting and Nonvoting Stock' Stout Advisory Services <https://www.stout.com/en/insights/article/price-differentials-between-voting-and-nonvoting-stock/> 4; the same point was raised in a US-tax case where it was found that the value attached to a minority interest in superior-shares should be comparable to the value of a minority interest in inferior-shares, and should not be conflated with the value of holding a controlling interest in the company (*Estate of Simplot v. Commissioner*, 249 F.3d 1191, 1195 (9th Cir. 2001)).

[106] n 118 below.

[107] Lund (2019) (n 88 Chapter 1 731).

[108] n 21 Chapter 1 1056.

[109] n 93 above 276. An assessment of the merits of mandatory offer requirements is beyond the scope of this thesis (in relation to which, see, for example: Schuster (2013) (n 78 above)).

[110] Cipollone (2012) (n 31 above 79); TSX Policy 3.5 para. 6.

[111] Cipollone (2012) (ibid 80).

[112] n 20 Chapter 1 60 – in this older study, it was found that the price paid for superior-shares in a takeover can, in some cases, exceed the price paid for inferior-shares by a level much larger than the variation in market price of the shares pre-takeover.

paid for superior-shares.[113] One explanation is the risk of litigation.[114] It has been purported that all shareholders are paid similar sums to the blockholder in order to avoid accusations of unfairness. In the US, upon a two-step reorganisation (which can be used to circumvent the equal treatment rules of tender offers), the board must be satisfied that the transaction is fair to all shareholders; by ensuring that the purchase price is not discounted, the board can evidence a degree of fairness that can pre-empt the risk of litigation holding-up the transaction.[115] Another explanation is that control premia represent the valuation of controller benefits – in strong investor protection jurisdictions, the ability to extract significant controller benefits is constrained, and, therefore, the premium attached to a controller's block of shares should be correspondingly reduced.[116] In fact, this is the explanation given by a cross-country study of controlling shareholder firms which found that control premia were significantly larger in weak, as compared to strong, investor protection jurisdictions.[117] A third explanation is that US WVR-firms often voluntarily adopt coat-tail or similar provisions at IPO.[118] It would seem that market forces influence issuers to negate future control premia, *ab initio*, in order to ensure the success of the listing. Apparently, the potential extraction of control premia is a controller benefit too far for outside investors, and, in strong investor protection jurisdictions, even in the absence of mandatory equal treatment rules, it appears that the extraction of a control premium is not a significant concern.

3. Theoretical Benefits to Inferior-Shareholders of WVR-Structure

As articulated above, many of the detriments of OSOV-controlling shareholder structure also apply to WVR-structure, with the significant downside that those detriments are exacerbated as the Wedge becomes larger. However, the enigma of WVR-structure is that it can also present consequential benefits to all shareholders, some of which derive from the very controller benefits that are often derided as being insidious. Controller benefits that accrue to a controller may not necessarily be detrimental to the health of the company or the interests of the other shareholders. For example, controller benefits could also be neutral to public shareholders, such as the reputational and self-worth benefits that the controller derives from being in control and management of a valuable, well-known business. Controller benefits may even be positive for public shareholders[119] - even though the controller may not be taking certain actions primarily to benefit the public shareholders, such actions could have consequential benefits for the public shareholders. As with the detriments, in some cases, the benefits to public shareholders apply equally to OSOV-controlling shareholder companies, whereas in other cases, the benefits are amplified by the fact that a WVR-controller may not hold significant equity in the company. One may argue that where the benefits apply equally, a discussion of

[113] Bauguess et al (2012) (n 92 above 1249); Arugaslan et al (2010) (n 92 above 175).
[114] n 93 above 286; C. Holderness and D. Sheehan, 'Constraints on Large-Block Shareholders' in *Concentrated Corporate Ownership*, ed. R. Morck (Chicago: The University of Chicago Press (2000)) 139, 162.
[115] Holderness and Sheehan (2000) (ibid 166).
[116] Dyck and Zingales (2004) (n 72 above 542); Barclay and Holderness (1989) (n 78 above 380).
[117] Dyck and Zingales (2004) (ibid 550).
[118] n 113 above. For example, in relation to Google, see: Amended and Restated Certificate of Incorporation of Alphabet Inc. filed on 2 October 2015, Article IV, Sections 2(e) and 5(e).
[119] R. Gilson and A. Schwartz, 'Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transaction Review' (2013) 169 *J. Institutional & Theoretical Econ* 160, 171; Gilson (2006) (n 6 above 1664).

WVR-firms is unnecessary since the relevant benefits could simply accrue to OSOV-controlling shareholder firms which are permitted on the premium-tier. However, there is still much to be gained in discussing the need for WVR-firms. As discussed in Chapter 1, WVR-structure can persuade founders to list their firms. The structure enables the founder to diversify wealth while retaining control. Without WVR-structure, such founders may decide either to not list their firms, or list and cede control, becoming a OSOV dispersed-ownership firm, and the benefits to public shareholders that would have been derived from a listed OSOV-controlling shareholder firm are not realised. WVR-structure therefore fosters the listing of firms with controlling shareholders (which may otherwise not list in such form), and deserves discussion even where the relevant benefits are equally applicable in a OSOV-controlling shareholder system. A discussion of the primary benefits to inferior-shareholders follows below:

Beneficial Related-Party Transactions

Related-Party transactions do not always necessarily entail tunnelling, and synergies between a controller's separate businesses could create efficiencies that are commercially beneficial to the relevant companies.[120] The presence of a controller could also enable a company to expand successfully, particularly in environments where business information is difficult to reliably verify or where a substantial trust-deficit in business exists – the attachment of a respected controller and brand to various conglomerate businesses could assuage the concerns of counterparties.[121] WVR-structure does not substantively differ from a OSOV-controlling shareholder structure in this case.

Diversification

As reflected upon in Chapter 1, a significant benefit for a founder in adopting WVR-structure is that a significant portion of that founder's wealth which is tied-up as an investment in the company can be crystallised upon IPO without the founder ceding control of the business.[122] With OSOV, the founder is resigned to either crystallising wealth and losing control as ownership becomes dispersed, or remaining as a controlling shareholder and retaining a significant financial investment in the company.

By the founder diversifying its own wealth, consequential benefits can accrue to the inferior-shareholders from the manner in which the business of the company will subsequently be conducted. For example, controlling shareholders of OSOV-firms, with a significant proportion of their wealth tied-up in the company, may attempt to mitigate the risks of being significantly financially exposed to the industry in which the company operates by ensuring that the investee company diversifies its business operations into other,

[120] M. Gutiérrez and M. Sáez, 'A Contractual Approach to Disciplining Self-Dealing by Controlling Shareholders' (2017) 2 *J. Law Financ. Account.* 173, 197; J. Dammann, 'Corporate Ostracism: Freezing Out Controlling Shareholders' (2008) 33 *J Corp L* 681, 707; Chen et al (2018) (n 66 above 1010).
[121] The attachment of named figures to businesses is particularly felicitous in certain jurisdictions, such as Italy (n 116 Chapter 1 164), and India ('Ratan Tata's Legacy' *The Economist* (1 December 2012) <https://www.economist.com/leaders/2012/12/01/ratan-tatas-legacy>).
[122] Arugaslan et al (2010) (n 92 above 175, 181).

often unrelated, industries, either organically or through acquisitions.[123] As a result of the drive to diversify, OSOV-controlling shareholder firms are particularly associated with the development of huge, unwieldy conglomerates as they mature.[124] Such diversification may not be in the best interests of the company nor be favourable to the minority shareholders who can themselves self-diversify by maintaining a varied portfolio. WVR-structure, and a large Wedge, can alleviate the incentives on the controller to act in this way. When Hong Kong Exchanges and Clearing (HKEX) was considering lifting the prohibition on WVR-structure, two of the noted benefits were that entrepreneurs would be able to diversify their personal wealth into other entrepreneurial projects which benefits the market as a whole, and that the ability to diversify personal wealth would reduce the preponderance of intra-firm empire-building.[125] Empirically, the implementation of WVR-structure that coincides with the divestment of significant equity by the controller is associated with, going forward, greater corporate focus through the disposal of non-core operations.[126] However, it should be noted that a will to diversify is not the only driver of empire-building or the creation of conglomerates, and other factors may persist, including, as described above, the entering into of inefficient projects driven by a desire to extract pecuniary or non-pecuniary controller benefits. The ability of the founder to diversify its wealth is also closely connected with a number of other potential benefits for inferior-shareholders, as discussed further below.[127]

Bonding Hypothesis

If outside shareholders view the controller as fundamental to the success of the business, the holding of superior-shares by that controller can benefit outside shareholders by bonding the controller to the firm.[128] If the controller has already divested the majority of its equity, it has more to lose than gain by selling its shares, since the controller will lose the pecuniary and non-pecuniary controller benefits in return for only the price of a sliver of equity.[129] The strength of the bond would be additionally reinforced in the UK, where takeover regulations, as above, would prevent the controller from receiving a premium for the voting rights, and could make the securities somewhat illiquid - a possible purchaser of shares may be deterred from acquiring the superior-shares, since an acquisition of 30 per cent or more of the voting rights would require the bidder to make an offer for all the shares in the company. Accordingly, a purchaser not wishing to obtain control of the company (but wishing to acquire a significant equity stake) would be more likely to acquire inferior-shares and avoid triggering the mandatory bid requirement. Even in the US, where the superior-

[123] An example can be seen with Sports Direct which has expanded beyond its initial focus on sportswear into luxury brands, department stores and video game retail (n 67 above 737).
[124] B. Cheffins, 'Corporate Law and Ownership Structure: A Darwinian Link?' (2002) 25 *UNSW L.J.* 346, 364; n 14 above 303. Also, see: Ratner (1970) (n 7 above 21) – '…the "entrepreneurial" image cultivated by the Mature Corporation merely serves as window dressing for sophisticated financial manipulations, such as those that characterized the "conglomerate" developments of the past decade'.
[125] HKEX, 'Concept Paper: Weighted Voting Rights' (August 2014) at IV-8. However, as discussed in Chapter 6, there are sound grounds for ensuring that founders have at least some '*skin-in-the-game*'.
[126] Bauguess et al (2012) (n 92 above 1252).
[127] See, for example: '*Risk-Taking*', *Long-Termism*' and '*Project Choice*' below.
[128] Fischel (1987) (n 91 above 137); SGX, 'Consultation Paper on Possible Listing Framework for Dual Class Share Structures' (16 February 2017) at 9. Also, see: n 121 above.
[129] A. Choi, 'Concentrated Ownership and Long-Term Shareholder Value' (2018) 8 *HBLR* 53, 68.

shares are unlisted, they could represent illiquid securities,[130] or the controller may be unable to secure a premium due to the existence of voluntarily-adopted coat-tail provisions or transfer-driven sunset clauses, further tying-in the controller.[131] It has also been noted that where superior-shares are not listed, it is indicative of a controller that has sacrificed liquidity in order to take a long-term approach – the controller likely possesses private information as to the potential cash-flow success of the company over the long-term, which the market should recognise when making investment decisions.[132]

The existence of controller benefits could also enhance the bonding effect in that they incentivise the controller to remain in control and not sell-out.[133] If controller benefits were reduced to a minimum level (for example, if inferior-shareholders were given the ability to appoint a majority of the board) the controller may garner few benefits from retaining a controlling stake in the company, and, unless adequately compensated, may seek pastures new. If the controller has already sold much of its equity, and therefore generated significant wealth, it is unlikely that the usual management bonding mechanism of high compensation with significant deferred consideration would be effective to retain the erstwhile controller as a manager. The shareholders of Tesla, Inc. have attempted to bond its CEO, Elon Musk (who has already generated significant wealth from the sell-down of equity in the company) to the firm in this way, but it has taken a breathtaking financial package that could amount to $50 billion if all performance targets are met.[134] Therefore, if the skills of the controller are highly valued by the other shareholders, optimally, a balance can be struck between the controller having sufficient 'skin-in-the-game' so that controller benefit extraction will not be excessive, while allowing the controller to divest of a sufficient proportion of equity to diversify wealth and permit a level of controller benefit extraction through ownership of superior-shares that encourages the controller to remain in control and perhaps day-to-day management.[135]

In fact, the controller-bonding hypothesis could be a crucial benefit for inferior-shareholders. Given the wide scope to manage the business granted to founders through WVR-structure, it is less likely that a WVR-firm IPO will be successful if potential investors do not have faith in the talents and ability of the superior-shareholders. For example, although the decision by WeWork to pull-out of its IPO on short-notice will have been based partly upon market scepticism as to the ongoing business plan and finances of the company, an underlying distrust of the founder's abilities was exposed when, soon after, it was announced that the founder would resign as CEO and potentially relinquish his superior-shares.[136] Similarly, it is unlikely that Uber would have countenanced a listing prior to the removal of Travis Kalanick, whose

[130] E. Böhmer et al, 'The Effect of Consolidated Control on Firm Performance: The Case of Dual-class IPOs' in *Empirical Issues in Raising Equity* Capital, ed. M. Levis (Elsevier (1996)) at 109; Ang and Megginson (1989) (n 22 Chapter 1 317); E. Böhmer et al, 'Managerial Bonding and Stock Liquidity: An Analysis of Dual-Class Firms' (2004) 28 *J. Econ. Finance* 117, 117; Gompers (2010) (n 21 Chapter 1 1053).
[131] See: Chapter 6; also see: n 118 above.
[132] Böhmer et al (2004) (n 130 above 119).
[133] n 129 above 59.
[134] C. Elson and C. Ferrere, 'Unequal Voting and the Business Judgment Rule' *Harvard Law School Forum on Corporate Governance and Financial Regulation* (7 April 2018).
[135] See: '*The New Tradeoff*' below.
[136] A. Edgecliffe-Johnson and E. Platt, 'WeWork founder trades voting power to back SoftBank rescue' *Financial Times* (21 October 2019) <https://www.ft.com/content/b9312eee-f440-11e9-b018-3ef8794b17c6>

behaviour had been very publicly denounced, as CEO, and unification of the WVR-structure to OSOV.[137] An implication of the market not accepting WVR-structure where they do not have faith in the superior-shareholders is that where successful WVR-firm IPOs do take place, there is a high likelihood that the public shareholders value the skills of the controller, and therefore, will see significant benefits in that controller continuing to be bonded to the firm.

The bonding hypothesis can also apply to management and employees. As has been iterated, with WVR-structure, the management team is insulated from outside influences; the inferior-shareholders can not remove directors from the board, and the market for corporate control is theoretically less robust and, in any event, dictated by the controller.[138] Therefore, as with controlling shareholder OSOV-structures, managers may be more likely to invest in firm-specific human capital, an essential element in the success of some types of firms.[139] Additionally, although (as described as a detriment above) a controller involved in management may view higher executive compensation as a justified controller benefit, if the controller is not associated with management, and management has confidence that the controller has faith in their skills and long-term strategy, executive compensation may be lower on the basis that, unlike with dispersed-ownership OSOV-firms, the firm does not need to compensate management for the risks that they will be dismissed pursuant to the caprice of short-term orientated dispersed-shareholders or as a result of a predatory takeover offer.[140] Accordingly, where management is not associated with the controller, executive compensation tends to be lower.[141] Other employees may also be influenced by the fact that the controller is 'bonded' to the firm, and this benefit is closely linked to '*Long-Termism*' which is discussed in more detail below. The long-term commitment of the controller can encourage the firm-specific human capital investment by employees so essential in companies with high asset-specificity such as high technology industries; the adoption of long-term projects by companies in such industries would give employees comfort that the company is committed to long-term relationships with those employees.[142] The success of the ownership structures of technology companies such as Google and Facebook may lie in the investment of human capital by employees into such organisations being supported by the ability of such companies to take a long-term approach - the controller is incentivised to take a long-term approach due to the competitive advantages generated by attracting and retaining the most talented staff, and WVR-structure enables the taking of such an approach. For example, in justifying the company's WVR-structure, in Google's 2011 Founders' Letter to Investors, it was stated, 'Our colleagues will be able to trust that they themselves and their labors of hard work, love and creativity will be well cared for by a company focused on stability and the long term.'[143]

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[137] M. Isaac, 'Uber Sells Stake to SoftBank Valuing Ride-Hailing Giant at $48 Billion' *The New York Times* (December 28, 2017). <https://www.nytimes.com/2017/12/28/technology/uber-softbank-stake.html>

[138] nn 55 and 86-90 above, and accompanying text.

[139] D. Denis and D. Denis, 'Majority owner-managers and organizational efficiency' (1994) 1 *J. Corp. Finance* 91, 106; DeAngelo and DeAngelo (1985) (n 20 Chapter 1 62); Fischel (1987) (n 91 above 137); Smart and Zutter (2003) (n 36 above 103); Böhmer et al (1996) (n 130 above 111).

[140] n 12 above 20; C. Knoeber, 'Golden Parachutes, Shark Repellents and Hostile Tender Offers' (1986) 76 *Am. Econ. Rev.* 155, 160

[141] H. Mehran, 'Executive compensation structure, ownership and firm performance' (1995) 38 *J. Financ. Econ.* 163, 179; M. Bertrand and S. Mullainathan, 'Are CEOs Rewarded for Luck? The Ones Without Principals Are' (2001) *Q.J. Econ.* 901, 921; Holderness and Sheehan (1988) (n 1 above 335).

[142] C. Mayer, 'Corporate Governance, Competition, and Performance' (1997) 24 *Corp. Gov.* 152, 168; n 3 above 28. Generally, in relation to the benefits that WVR-structure can confer on tech-companies, see: Reddy (2020) (n 183 Chapter 1).

[143] Alphabet's 2011 Founders' Letter (31 December 2011) <https://abc.xyz/investor/founders-letters/2011/>

Additionally, controlling shareholder companies are often associated with the development of strong and ingrained relationships with suppliers, customers and other stakeholders,[144] resulting from the long-term bonding of the controller to the firm. Indeed, the very presence of a family controlling shareholder may send a message to potential contracting parties that the company's management can be trusted since they can be assumed to have a desire to manufacture long-lasting contractual relationships;[145] this is particularly beneficial where the relevant firm has important stakeholder relationships, such as with vital customers, suppliers or partners.[146] Also, if the customer and product markets associate the company's success and product-quality with the involvement of the controller, the bonding of the controller to the firm can also improve the sales of a firm where ongoing support or service of the products sold is an important factor for customers.[147]

Higher Takeover Prices

A corollary to beneficial takeovers being blocked is that, when takeovers do occur, in the presence of a controlling shareholder, the offer price for those takeovers should be higher than would otherwise be the case in a dispersed-ownership structure. Whether higher takeover prices where, essentially, a wealth-transfer occurs from the buyer to the existing shareholders, are, holistically, efficient or beneficial is beyond the scope of this thesis; however, since the provenance of the prohibition of premium-tier WVR-firms appears to relate to protecting public shareholders, the factor deserves consideration. In a mandatory bid regime, higher takeover prices could be considered a benefit to public shareholders, since they will be able to share in such higher takeover prices with the controller. One reason is the ability of the controller to negotiate the offer price with the bidder.[148] In a dispersed-ownership situation, since the shareholders are dispersed, and therefore subject to collective action and free-rider issues,[149] they are not able to effectively negotiate with the bidder, and, instead, the negotiations would take place between the board and the bidder (leading to a board-recommended or hostile bid), even though ultimately, in the UK, the decision to sell is that of, and the success of the takeover is dependent upon, the shareholders. The board of a UK-company may well be motivated to negotiate strongly on behalf of the shareholders (since the executive directors will not want to be replaced by a new management team, and those directors will have a duty to negotiate the best price), but a number of extraneous factors will affect the decisions of those directors (such as severance pay), and, in a hostile bid scenario, the bidder will have effectively determined to go above the heads of the directors. The

[144] This is particularly true of family controlled companies – see: Cheffins (2002) (n 124 above 363). Also, see: Mayer (1997) (n 142 above 168); n 3 above 9.
[145] R. Gilson, 'Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange' (2007) 60 *Stan. L. Rev.* 633, 643; Cheffins (2002) (ibid 363).
[146] In the context of takeover defences generally: Cremers et al, 'Staggered boards and long-term, firm value, revisited' (2017) 126 *J. Financ. Econ.* 422, 442; Cen et al, 'Discipline or Disruption? Stakeholder Relationships and the Effect of Takeover Threat' (2016) 62 *Manag. Science* 2820, 2831; W. Johnson et al, 'The Lifecycle Effects of Firm Takeover Defenses' (2018) 1, 29 <http://dx.doi.org/10.2139/ssrn.2808208>; Mayer (1997) (n 142 above 168).
[147] n 121 above.
[148] Fischel (1987) (n 91 above 138); Bacon et al, 'The Board of Directors and Dual-Class Recaptalizations' (1997) 26 *Financ. Manag.* 5, 5. In relation to antitakeover devices generally: H. DeAngelo and E. Rice, 'Antitakeover Charter Amendments and Stockholder Wealth' (1983) 11 *J. Financ. Econ.* 329, 335; S. Linn and J. McConnell, 'An Empirical Investigation of the Impact of "Antitakeover" Amendments on Common Stock Prices' (1983) 11 *J. Financ. Econ.* 361, 395.
[149] nn 11-13 above, and accompanying text.

second reason is that dispersed-ownership shareholders, which will generally possess less pertinent knowledge as to the business and prospects of the firm compared to insider controllers, may decide to sell to a bidder when the efficient outcome would be to retain the shares unless a much higher price is offered.[150] The third reason is that the bidder must compensate the controller for the loss of controller benefits, and so the price at which a successful offer may be triggered will need to be higher than would be the case in a dispersed-ownership system where there is no controller extracting controller benefits.[151] Stulz (1988) mathematically modelled that bid premium increases with increasing insider ownership,[152] and, as further modelled by Harris and Raviv (1998),[153] with a WVR-firm, as the Wedge increases, the value of controller benefits to the incumbent controller also rises, meaning that the compensation that the controller will expect for selling its stake will further increase. In a mandatory bid regime like the UK, this would also lead to greater returns for all selling inferior-shareholders. The empirical evidence, generally, also suggests that takeover premia are higher in takeovers of WVR-firms compared to comparable OSOV-firms.[154]

Project Choice

The incentivisation of WVR-controllers to pursue inefficient projects, described in the detriments of WVR-structure above, should be balanced by the possibility for WVR-structure to facilitate efficient projects. The insulation of WVR-firm management from extraneous influences was described as a detriment above, but that very insulation can also positively influence the types of projects that managers will entertain. For example, management will be less pre-occupied in wasting resources in signalling performance to public shareholders, and less likely to invest in projects with observable payoffs that will produce lower returns than projects that are more challenging to monitor, or to employ costly signalling devices such as dividend payments, share buy-backs, or leverage to inform outsiders that performance is robust where it is otherwise difficult to monitor.[155] Compared to OSOV dispersed-ownership firms, managers may also be less likely to pursue projects that increase the costs of removing management, or produce immediate compensatory benefits to management, since they will have less fear in losing-out on deferred compensation as a result of dismissal or a takeover.[156] Chemmanur (2012) also suggested that WVR-structure can be beneficial where firms have choices between projects with high and low near-term uncertainty, with the project with high

[150] n 107 above 687; Z. Goshen and R. Squire, 'Principal Costs: A Theory for Corporate Law and Governance' (2017) 117 *Colum. L. Rev.* 767, 784; n 12 above 11.
[151] n 78 above.
[152] n 82 above 33.
[153] n 82 above.
[154] Bauguess et al (2012) (n 92 above 1249); Smart and Zutter (2003) (n 36 above 102); Bauguess et al (2007) (n 92 above).
[155] K. Lehn et al, 'Consolidating corporate control: Dual-class recapitalizations versus leveraged buyouts' (1990) 27 *J. Financ. Econ.* 557, 564; Fischel (1987) (n 91 above 138); Alchian and Demsetz (1972) (n 158 Chapter 1 789); DeAngelo and DeAngelo (1985) (n 139 above 35); M. Cornett and M. Vetsuypens, 'Voting Rights and Shareholder Wealth: The Issuance of Limited Voting Common Stock' (1989) 10 *MDE* 175, 176.
[156] J. Stein, 'Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior' (1989) 104 Q.J. Econ. 655; n 12 above 19; N. Mizik, 'The Theory and Practice of Myopic Management' (2010) 47 *J. Mark. Res.* 594, 596. Although, in specific circumstances, there may be incentives on a controlling shareholder to engage in earnings management for reasons not related to employment security or increased payouts under remuneration packages (see, for example: Lee et al, 'Earnings management by controlling shareholders who plan for stock gifts: Korean evidence' (2018) 25 *Asia-Pac. J. Account. E.* 313; Hou et al, 'Performance Commitments of Controlling Shareholders and Earnings Management' (2015) 32 *Contemp. Account. Res.* 1099).

near-term uncertainty having the potential for much greater profitability.[157] Outside shareholders take longer to determine the possible success of projects with high near-term uncertainty, valuing such products less highly all things being equal, and, as such, management requires insulation from removal, while share price may be undervalued, in order to pursue the more valuable project. The author predicted that this quality lends itself to industries such as newspapers, movies and those that require high R&D investment, and, therefore, those industries can benefit from the utilisation of WVR-structure.[158] Goshen and Squire (2017)[159] also noted that when dispersed-shareholders are given rights that allow them to impinge upon management decisions, they may make poor decisions either due to issues of competence (for example, through being misinformed or lacking the expertise to adequately opine upon a major decision) or conflict (an example would be where the shareholders are short-term orientated or have conflicting interests),[160] which, again, could influence management to forsake high near-term uncertainty projects even though they will eventually be highly profitable. The authors noted that WVR-structure can alleviate these issues.[161] It should be noted that, in relation to project choice, many of the benefits can also be identified in OSOV-controlling shareholder firms, but, with WVR-structure, managers may be even less preoccupied with the observability of projects and the impact on short-term profits where the controller holds less of the equity.

Post-IPO Equity Funding

A further benefit is secured over OSOV-controlling shareholder structure in that investments by, and in, the firm may be promoted through the use of WVR-structure. Certain projects may require further funds, which a controlling shareholder may be unwilling to finance through equity if the controller's voting interest will be diluted.[162] This may precipitate the incurrence of debt in circumstances where equity financing may be more efficient for the firm and therefore of benefit to all the shareholders.[163] Alternatively, a capital constrained company may forego an otherwise profitable project, if debt is difficult to source (which is often the case for long-term, possibly uncertain, projects).[164] A WVR-structure would allow the firm to issue inferior-shares to obtain finance, or as consideration for an acquisition, without the controller losing control,[165] which therefore should encourage the controller to cause the company to invest in projects that are potentially profitable.[166] WVR-structure also provides flexibility in acquisition structure, with General

[157] n 6 Chapter 1 306.
[158] Ibid 315; Davies et al, 'Measuring the Costs of Short-Termism' (2014) 12 *J. Financ. Stab.* 16, 18 also modelled that managers that are overly concerned about short-term performance metrics may forego otherwise profitable projects.
[159] n 150 above 767.
[160] Ibid 784. The authors labelled these 'principal costs'.
[161] Ibid 826.
[162] Rydqvist (1992) (n 44 Chapter 2 51).
[163] n 97 Chapter 1, and accompanying text.
[164] nn 93-95 Chapter 1, and accompanying text.
[165] Smart and Zutter (2003) (n 36 above 103); M. Partch, 'The creation of a class of limited voting common stock and shareholders' wealth' (1987) 18 *J. Financ. Econ.* 313, 323; G. Jarrell and A. Poulsen, 'Dual-Class Recapitalizations as Antitakeover Mechanisms: the Recent Evidence' (1988) 20 *J. Financ. Econ.* 129, 133; V. Dimitrov and P. Jain, 'Recapitalization of one class of common stock into dual-class: Growth and long-run stock returns' (2006) 12 *J. Corp. Finance* 342, 361; Bauguess et al (2012) (n 92 above 1246); n 81 above 11; Fischel (1987) (n 91 above 140).
[166] S. Banerjee, 'Dual-class share issues and mitigating the costs of corporate democracy' (2005) *Tulane University Working Paper* 1, 19.

Motors' acquisition of EDS referenced in Chapter 2[167] being an example where WVR-structure enabled the issuance of inferior-shares to the sellers with discrete dividend rights that tracked the performance of the acquired business, without giving those sellers disproportionately high voting power in the acquiring entity.[168] The expediency of WVR-structure can also be observed in the context of the UK-Government's white paper on national security and investment.[169] The white paper proposes that acquisitions of businesses above certain thresholds should be subject to a national security test that could, if applicable, give the Government powers to block the acquisition or condition its closing on the fulfilment of remedial action.[170] Although one of the proposed triggering events relates to the acquisition of more than 25 per cent of the votes *or* shares in an entity,[171] the paper suggests that the primary concern is that a party prejudicial to national security may obtain a degree of control over the entity.[172] If the final legislative provisions are clearer that the concern is control over voting rights, a WVR-structure could open-up an entity to foreign investment without national security concerns being triggered, since control will remain in the hands of the existing controller.[173] Access to these sources of further financing by companies associated with national security issues can benefit all the shareholders as a whole, and WVR-structure is seen as beneficial in this regard in jurisdictions with even stricter foreign investment restrictions.[174]

Long-Termism

On 1 February 2016, Laurence Fink, CEO of asset manager Blackrock, the world's largest investor, stated, in a letter to S&P-500 CEOs: 'Today's culture of quarterly earnings hysteria is totally contrary to the long-term approach we need.'[175] The sentiment of the comment was that in a dispersed-ownership listed-company, institutional shareholders were overly focused on quarterly results, leading to company management, looking to maximise payouts under their often short-term orientated remuneration packages, prioritising short-term shareholder profits rather than investing in long-term projects that could be profitable in the long-term, but perhaps detrimental from a financial perspective in the short-term. An oft-cited quality attributed to WVR-structure (and controlling shareholder OSOV-firms), where the controller does not need to be beholden to outside shareholders with short-term proclivities, is that it engenders a long-term approach to

[167] n 98 Chapter 2.
[168] n 116 Chapter 1 148; Gordon (n 12 above 71).
[169] National Security and Investment: A consultation on proposed legislative reforms (July 2018).
[170] The white paper follows-on from the implementation of new powers pursuant to which takeovers can be blocked on 'public interest grounds', where the relevant merger or acquisition results in the relevant company ceasing to be distinct, and the company operates in the military, computer hardware, or quantum technology sectors (The Enterprise Act 2002 (Share of Supply Test) (Amendment) Order 2018). The white paper goes much further by proposing a 25% control trigger-point for potential government action.
[171] Ibid 34.
[172] Ibid 35. A further triggering event includes the acquisition of significant influence or control over an entity (ibid 36).
[173] Although beyond the scope of this thesis, it is submitted that foreign investment restriction legislation should consider the application of WVR-structure in more detail. For example, thought should be given to the application of the rules where superior-shares convert into inferior-shares as a result of sunset clauses (see: Chapter 6), resulting in an increase in the proportion of votes held by the, potentially foreign, inferior-shareholders.
[174] Cipollone (2012) (n 31 above 70).
[175] BlackRock, 'Larry Fink's 2016 Letter to CEOs' <https://www.blackrock.com/corporate/investor-relations/2016-larry-fink-ceo-letter>

business.[176] The NYSE and NASDAQ listings of inferior-shares in Google, Berkshire Hathaway, Blackstone, Facebook and Mastercard, amongst others, were each characterised by the capital structures promoting efficiencies associated with boards being able to apply long-term approaches to the businesses of their companies.[177] In particular, Google, at IPO, stated, 'we have set up a corporate structure that will make it harder for outside parties to take over or influence Google. This structure will also make it easier for our management team to follow the long term, innovative approach emphasized earlier.'[178] Similarly, the founders of Snap stated that the public WVR-structure was being implemented to 'permit us to continue to prioritize our long-term goals rather than short-term results'.[179] Alibaba argued that a WVR-structure, at least in relation to board appointments, would allow the company to maintain its corporate culture and pursue long-term opportunities free from unreasonable demands to boost short-term profitability.[180] Böhmer et al (1996) polled executives of WVR-firms, and found that, although the ability to raise capital and diversifying wealth without losing control weighed heavily on the minds of the executives when choosing a WVR-listing, the ability to pursue long-term interests over short-term profits was also a frequently raised reason.[181] Indeed, Cipollone (2012) elucidates that WVR-structure results in 'efficiencies providing controlling minority shareholders with entrenched and protected positions from corporate takeovers that allows other shareholders to benefit from the long-term value of the founder's vision and entrepreneurial spirit.'[182]

Taking a long-term approach, that is purportedly supported by WVR-structure, can particularly benefit technology companies. They are often involved in product innovation, and, especially in their early, growth-phase years, seek success through the exploitation of product-cycles, which can increase R&D investment at the expense of short-term profits.[183] Biomed companies also similarly have long product-cycles.[184] If founders are under pressure from equity market investors to maintain strong short-term profits and distributions, the ability of the founder to pursue such product-cycles will be diminished.[185] Away from the technology and biomed industries, founders may need to maintain control to pursue a long-term, innovative vision that is not related to the invention of new products – for instance, innovative employee

[176] For example, Fischel (1987) (n 91 above 139); DeAngelo and DeAngelo (1985) (n 139 above 35); G. Dent, 'Dual Class Capitalization: A Reply to Professor Seligman' (1987) 54 *Geo. Wash. L. Rev.* 725, 764; n 129 above 59; Goshen and Hamdani (2016) (n 76 Chapter 1); L. Anidjar, 'Toward Relative Corporate Governance Regimes: Rethinking Concentrated Ownership Structure Around the World' (2019) 30 *SLPR* 197, 205; Cipollone (2012) (n 31 above 71); Bebchuk and Kastiel (2017) (n 58 above 611); Cremers et al (2018) (n 92 above 32); SGX Consultation (2017) (n 128 above 9); Feldman (n 57 Chapter 1 2); HKEX Concept Paper (2014) (n 125 above 23).
[177] Cipollone (2012) (n 31 above 71).
[178] Google Inc. Amendment No. 8 to Registration Statement (filed on 16 August 2004) at 29.
[179] Snap Inc., Amendment No. 2 to Registration Statement (filed on 16 February 2017) at 167.
[180] T. Holland, 'Alibaba's Plan to Stuff Board Hardly in Investors' Interests' *South China Morning Post* (28 August, 2013).
[181] Böhmer et al (1996) (n 130 above 96 and 116).
[182] Cipollone (2012) (n 31 above 71).
[183] Reddy (2020) (n 142 above 16-17); S. Kupor, 'Sorry CalPERS, Dual Class Shares Are A Founder's Best Friend' *Forbes CIO Network* (14 May 2013) <https://www.forbes.com/sites/ciocentral/2013/05/14/sorry-calpers-dual-class-shares-are-a-founders-best-friend/ - 5e896b6412d9>
[184] n 32 Chapter 1 8.
[185] Google's founders, in justifying its capital structure, stated: 'Technology products often require significant investment over many years to fulfill their potential. For example, it took over three years just to ship our first Android handset, and then another three years on top of that before the operating system truly reached critical mass. These kinds of investments are not for the faint-hearted. We have protected Google from outside pressures and the temptation to sacrifice future opportunities to meet short-term demands.' (n 143 above). Also: 'Investing in a product cycle increases short-term R&D expenses and thus reduces near-term earnings. Short-term investors don't like this – and generally can't see what the innovator so plainly sees in the future. Rather, the investors in turn put pressure on the company to reduce investment and instead generate near-term earnings growth, encouraging short-term decision-making.' (n 183 above).

incentivisation mechanics, marketing campaigns, distribution processes or simply a confidence in one's ability to outperform all other competitors. The way in which the company differentiates itself from the rest of the market and the founder's self-perceived ability to outperform the market in the long-term has been described as the founder's 'idiosyncratic vision'.[186]

Whether public shareholders prioritise short-term profits, or, indeed, whether taking a long-term approach to business is, in fact, overall beneficial to companies, shareholders and society generally, are two issues outside the scope of this thesis.[187] However, it should be noted that both areas are controversial. For example, although some studies suggest that institutional investors are besotted by short-term considerations, such as quarterly financials,[188] and that the markets are subject to irrational short-term bias with 'systematic' informational disparities leading to disproportionate short-term market behaviour,[189] other studies have noted that fund managers (and the investment consultants that advise them) do take into account long-term considerations such as R&D investment,[190] and that the influence of market short-termism on managerial behaviour may be overstated.[191] Even in the hedge-fund space, the accusation that activist investors generate purely short-term benefits has been challenged.[192] Furthermore, even if short-term behaviour by boards can result in the prioritisation of distributions and share buy-backs, and reduced investment in, for example, innovation and R&D, which is essential to the long-term health of the company,[193] conversely, holding management's feet to the fire with respect to short-term performance can play an important signalling mechanism allowing shareholders to assess the performance and ability of management.[194] Notwithstanding the lack of resolution to the debates, in the context of this thesis, three aspects bear consideration. Firstly, even a mere perception that the markets are short-termist, whether justified or not, can influence managers, and a number of theoretical and empirical studies have found that managers in dispersed-ownership firms make short-term orientated decisions as a result of at least a perception that the markets are myopic.[195] Second, even if the majority of the market takes a long-term approach, short-term shareholders can have a disproportionate effect on managerial behaviour. 72 per cent of UK-market turnover is attributed to hedge

[186] Goshen and Hamdani (2016) (n 176 above 577).
[187] For a summary of the benefits of stock market long-termism see: *Stock market short-termism: law, regulation and reform*, ed. K. Willey (Basingstoke: Palgarve Macmillan (2019)) at 195-218.
[188] D. Goodhart and C. Grant, 'Making the City work' (1988) 528 *Fabien Society* 1, 19.
[189] See, for example: *Inefficient Markets: An Introduction to Behavioral Finance*, ed. A. Shleifer (Oxford:OUP (2000)); R. Gilson and R. Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' (2003) Harvard Law School Discussion Paper No 446 1, 14; Moore and Walker-Arnott (2014) (n 55 above 421); n 187 above 130-147; Davies et al (2014) (n 158 above 20).
[190] n 160 Chapter 1 52-53; B. Bushee, 'The Influence of Institutional Investors on Myopic R&D Investment Behavior' (1998) 73 *Account. Rev.* 305, 322.
[191] J. Abarbanell and V. Bernard, 'Is the US Stock Market Myopic' (2000) 38 *J. Account. Res.* 221.
[192] For example: L. Bebchuk et al, 'The Long-Term Effects of Hedge Fund Activism' (2015) 115 *Colum. L. Rev.* 1085, 1141; L. Bebchuk, 'The Myth that Insulating Boards Serves Long-Term Value' (2013) Harvard Discussion Paper No, 755 1, 29 *et seq*.
[193] G. Manso, 'Motivating Innovation' (2011) 66 *J. Financ.* 1823; N. Slawinski and P. Bansal, 'Short on Time: Intertemporal Tensions in Business Sustainability' (2015) 26 *Organ. Sci.* 531, 533; S. Cheng, 'R&D Expenditures and CEO Compensation' (2004) 79 *Account. Rev.* 305, 313.
[194] R. Thakor, 'A Theory of Efficient Short-termism' (2016) <http://ssrn.com/abstract=2821162>; M. Burkart et al, 'Large Shareholders, Monitoring, and the Value of the Firm' (1997) *Q.J. Econ.* 693, 717.
[195] For an account of the manner in which management of a dispersed-ownership company can react to short-term-orientated shareholders with short-term-orientated behaviour, see: Moore and Walker-Arnott (2014) (n 55 above 430 and 438); M. Jensen, 'Agency Costs of Overvalued Equity' (2005) *Financ. Manag.* 5, 6; Ang and Megginson (1989) (n 130 above 305); A. Brandenburger and B. Polak, 'When managers cover their posteriors: making the decisions the market wants to see' (1996) 27 *RAND J. Econ.* 523; Mizik (2010) (n 156 above 594).

funds, high frequency traders and proprietary traders - actors often labelled as short-termists.[196] High market turnover of that type can have an effect on share price, and therefore an influence on management behaviour.[197] Finally, and perhaps most importantly, encouraging a long-term approach to business is a regulatory priority in the UK.[198] Therefore, from a policy-perspective, engineering structures that are conducive to taking such a long-term approach will be essential.

How might WVR-structure enable long-termism? Management entrenchment and the absence of a market for corporate control, which were also notionally described as detriments earlier in this Chapter, insulate management from the whims of a short-term orientated market, and, therefore, assuming that the relevant controller itself bears a long-term outlook in relation to the prospects of the company, the management team will not be fearful of losing their employment if short-term metrics are not positive.[199] Stein (1988) modelled how the market for corporate control can cause management to be overly preoccupied with short-term share price in priority to the long-term interests of the company.[200] Management will be at the behest of those shareholders who may make misjudgments in accepting predatory takeover offers that are not in the best interests of those shareholders or the firm.[201] The presence of a controller eliminates this issue as well as creating an environment beneficial for firms that need to invest in intangible assets and human resources, which are long-term assets the value of which may be misjudged by public shareholders.[202] It has been further speculated that innovation is promoted in companies where there is greater tolerance of short-term moribund share performance.[203] Effectively, entrenchment creates a permissive environment in which a company can take a long-term view to its business.

It should be noted that it is not unequivocal that WVR-structure, in fact, results in more long-term orientated companies than equivalent companies with dispersed-ownership models. This uncertainty is apparent in assessing the European Commission's somewhat mercurial views on how to encourage 'long-termism'. In 2007,[204] the European Commission acknowledged the argument that controlling shareholders or entrenched boards would be more focused on long-term development, but dismissed this on the basis that in response to a questionnaire[205] on 'control enhancing mechanisms' (such a WVR-structure), the majority of investors expressing dissatisfaction with such mechanisms were long-term investors.[206] However, by 2014,[207] the European Commission was advocating the use of additional voting rights and loyalty shares to enhance

[196] Kay Review (2012) (n 30 Chapter 1 38).
[197] A. Shleifer and R. Vishny, 'Short Horizons of Investors and Firms' (1990) 80 *Am. Econ. Rev.* 148, 151; Bushee (1998) (n 190 above 328); B. Bushee, 'Do Institutional Investors Prefer Near-Term Earnings over Long-Run Value?' (2001) 18 *Contemp. Account. Res.* 207.
[198] For example: Kay Review (2012) (n 196 above 20); HM Government Green Paper' (2017) (n 30 Chapter 1 64).
[199] M. Narayanan, 'Managerial Incentives for Short-Term Results' (1985) 40 *J. Finance* 1469, 1479.
[200] J. Stein, 'Takeover Threats and Managerial Myopia' (1988) 96 *J. Political Econ.* 61.
[201] n 150 above.
[202] Gilson (2006) (n 6 above 1669); Ang and Megginson (1989) (n 130 above 305).
[203] GUBERNA Position Paper, 'Re-Designing Corporate Governance to Promote Innovation' (January, 2016) at 7; Manso (2011) (n 193 above 1852).
[204] European Commission Staff Working Document dated 12 December 2007 - Impact Assessment on the Proportionality between Capital and Control in Listed Companies (SEC(2007) 1705).
[205] ISS in collaboration with Sherman & Sterling LLP and the European Corporate Governance Institute as commissioned by the European Commission, 'Report on the Proportionality Principle in the European Union' (18 May, 2007).
[206] n 204 above 32.
[207] EU Draft Report dated 19 December 2014 on the proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC and Directive 2013/34/EU (2014/0121(COD)).

the influence of long-term shareholders – mechanisms that could enable controlling shareholder entrenchment.

Empirical evidence of the long-term benefit provided by WVR-structure is similarly inconclusive. It has been shown that WVR-firms are associated with greater capital expenditure or investment.[208] Jordan et al (2016) also found that WVR-firms had greater sales growth and R&D intensity (defined as R&D expenditure over assets) than OSOV-firms, and that the trend was positively correlated with the Wedge;[209] WVR-firms unifying into OSOV, on the other hand, showed falls in sales growth and R&D intensity,[210] leading the authors to conclude that a decline in growth opportunities drives WVR-firms to unify, since the WVR-structure was no longer necessary or conducive for firm performance.[211] However, other studies have shown that WVR-firms do not invest more in R&D than OSOV-firms.[212] It should be noted, though, that 'investment' may not be a complete proxy for long-termism, and the level of sums invested by a company with a controller could also relate to the nature of expropriation; for example, on the one hand, basic tunnelling of cash-flow by a controller could leave less cash available for investment, whereas, on the other hand, if the relevant expropriation is by way of 'sweet-heart' deals, or through diversification or empire-building resulting in investments in inappropriate projects, such expropriation would be discernible by increased levels of investment. Also, there are many aspects of short-term behaviour that do not relate to the foregoing of R&D and long-term investment. Taking a different measure, Baran et al (2017) found that an increasing Wedge correlated with a greater quantity and quality of innovation as evidenced by more patent filings and citations, but that the positive correlation diminished over longer time periods.[213] Further circumstantial evidence provided by Jordan et al (2016) found that WVR-firms had significantly fewer short-term and transitory shareholders,[214] and were subject to fewer takeovers, suggesting that WVR-firms had fewer short-term pressures.

Although the empirical evidence does not fully comport with greater long-termism, any inferences must take into account the diversity of controllers[215] since some controllers will have adopted WVR-structure to take a long-term approach (with a desire to spend more on R&D, for example) and others will have done so for different reasons (possibly with expropriation of minority shareholders in mind). Alternatively, the intentions of the controller may simply shift over time as the talents of the founder wane or control passes to heirs.[216] Therefore, the nature and identity of the controller is critical in ascertaining the effect on long-term strategy, and 'investment' may not be an adequate representation of beneficial long-termism. It has been

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[208] Bauguess et al (2012) (n 92 above 1251); Lehn et al (1990) (n 155 above 577); Dittmann and Ulbricht (2007) (n 103 above 187).
[209] n 92 above 308.
[210] Ibid 321 and 322.
[211] Ibid 322.
[212] Arugaslan et al (2010) (n 92 above 174); Mikkelson and Partch (1994) (n 92 above 197); Cremers et al (2018) (n 92 above 19) found that OSOV firms spend more on R&D, although there were no significant differences in capital expenditure generally. In relation to antitakeover devices generally, it was also found that such devices correlate with a decrease in R&D investment (L. Meulbroek et al, 'Shark Repellents and Managerial Myopia: An Empirical Test' (1990) 98 *J. Political Econ.* 1108, 1115; M. Johnson and R. Rao, 'The Impact of Antitakeover Amendments on Corporate Financial Performance' (1997) 32 *Financ. Rev.* 659, 681; R. Daines and M. Klausner, 'Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs' (2001) 17 *J. L. Econ. & Org.* 83, 104).
[213] Baran et al, 'Dual Class Firm Structure and Innovation' (2017) <https://ssrn.com/abstract=3183517>
[214] n 92 above 310.
[215] Also, see: 'A Note About Diversity of Firms and Controllers' in Chapter 4.
[216] nn 60-61 above, and accompanying text.

found that founder-CEO controlled firms spend more on R&D than non-founder controlled firms,[217] and R&D spending is generally less where corporate control has been inherited.[218] Another study discovered that founder-controlled firms are more, and heir-controlled firms are less, R&D intensive than dispersed-ownership firms[219] (although the effects may be attributable to the fact that founder-CEO controlled firms are generally younger). Similarly, in a meta-analysis of 74 studies on family-firms, it was found that founder-led family-firms invested more in R&D than non-family-firms, but the trend was reversed for successor-led family-firms,[220] emphasising that the identity of the controller can have a significant effect on the propensity for long-termism. The type of company, including its maturity, industry and market, can also have a bearing upon whether the presence of a controlling shareholder encourages 'long-termism'. For example, as alluded to above, a WVR-firm may operate in an industry where the reputational advantages of such an approach can give the company a competitive advantage, whether that be in relation to attracting talented employees[221] or forming stable relationships with long-term suppliers and customers.[222]

The support of long-termism through management entrenchment is also a quality of OSOV-controlling shareholder-structures, but the propensity may be amplified with WVR-structure since the controller will be less concerned by any short-term personal changes in net-worth correlating with share price movements. With OSOV, share price is apposite if the controlling shareholder intends to sell-down equity, but with WVR-structure, it is likely that the controller will already have disposed of a substantial proportion of its equity. Of course, if the market is indeed overall short-term orientated, inferior-share price may decline if short-term performance is poor, particularly if long-term value is not easily observable, but a diversified WVR-firm controller will be able to stay the course, and those inferior-shareholders who are also long-term orientated and continue on the journey with the controller will be able to enjoy those long-term profits along with the controller. Accordingly, a mathematical model by Burkart et al (1997) predicts that high-growth companies, particularly start-ups with low current earnings compared to future potential, are likely to be benefited by, and prefer, WVR-structure.[223]

The obvious downside is that if the controller's ownership of equity is miniscule, the controlling shareholder may be completely apathetic to the share price. Although ignoring short-term share price fluctuations can be conducive to taking a long-term view of the business, the short-term share price can also provide a useful signalling mechanism,[224] and even promote better long-term performance by reducing managerial slackness.[225] Whereas the traditional supporter of WVR-structure may argue that share price fluctuations represent short-lived profit deficiencies in circumstances where the public shareholders, with informational deficiencies or with short-term horizons, can not, or will not, fully appreciate, or price, the

[217] R. Fahlenbrach, 'Founder-CEOs, Investment Decisions, and Stock Market Performance' (2009) 44 *J. Financial Quant. Anal.* 439, 446.
[218] n 60 above 345.
[219] R. Anderson et al, 'Founders, heirs, and corporate opacity in the United States' (2009) *J. Financ. Econ.* 205, 212.
[220] Essen (2015) (n 60 above 13).
[221] n 142 above.
[222] n 144 above.
[223] n 194 above 718.
[224] n 194 above.
[225] Bebchuk (2013) (n 192 above 45).

long-term benefits of managerial actions,[226] such share price falls could also represent a badly-managed firm with little in the way of long-term prospects and a controller who has either lost appetite for the business, is overly focused on egregious controller benefit extraction, or simply has a misguided belief that its long-term plan will be successful. Often, the long-term plans of the controller, and the long-term benefits of investment, may be masked and not easily discernible by outside shareholders, and therefore it may be impossible for the market to ascertain whether the controller's allusions to long-termism are merely a front for indolent or insidious behaviour, or an overly risky strategy that has little prospect of success. Although Chemmanur's (2012) model above showed that WVR-structure allows founders to pursue projects with high near-term uncertainty without fear of losing control, such projects are only predicted to yield higher cash-flows than projects with low near-term uncertainties if the founder is talented.[227] It can be difficult for outside investors to discern the type and talent of the founder, and it has even been noted that a founder that has adopted WVR-structure primarily to expropriate inferior-shareholders could try to mimic a 'good' founder by implementing voluntary minority protections at IPO.[228]

As ever, a balance is in play. Although a WVR-founder will not fear a hostile takeover as a result of declining share price, even with only a small equity holding, a WVR-firm controller is not completely dissociated from the economic health of the company. The controller may still gain substantial non-pecuniary benefits from ensuring that the company remains successful, thereby encouraging a long-term approach in industries where, as above, success is promoted by a reputation for long-termism. Also, a controller intending to issue further equity for investment, financing or acquisition purposes will desire that the equity is priced at a level that reduces the cost of capital.[229] Finally, although the controller's equity holding, as a constraining influence, has less of an impact on WVR-controllers than OSOV-controllers,[230] unless the controller has reduced its equity ownership to a miniscule level, declining share price will have at least some effect on the controller's wealth. However, given the difficulties for investors in ascertaining the nature and qualities of founders, it may, as endorsed in Chapter 6, be conducive to ensure that founders own more than minute levels of equity. By ensuring that the founder has more than trivial 'skin-in-the-game', an untalented founder or a founder focused on inferior-shareholder expropriation will suffer at least a non-inconsequential diminishment in wealth that could have a constraining effect on excessive controller benefit extraction and, in the case of untalented founders, incentivise the appointment of more talented third party managers. The key, though, will be to ensure that the required level of retained-equity is not so large that it inhibits the very ability of the controller to take the long-term approach enabled by WVR-structure.

Risk-Taking

Closely connected with long-termism is the concept of risk-taking. With OSOV dispersed-ownership firms, a regulatory prioritisation of robust monitoring (resulting in various mechanisms, such as

[226] Shleifer and Vishney (1990) (n 197 153).
[227] n 157 above 306.
[228] Ibid 306.
[229] See: *Equity Markets* in Chapter 5.
[230] Ibid.

independent directors, being implemented to substitute for a lack of scrutiny by dispersed-shareholders) has been accused of blunting innovation in favour of curtailing the excesses of unfettered management.[231] Within such a culture of compliance, management is less likely to take the risks that are required to truly innovate and substantially improve returns. Although the monitoring mechanisms have been put into place in order to protect dispersed-shareholders, given that those shareholders are generally well-diversified, it is likely that they would have a degree of appetite for risk in order to improve upside.[232] Two aspects of WVR-structure can encourage greater risk-taking and innovation, that could benefit all the shareholders in the company.

Firstly, even though the corporate governance requirements that seemingly inhibit risk-taking will still apply to premium-listed WVR-firms, their impact on the controller's decision-making (and risk-taking) will be reduced where the management team is entrenched.[233] Although the lesser effectiveness in controlling shareholder firms generally of independent directors, discussed above, and the UK CGC, discussed in Chapter 5, can be viewed negatively in not constraining the acts of controllers, it can also be viewed positively by giving controllers greater freedom to take risks.

Second, WVR-structure can enhance risk-taking from the perspective of the economic incentives of the controller. An analogy can be made to wager formulation outlined by Kahneman.[234] This explained the common psychological loss aversion apparent amongst most individuals, and its exacerbation on single bets, compared to its mitigation when aggregated across multiple independent bets. For example, in its simplest form, consider a wager on the toss of a coin where a gain of £200 is offered for heads, but a loss of £100 is suffered for tails. In a single bet, it is inferred that the average person will reject the wager due to the loss aversion in losing £100 weighing more heavily than the potential to win £200. However, if such a person were offered multiple independent bets of the same nature, it is more likely that such a person will accept the aggregated wager. Although this is an extreme example, even with more complex scenarios and less stark differences between loss and gain, Kahneman showed that the aggregation of favourable gambles progressively moderates loss aversion by reducing the possibility of losses being sustained. Extending this to the corporate world, it is easy to foresee a scenario where management turns down a single gamble on analogous terms to the coin toss, due to aversion to the potential loss - their employment could be under threat as a result of a short-term focus by a dispersed and fluctuating ownership. The situation would be improved in a OSOV-controlling shareholder scenario, where a long-term controller is present; such a shareholder has much to gain if management were to take many such independent gambles on such terms over the course of numerous years, assuming that the individual losses when incurred are not so large as to seismically imperil the future of the company. However, a competing influence is the undiversified nature of the controller's wealth - if a large proportion of the controller's wealth is invested in the firm, the controller's impulse to take such risks may be attenuated by the large losses that the controller could sustain in the short-term if an individual 'bet' is not successful. With the controller's high exposure to the value of the company, management (being influenced by the controller's views) may forego the pursuit of risky, potentially

[231] For example: S. Bianchini et al, 'Corporate Governance, Innovation and Firm Age: Insights and New Evidence' (2015) *GREDEG Working Papers Series* 2015-05 1; GUBERNA (2016) (n 203 above).
[232] Cheffins (2002) (n 124 above 356).
[233] Smart and Zutter (2003) (n 36 above 103).
[234] n 80 above 336.

valuable, investments.[235] Empirical evidence suggests that OSOV-controllers are indeed statistically risk averse.[236] In practice, as with long-termism, the nature of the particular controlling shareholder and its appetite for a long-term perspective will be relevant. The propensity for risk-taking, though, can be significantly impacted by the implementation of WVR-structure, where the controller has sold substantial equity to diversify while retaining control. The gambling hypothetical would remain apt, since the controller can purvey the aggregation of such individual decisions over an extended period of time, but now, the controller, being better diversified, would not be burdened by tectonic shocks to its net-wealth by individual decisions.[237] Essentially, by hedging its ownership of the firm, the controller can benefit all shareholders by not having to engage in value-decreasing hedging within the firm.[238] Empirically, Bauguess et al (2012),[239] found that risk-taking (measured by the standard deviation of daily returns) was fostered in closely-held firms, after the implementation of WVR-structure and the divestment of significant equity by the controller, which was wealth-enhancing and beneficial to shareholders as a whole.[240] Of course, as even the worst Las Vegas gambler knows, risk-taking for risk-taking's sake will not be conducive to overall wealth. While risk-taking in a calculated manner can enhance wealth, it can not be ignored that a WVR-firm controller out-of-his/her depth may take risks that destroy firm value in the short- and long-term; after all, the financial risk is shifted from the controlling shareholder to the outside shareholders.[241] Therefore, only sensible risks taken on an ongoing basis will be beneficial, which will very much depend upon the competence and perspicaciousness of the controller.[242] This highlights two factors which will be revisited in Chapter 6. Given the difficulties for public shareholders in assessing the qualities of controllers, it may be unwise to allow a controller to completely detach itself from the company's equity – a *de minimis* level of equity will still enable risk-taking, but not to the extent that the risks become purely speculative. Also, to the extent that public shareholders have decided (if they have a choice[243]) to invest in a WVR-firm based upon their faith in the controller, it would be prudent to protect them from future transfers to unexpected controllers.[244]

[235] Edmans (2014) (n 122 Chapter 1 33); also see: Cheffins (2002) (n 124 above 357); C. Holderness, 'A Survey of Blockholders and Corporate Control' (2003) *FRBNY Econ. Policy Rev.* 51, 56; Ashton (1994) (n 21 above 927); *The Law and Finance of Corporate* Acquisitions, eds. R. Gilson and B. Black (Westbury, NY: Foundation Press (1995)) at 784.
[236] M. Faccio et al, 'Large Shareholder Diversification and Corporate Risk-Taking' (2011) 24 *Rev. Financ. Stud.* 3601, 3621 (risk was measured by the volatility of profitability). However, it was noted in C. Himmelberg et al, 'Understanding the determinants of managerial ownership and the link between ownership and performance' (1999) 53 *J. Financ. Econ.* 353, 368 that management ownership was itself a factor of firm characteristics (i.e. endogenic), such that a firm that takes greater risks would result in management desiring to own less equity.
[237] Bauguess et al (2012) (n 92 above 1245); n 21 above 927; Gilson and Black (1995) (n 235 above 784); HKEX Concept Paper (2014) (n 125 above IV-8); Fischel (1987) (n 91 above 140); Hu and Black (2006) (n 24 above 852); Cipollone (2012) (n 31 above 69).
[238] Hu and Black (2006) (n 24 above 852).
[239] Bauguess et al (2012) (n 92 above 1252).
[240] Ibid 1251.
[241] Cipollone (2012) (n 31 above 69).
[242] An analogy can be drawn to empirical evidence that suggests that takeover defences only benefit firm performance when the management team is talented (see: nn 128 and 199 Chapter 4, and accompanying text).
[243] nn 89-92 Chapter 1, and nn 14-17 Chapter 6, and accompanying text.
[244] Notwithstanding that UK mandatory offer requirements provide a degree of protection to inferior-shareholders in this regard, Chapter 6 discusses the further justification for transfer-driven sunset provisions.

4. The WVR-Firm Tradeoff

In this Chapter the theoretical detriments and benefits of WVR-structure, from the perspective of the inferior-shareholders, have been discussed. The remainder of this Chapter will deliberate upon the tradeoff between those benefits and detriments, and develop a new formulation that treats such benefits and detriments as the consequences that materialise from the extraction of differing controller benefits. In subsequent Chapters, the empirical evidence will be evaluated to ascertain whether the tradeoff is generally shifted into a net-beneficial or net-detrimental position, and the concept of the new formulation of the tradeoff will be used to ascertain whether constraints can be used to tilt the tradeoff in a beneficial direction.

The Tradeoff – Literature Review

The concept of a tradeoff in the context of capital structure is not novel. With respect to OSOV-controlling shareholders, Gilson and Gordon (2003) first coined the term 'the controlling shareholder tradeoff'.[245] The controlling shareholder tradeoff suggests that, with a publicly listed-company, potential equity investors will have a preference for the presence of a controlling shareholder if the benefits from decreased managerial agency costs are greater than the detriments (if any) from the extraction of controller benefits by such controlling shareholder.[246] Relatedly, from the perspective of the controller, an ability to extract controller benefits may be a necessary mechanism to compensate the controller for the increased monitoring costs, lower liquidity and lack of diversification represented by holding a controlling block.[247] Even in jurisdictions where the extraction of pecuniary controller benefits is constrained, the prevalence of, sometimes benign, non-pecuniary controller benefits explains the existence of controlling shareholder firms in such jurisdictions.[248]

With the introduction of WVR-structure, the decrease in managerial agency costs in the form of increased monitoring or equity-linkage may no longer be extant, and the dynamics of controller benefit extraction are distorted. As a result, different tradeoffs apply. Choi (2018) highlighted the importance of (i) aligning the controller's interests with those of the inferior-shareholders by ensuring that the controller holds sufficient equity; and (ii) securing the controller's long-term commitment to the firm.[249] The author noted that a tradeoff exists in relation to controller benefits - to the extent that such benefits are large, they reduce the alignment in (i), but enhance the long-term commitment in (ii). The balancing act presupposes that the inferior-shareholders value the contribution of the controller to the business, and that controller benefits bind the controller to the firm, which they will if they are substantial enough such that the value that the controller places in ownership outweighs the price it could achieve by selling its shares to a third party and exiting the business. The increasing Wedge in a WVR-structure allows controller benefits to be extracted more

[245] n 18 above.
[246] Although, since there may be visibility issues with regards to potential investors discerning the levels of agency costs and controller benefit extraction, the concept of a controlling shareholder tradeoff may be tainted in an imperfectly efficient market.
[247] Gilson and Gordon (2003) (n 18 above 785); Gutiérrez and Sáez (2017) (n 120 above 179); Gilson and Schwartz (2013) (n 119 above); Gilson (2006) (n 6 above 1665).
[248] Gilson (2006) (ibid 1665).
[249] n 129 above 67.

economically (from the perspective of the controller) than would be the case with a controlling shareholder OSOV-structure. Taking this theory to its natural conclusion would suggest that the tradeoff to be considered in order to achieve optimality involves ascertaining a firm-specific ideal Wedge. As has been recently put: 'legislators must recognize that controlling shareholders may gain private benefits of control…instead of trying to eliminate this, they should encourage it so long as it occurs at an efficiently optimal rate and incentivizes controlling shareholders to promote the company's best interests.'[250]

As described briefly above, Goshen and Squire (2017)[251] have remarked upon the balance between principal costs and agency costs.[252] The authors extended the theme to WVR-structure, noting that agency costs are high in WVR-firms, since the controller can manage the firm in a self-serving way if it is insulated from direct control from outside shareholders, but principal costs are low, since the outside shareholders, who may be prone to making irrational, uninformed or short-term decisions, are not able to interfere in the way the business is operated.[253] Again, the Wedge appears to be determinate in the tradeoff, and the principal-agency costs theorem is therefore closely-related to Choi's alignment-commitment theorem. A large Wedge could increase agency costs, while a small Wedge could increase principal costs since the controller will be more sensitive to share price movements and, therefore, the opinions of the outside shareholders. In reviewing empirical evidence, the authors noted that if managers were simply concerned about maintaining control, the Wedge generally found in WVR-firms would be much more extreme.[254] The intimation is that the market has, through operation of a tradeoff, restricted the extent of the Wedge to reduce agency costs by ensuring that the controller would still suffer at least some pain if it considered extracting controller benefits that were detrimental to firm value.

Evidence of the tradeoff can also explain the 'takeover-defence/agency-cost' versus 'optimal-insider-control' debate. Ang and Megginson (1989) explain that insiders issue inferior-shares either to insulate themselves from takeover activity and outside shareholder scrutiny in order to act in a self-serving manner, or to enable decision-making with a long-term perspective and the development of firm-specific skills that benefit all shareholders.[255] The authors' empirical evidence lends support for both hypotheses. They found that most post-IPO WVR-recapitalisations involved non-cash issuances of inferior-shares, which the authors stated possibly supports a primary purpose of entrenchment, but were also associated with positive abnormal returns for shareholders and generally stable post-recapitalisation Wedges, both of which support a primary purpose to benefit the firm as a whole. The discrepancy can be explained by applying the concept of a tradeoff. The founder, in these cases, had decided to list to diversify wealth, and the decision to use a WVR-structure is, in practice, a mixture of the 'takeover-defence/agency-cost' and 'optimal-insider-control'

[250] Anidjar (2019) (n 176 above 245).
[251] n 150 above.
[252] n 160 above, and accompanying text.
[253] Ibid 806; Lund (2019) (n 107 above 716). In relation to an application of the principal/agency costs tradeoff in the context of Snap, see: Sharfman (2018) (n 88 Chapter 1 27); Anand, 'Governance Complexities in Firms with Dual Class Shares', (2018) 3 *Annal. Corp. Gov.* 184, 202; Lund (2019) (n 107 above 740).
[254] DeAngelo and DeAngelo (1985) (n 139 above 55).
[255] Ang and Megginson (1989) (n 130 above 303 and 305).

hypotheses - partly to secure controller benefits, and partly to ensure the long-term success of the firm.[256] It is therefore unhelpful to create a distinction between the two hypotheses.

The New Tradeoff

The tradeoff theories above do not, however, discriminate between different types of controller benefits. Some controller benefits are more benign (from the perspective of inferior-shareholders) than others, and controller benefits can be pecuniary or non-pecuniary. Accordingly, in relation to Choi's alignment-commitment theorem, certain controller benefits may, in fact, undermine the long-term commitment of the controller to the firm and, therefore, increasing the Wedge could be detrimental to both alignment and long-term commitment. For example, a relevant non-pecuniary controller benefit is the ability of the controlling shareholder to decide to take a back-seat and pass control on to a family member or heir. The inferior-shareholders may not have invested in the firm on the basis that another individual will be managing the company, and that controller benefit, in fact, reduces commitment and alignment. Therefore, the alignment-commitment tradeoff can be analysed in the context of the types of controller benefits that may be extracted. The optimal situation will not be attained by only ensuring that the Wedge is at the 'correct' firm-specific level, but by also ensuring that constraints are in place to prevent certain types of controller benefits that are more averse to the interests of inferior-shareholders than others.[257] Similarly, Goshen and Squire's principal-agency costs theorem, in the context of WVR-structure, also benefits from being framed through the prism of types of controller benefits. The basic notion of the theory is that the grant of greater governance rights to outside shareholders will reduce agency costs, but increase principal costs in WVR-firms. However, if certain controller benefits are benign or have beneficial consequences to outside shareholders, curbing such controller benefits through giving outside shareholders greater rights will increase principal costs without reducing agency costs. Therefore, the optimal balance can only be achieved by targeting the restriction of pernicious controller benefits rather than taking a scattergun approach. Finally, both the 'takeover-defence/agency-cost' and 'optimal-insider-control' hypotheses, which were outlined by Ang and Megginson, also relate to the extraction of controller benefits by the insider. In the former 'takeover-defence/agency-cost' hypothesis, the controller benefits are detrimental to other shareholders, while in the latter 'optimal-insider-control' hypothesis, the controller benefits are benign. For example, a desire to procure the company's long-term success and invest in firm-specific skills and assets defined Ang and Megginson's optimal-insider-control hypothesis, but they are also, in and of themselves, controller benefits that are benign and may, assuming that the current controller possesses the requisite talent, generate consequential benefits for the firm as a whole. Verifying which of 'takeover-defence/agency-cost' and

[256] Chemmanur (2012) similarly noted that founders will have in mind both value creation and extraction of controller benefits. In modelling the behaviours of founders adopting WVR-structure, the author calculated that the extent of the Wedge also represents a tradeoff - the greater the Wedge, the less the disciplining effect of equity ownership, but the greater the ability of the controller to create shareholder value and extract controller benefits. The author modelled that loss of discipline usually outweighs value creation when controller benefits are large, and so the driver toward a high Wedge in such circumstances is the extraction of controller benefits rather than value creation; as such a cap should be placed on the maximum Wedge permissible (n 157 above 315).

[257] See: Chapter 6. Choi (2018) does, in conclusion, recognise that constraints should be in place to prevent the controller extracting 'too much' controller benefits, but supports *ex post* judicial examination rather than implementing constraints that prevent egregious extraction in the first place (n 129 above 79).

'optimal-insider-control' governs will be dictated by which of pernicious or benign controller benefits dominate.

A better formulation of the WVR-firm tradeoff therefore involves viewing the arrangement as a tradeoff between pernicious and benign controller benefits. As such, the nomenclature in the common literature describing controller benefits as 'private' may be misleading. Controller benefits will be benign if the positive consequences of their extraction on public shareholders (as a result of the controller's benefits either being shared with the public shareholders, or generating separate consequential benefits for public shareholders) equal or outweigh the negative consequences of their extraction on public shareholders, or if those benefits simply have no effect on the public shareholders. In contrast, controller benefits will be pernicious if the negative consequences outweigh the positive consequences on public shareholders. Benign controller benefits may not, semantically, be private if they are shared with, or create consequential benefits for, the public shareholders. Therefore, in this thesis, 'private benefits of control' have generally been termed as 'controller benefits'. In order to achieve a net socially-optimal state, a balance needs to be struck so that the controller can extract benign controller benefits, and, in order to persuade the founder to list (and bond the founder to the firm), even minimally pernicious controller benefits, while at the same time deterring the extraction of excessive pernicious controller benefits that can either discourage investment by outsiders or, to the extent outsiders have invested, expropriate the inferior-shareholders to a greater extent than the benefits that they secure.

A number of the benefits of WVR-structure outlined in this Chapter can be framed as controller benefits that result in benign consequences – for example, the ability to take a long-term approach, take risks, possess freedom of choice in relation to projects, be judicious in whether to accept takeover bids, pursue greater prestige, and focus on the core business of the company without pressure to diversify all result in pecuniary or non-pecuniary benefits for the controller, but, in specific circumstances, can also generate beneficial outcomes for the public shareholders. Goshen and Hamdani (2016)'s championing of WVR-structure presents a further example. They argue that an entrepreneur may value control with no intention to extract controller benefits,[258] and, instead, WVR-structure has been adopted to allow it to pursue its idiosyncratic vision. In fact, wishing to retain control to pursue an idiosyncratic vision is, in and of itself, a non-pecuniary controller benefit, and so, this 'ideological controller' is, in reality, a demonstration of balancing pernicious and benign controller benefits.

The time-dimension of the WVR-Tradeoff should also be considered. Ang and Megginson noted that firms may unify WVR-structure into OSOV once they are no longer of benefit to the controller.[259] The discussion only really views such unification decisions through the eyes of the controller, since the controller will have to initiate any decision to unify the capital structure. However, from the perspective of the inferior-shareholders, the tradeoff may also change over time. The benign controller benefits that may have dominated at IPO may, over time, begin to be overshadowed by more pernicious elements. For example,

[258] n 176 above 576.

[259] Ang and Megginson (1989) (n 130 above 304). Also, see: Gilson (2006) (n 6 above 1670) who envisaged that life-cycle or intergenerational changes could result in controller benefits being of less value to an incumbent controller, resulting in greater efficiencies being garnered through breaking-up the controlling position.

management of the company may convey to a less talented team, the skills of a founder may gradually wane, or the company may mature to an extent that short-term profit targets provide a useful signalling mechanism where growth has plateaued. This highlights the importance in ensuring that constraints take effect to limit pernicious controller benefits and/or foster a unification of the capital structure into OSOV, when the likelihood arises that pernicious controller benefits will outweigh those that are benign. Sunset clauses, as discussed further in Chapter 6 effectively operate based upon an acknowledgement that the occurrence of certain events are indicative of a greater risk that pernicious controller benefits will start to outweigh benign controller benefits.

Both Choi and Goshen and Squire indicate that their tradeoff concepts are firm-specific. When the tradeoff is reduced to a simple balance between types and levels of controller benefit extraction as delineated above, firm-specificity is still applicable. For certain types of firms, no optimal tradeoff may be possible with WVR-structure, and, instead, a OSOV-structure will be preferable. For example, for a mature company with an established product and stable market, the management team may not hold any firm-specific talents and the long-term prospects and business plan of the company may be easily observable by the public markets. In such a case, benign controller benefits may be sparse or non-existent, meaning that, if WVR-structure is implemented, the extraction of pernicious controller benefits will dominate. Market forces may influence the decision to proceed with a OSOV-structure since investors may be unwilling to invest in a WVR-firm where there are no perceptible benefits to the outside investors in conceding to such a structure. As discussed above[260] and in Chapter 4, for other types of firm, a positive tradeoff may be more easily discernible. Goshen and Hamdani (2016) arrive at a similar conclusion using a narrower formulation, noting that a balance needs to be struck by an entrepreneur's freedom to pursue its idiosyncratic vision through retaining control, and an investor's protection against the extraction of controller benefits by securing a level of control themselves.[261] The authors postulate that entrepreneurs and investors allocate cash-flow and voting rights appropriately to achieve the correct balance.[262] Accordingly, the obvious consequence of prohibiting WVR-structure is that one option that could assist in achieving the relevant balance is eliminated, meaning that in certain circumstances, the most efficient balance will not be possible.

5. Conclusion

WVR-structure distorts the simpler dynamic of a controlling shareholder holding a majority of the voting and cash-flow rights in a OSOV-firm. The distortion, driven by the fact that the controller of the majority of the voting rights no longer holds a proportionate level of cash-flow rights, can instigate positive and negative effects from the standpoint of outside shareholders. From a detrimental perspective, since the controller does not suffer commensurate pain from its actions, the distortion can increase the incentive on the controller to tunnel, extract high executive remuneration, make inefficient decisions, amplify non-pecuniary pernicious controller benefit extraction, block efficient takeover activity, and either continue to manage the firm when

[260] nn 183-186 above.
[261] n 176 above 586.
[262] Ibid 587.

talents have waned or pass control on to unsuitable heirs. From a beneficial perspective, since the controller will be better diversified and less concerned as to the consequences of depressed short-term share price, the distortion can promote long-termism, risk-taking, investment in profitable projects with high near-term uncertainty, and greater core-business focus. The structure can also promulgate a bonding-effect that ties a talented founder to the firm, increase offer prices when takeovers do occur, and support operational and acquisition financing through equity rather than debt. Importantly, as also discussed in Chapter 1, permitting WVR-structure can persuade founders to float their companies, when they would otherwise be deterred, especially if the business of the relevant company entails long product-cycles, asymmetric information distribution, or unobservable projects. Encouraging the listing of firms where the benefits of the structure outweigh the detriments allows public investors to share in their success and growth, as well as creating companies that are able to pursue successful long-term, innovative visions without being inhibited by the whims of short-term orientated investors or the constraints on growth that could be imposed by debt or private equity funding.

Obviously, if the positive qualities of WVR-firms outweigh the negative aspects, overall a WVR-firm can be net-beneficial to public shareholders. A WVR-tradeoff exists which can be framed in terms of pecuniary and non-pecuniary controller benefits. The extraction of benefits by a controller can have beneficial, neutral or detrimental consequences on the interests of public shareholders. If the controller benefits that are benign (overall beneficial or neutral) outweigh those that are pernicious (overall detrimental), the structure will represent an efficient choice from the perspective of the inferior-shareholders. The positive qualities of WVR-firms are derived from the extraction of controller benefits that are also overall beneficial to, or have beneficial consequences for, inferior-shareholders. On a normative basis, as discussed throughout this thesis, the extraction of benign over pernicious controller benefits is more likely in certain types of companies, such as high-growth, tech-firms. Furthermore, in relation to such firms, while WVR-structure is prohibited on the premium-tier, as has been postulated by other tradeoff models, the most efficient structure conducive to their success will not be available. Introducing an option for tech-companies that could both encourage further flotations, and promote the success of such firms for the benefit of all shareholders, is a strong argument for relaxing the premium-tier WVR-prohibition.

However, it is not solely high-growth, innovative firms that choose WVR-structure. Although, in the US, around half of WVR-structure listings since Google's IPO have been tech-firms,[263] WVR-structure is also prevalent amongst companies in the media, entertainment and sports industries,[264] and the risk remains that some companies are choosing WVR-structure where the pernicious controller benefits outweigh the benign. In the next Chapter, the empirical evidence on WVR-firms will be evaluated with a view to identifying trends as to whether WVR-structure is being used for 'good or evil'. If the structure is generally generating positive performance, the justification to restrict the use of WVR-structure in the UK becomes even less credible.

[263] Solomon (2015) (n 37 Chapter 1); J. Fisch and S. Solomon, 'The Problems of Sunsets' (2019) *U. of Penn., Law School Research Paper* No. 19-04 1, 7; S. Feldman (2016) (n 36 Chapter 1 1342).
[264] Smart and Zutter (2003) (n 36 above 105); Ashton (2012) (n 21 above 939); Enriques et al (2017) (n 31 Chapter 2 83); IRRC Institute and ISS, 'Controlled Companies in the Standard & Poor 1500: A Ten Year Performance and Risk Review' (October 2012); Gompers et al (2010) (n 130 above 1065).

Without pre-empting the evaluation of the empirical evidence, the issue remains that in specific cases the detriments could outweigh the benefits. However, citing this as a justifiable reason to restrict such structures is tenuous. Dispersed-ownership OSOV-firms also present potential detriments, such as managerial-agency costs and the propensity for directors to prioritise short-term profits over longer-term interests; in some cases, the detriments outweigh the benefits, yet the regulatory response is to implement measures that attenuate the detriments - for example, the use of performance-related pay to link managerial and shareholder interests, and the drafting of directors' duties and corporate governance codes to guide directors toward taking into account the long-term health of the company. A similar approach could be taken with WVR-structure, permitting the structure conditional upon the implementation of bespoke constraints that blunt the specific detriments of the structure.[265] Using the formulation set forth in this Chapter, constraints should be viewed through the prism of differing controller benefits. The constraints should moderate the extraction of pernicious controller benefits. However, a balance must be achieved, since eliminating the extraction of controller benefits in their entirety would also moderate the extraction of benign controller benefits, thereby undermining both the reasons for which a controller would choose the structure and the possible benefits of the structure once listed. If the balance is not achieved and the constraints take on a scattergun approach, issuers will be unlikely to make use of the structures in a listed-company environment. It may even be acceptable to permit controllers to extract even pernicious controller benefits to the extent that they are not excessive and do not overshadow the benefits of the structure. For example, allowing controllers who are involved in management to extract remuneration (particularly long-term performance-related) that exceeds, although not significantly, market norms could be a price that investors are willing to pay to be given the opportunity to invest in an innovative firm with great growth potential, managed by a talented founder. Equally, if the empirical evidence shows that WVR-firms are disproportionately discounted by the market, the founder may also view a pecuniary controller benefit such as high executive remuneration as acceptable compensation for the founder not receiving adequate recompense for shares sold on the market at the time of IPO. Achieving the correct balance is made even more challenging by the fact that the constraints must take into account different types of controller benefits, different types of firms and controllers, and variations related to the life-cycle of firms. Taking-on that challenge, Chapters 5 and 6 turn to the varieties of constraints and their potential to effectively strike the correct balance.

[265] Gurrea (2019) (n 109 Chapter 2 section 7) suggested that the approach to WVR-structure should be driven by the investor environment of the relevant jurisdiction - a spectrum could exist with, at one end, jurisdictions with strong investor protection laws and high levels of sophisticated investors accommodating WVR-firms without further constraints, and, at the other end, jurisdictions with weak investor protections and unsophisticated investors prohibiting WVR-firms. In between the margins, jurisdictions could permit WVR-firms with varying degrees of constraints.

CHAPTER 4:
THE EMPIRICAL EVIDENCE

1. Introduction

In the previous Chapter, conceptually, it was shown that in certain circumstances the WVR-tradeoff can be net-beneficial from benign controller benefits outweighing pernicious controller benefits extracted by the controller. In this Chapter, that theory will be tested by analysing empirical studies, relating to the 'performance' of WVR-firms.

There are numerous measures of 'performance'. Empirical studies that test a variety of different measures of WVR-firm performance will be critically evaluated. In the first instance, event-based studies that examine share price reactions to post-IPO recapitalisations of OSOV-firms into WVR-firms, and to post-IPO unifications of WVR-structure into OSOV, will be reviewed. Although evidence is mixed, it is of no surprise, given institutional investor distaste for WVR-structure,[1] that mostly negative share price reactions result from recapitalisations, and positive share price reactions result from unifications. However, event-based studies only examine momentary share price reactions, and the relevant share price fluctuations could be responses to other events surrounding the recapitalisation or unification.

Rather than focusing on snapshots in time, it is more instructive to evaluate studies that track share price of WVR-firms over time, particularly since this thesis is centred upon firms that adopt WVR-structure from IPO, rather than firms converting to WVR-structure mid-stream. Therefore, the subsequent section reviews the plethora of studies that examine firm valuations of WVR-firms and OSOV-firms over periods of time. Although the evidence is not incontrovertible, generally such studies show WVR-firms to be associated with lower firm valuations than OSOV-firms. Although the results are suggestive of the WVR-firm tradeoff being shifted into a net-detrimental position in most cases, two caveats apply. Firstly, a number of studies also show positive effects of WVR-structure on firm valuation, sometimes when specific circumstances or firm-qualities apply. Second, low firm valuations may not evidence expropriation or a poorly performing management team, but rather the market's attitude toward WVR-structure, with the market systematically discounting such firms in anticipation of future expropriation or poor performance that does not come to pass. The second caveat can be tested by evaluating two further varieties of study.

A handful of studies compare buy-and-hold returns of notional portfolios of WVR-firms to notional portfolios of matched OSOV-firms. In most cases, portfolios of WVR-firm inferior-shares outperform portfolios of OSOV-firms. Therefore, even though share prices of WVR-firms are discounted compared to OSOV-firms, it would appear that the discount has been exaggerated, since, over time, on average, WVR-share price increases by a greater level than OSOV-share price. The results of buy-and-hold return studies are not indicative of expropriation dominating over more beneficial aspects of WVR-firms. Either the discounts are unjustified or they are applied by investors to ensure that they are compensated (through

[1] n 41 Chapter 1, and n 64 Chapter 2.

increased returns) for the risk that they may be expropriated (or burdened with a poor, entrenched management team). Finally, does that risk bear-out in practice?

The last set of studies assess various measures of operating performance, mainly reflecting profitability, of WVR-firms compared to OSOV-firms, and, in general, WVR-firms display better operating performance than OSOV-firms over time. This would suggest that the discounts being applied to WVR-firms are not justified by those firms performing worse than OSOV-firms, and, therefore, those discounts are not warranted by a need for compensation to incur increased risk – those risks do not seem to transpire in the real-world. Since WVR-firms are outperforming similar OSOV-firms in terms of accounting measures of performance, it does not appear that those firms are being managed worse than OSOV-firms or subject to excessive expropriation (or at least to the extent there exists poor management or expropriation, they are overshadowed by qualities endowed on WVR-firms that are conducive to better operating performance). The conclusion can be challenged if expropriation is occurring after profits have been generated – however, as will be discussed, at least in high investor protection jurisdictions, the opportunities for the extraction of pecuniary controller benefits after-profits is severely limited.

It will be contended that the empirical evidence does not warrant the prohibition of WVR-firms from the premium-tier. The market protects itself from the perceived risks of WVR-structure by pricing-in that risk, and, therefore, if the provenance of the premium-tier prohibition of WVR-firms, as alluded to in Chapter 3, is to protect public shareholders, that protection is unnecessary where investors are organically protected and earn positive returns from investing in WVR-firms. As discussed in Chapter 1, at least in the technology sphere, those firms that would otherwise avail themselves of WVR-structure do not appear to be nevertheless listing as OSOV-firms. If WVR-structure does not harm public investors, it is rational to liberalise the market to increase the chances that large private UK-tech companies[2] will list and give public shareholders the opportunity to garner positive returns. Given that some evidence suggests that WVR-firm portfolios earn greater returns than OSOV-portfolios, and WVR-firms are more profitable than OSOV-firms, it would seem that the market is overly discounting WVR-firms, and, in fact, the discussion should move toward reducing the cost of capital for WVR-firms, to, amongst other reasons, further encourage flotations. Those discussions continue in the subsequent Chapters.

It should be noted, though, that the picture is not simple. Although conclusions can be extrapolated based upon the findings, there is no slam-dunk, and outlier studies do exist. Equally, though, it certainly can not be conclusively evidenced that WVR-firms are empirically harmful to public investors. Furthermore, several studies use greater levels of sub-sampling than others, and deduce that WVR-structure is beneficial for certain types of firms, or in certain types of circumstances, but detrimental for other types of firms or circumstances. Time elements may also be pertinent, with divergences between studies possibly resulting from differences in the time periods studied. Also, more recent studies have been directed toward ascertaining whether the WVR-tradeoff changes over time on a firm-by-firm basis. The few studies that evaluate several measures of performance are valuable in this regard, since they test the various performance measures using the same samples and time periods.

[2] nn 52-53 Chapter 1, and accompanying text.

The majority of research in this area has been conducted on US-firms, and, unfortunately, historic studies on UK WVR-firms, when they were more widespread, are sparse. However, the US provides the most favourable analogy to the UK. The US-equity markets are the closest to the UK in terms of the nature of ownership of publicly listed-companies, and the profile of investors.[3] Additionally, the UK and US are often characterised as strong investor protection jurisdictions;[4] a factor, as will be discussed, important in assessing the empirical evidence and in developing policy. Given the pre-eminence of US-studies, the overviews of the various categories of empirical studies below will note whether US or non-US listed-companies have been studied in each case.[5]

2. A Note About Diversity of Firms and Controllers

An obvious point, although one that is often ignored when discussing WVR-firms, is that WVR-structure may be beneficial to all shareholders for some types of firms, and in certain conditions, and detrimental to public shareholders for other types of firms.[6] As well as firm qualities impacting upon whether a WVR-structure is beneficial or detrimental to all shareholders, the identity and nature of the controller may be as, or even more, crucial.[7] These aspects can have an impact on the empirical evidence.

Diversity of Firms

In Chapters 1 and 3, it was deliberated that WVR-structure could be particularly beneficial for certain types of firms and industries. For example, WVR-structure can 'bond' controllers to the firm, which can be beneficial for firms where customers or suppliers associate the controller's involvement with success and product-quality,[8] which require employees to invest in significant firm-specific skills,[9] or where the development of ingrained stakeholder relationships of trust and commitment is crucial.[10] Where investment in long-term projects with high near-term uncertainty, that may not be easily financed with debt, is critical to the success of a firm, WVR-structure may enable such a firm to thrive.[11] At a more granular level, technology and biomed companies with product innovation and long product-cycles may generate substantial value from the adoption of WVR-structure, by insulating managers from short-term share price declines while implementing the necessary long-term investment.[12] Even outside of the product sphere, companies with

[3] nn 66-68 Chapter 2.
[4] n 27 Chapter 3.
[5] For a US-centric review of the empirical evidence, see: B. Reddy, 'More than Meets the Eye: Reassessing the Empirical Evidence on US Dual-Class Stock' (2020) <https://ssrn.com/abstract=3554428>
[6] R. Adams and D. Ferreira (2008) (n 92 in Chapter 3 84); Smart and Zutter (2003) (n 44 in Chapter 1 88); Anand (2018) (n 253 Chapter 3 206); S. Nüesch, 'Dual-Class Shares, External Financing Needs, and Firm Performance' (2016) 20 *JMG* 525, 527; Rydqvist (1992) (n 44 Chapter 2 53).
[7] Denis and Denis (1994) (n 139 Chapter 3 93).
[8] nn 147 and 222 Chapter 3, and accompanying text.
[9] nn 139-142 and 221 Chapter 3, and accompanying text.
[10] n 146 Chapter 3, and accompanying text.
[11] nn 157 and 165-166 Chapter 3, and accompanying text.
[12] nn 183-185 Chapter 3, and accompanying text.

innovative visions that are not easily appreciated by the equity markets,[13] and high-growth companies (particularly start-ups) with low current earnings compared to future potential,[14] may be able to garner better performance and overall value through the use of WVR-structure. However, for other types of firms, such as a mature company with an established product and stable market, where the management team does not hold any firm-specific talents and the long-term prospects and business plan of the company are easily observable by the public markets, WVR-structure may not be correlated with a net-beneficial WVR-tradeoff.[15]

Diversity of Controllers

As well as firm qualities impacting upon whether WVR-structure is beneficial or detrimental to all shareholders, the identity and nature of the controller may be as, or even more, crucial.[16] For example, where the superior-shares dispersed,[17] issues prevalent in a controller being able to unilaterally direct the actions of the company (while holding a disproportionately low level of cash-flow rights) will not be present. Although only controller-WVR-firms are considered by this thesis, many empirical studies do not make this distinction. In the US, the distinction between corporation-controlled and individual-controlled WVR-firms is not a significant factor since nearly all such firms are individual-controlled,[18] but in other jurisdictions, the quality could have an impact, with studies showing that corporate-controlled firms are discounted less heavily by the market than individual-controlled companies.[19] Within the subdivision of individual-controlled firms, differences in firm performance exist between firms that are founder-controlled, and those where control has passed to heirs or other family members,[20] and evidence suggests that the propensity to invest in R&D and long-term expenditure varies between the two types of controllers.[21] Differences may also relate to the extent to which a firm's worth is tied to the identity, and continued involvement, of the controller.[22] The WVR-tradeoff is more likely to be shifted in a beneficial direction with a visionary and talented founder.[23]

Although, differences may also subsist between blockholders who are involved in management, compared to blockholders who are distinct from management,[24] at higher voting-ownership levels (the focus of this thesis), a true controlling shareholder has the ability to control management indirectly, and the relevant distinction becomes blurred and is not as significant.[25]

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[13] n 186 Chapter 3, and accompanying text.
[14] n 223 Chapter 3.
[15] See: *The New Tradeoff* in Chapter 3.
[16] Denis and Denis (1994) (n 139 Chapter 3 93).
[17] n 121 Chapter 1, and accompanying text; also see: M. Lemmon and K. Lins, 'Ownership Structure, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis' (2003) 58 *J. Financ.* 1445, 1464.
[18] n 243 below.
[19] n 1 Chapter 3 344.
[20] nn 60-61 and 216 Chapter 3, and accompanying text.
[21] nn 217-220 Chapter 3.
[22] See: the opening remarks of the CEO of the Hong Kong Securities and Futures Commission (SFC) at the SFC's media luncheon on 19 March 2015 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/corporate-news/doc?refNo=15PR25> - 'Many have said that weighted voting rights makes sense where the whole enterprise value is completely tied up with the identity of a founder'; also see: n 8 above.
[23] n 227 Chapter 3.
[24] HKEX Concept Paper (2014) (n 125 Chapter 3 IV-2).
[25] K. Wruck, 'Equity Ownership Concentration and Firm Value: Evidence from Private Equity Financings' (1989) 23 *J. Financ. Econ.* 3, 16.

All of these considerations point toward what Holderness labelled the 'richness of blockholders'.[26] Within broad categories of blockholders, there may be further distinctions relating to the personal intents, ambitions, incentives, skills and altruism of the individual controller.[27] An individual controller of one firm may have a personal preference to prioritise the long-term wealth and success of the company, whereas an individual controller of another, otherwise identical, firm may prioritise short-term profit through expropriation of the inferior-shareholders. For example, for a media company, a WVR-structure could allow the controller to procure equity investment while preserving the editorial freedom of the publication,[28] which could either improve profitability by inspiring greater public trust, or could result in the controller pursuing a political agenda with complete disregard for the profitability of the company. A sovereign-controller could use WVR-structure to sell equity while maintaining control, and cause the firm to enter into synchronicities with other entities controlled by the same state (particularly since the UK's related-party transaction rules do not apply to sovereign-controlled companies[29]), which is either beneficial to all companies involved, or a means of tunnelling profits. Even in the technology sector, WVR-structure may support an idiosyncratic vision which requires indulgence of the mutability of product-cycles to generate strong long-term earnings, or it may shelter a failing long-term vision, sacrificing short-term profitability without any prospect of a future turnaround in performance.

Impact of Diversity on Empirical Studies

Empirical studies that simply group WVR-firms and OSOV-firms into uniform groups will see their results coloured by the fact that WVR-structure is (as is OSOV-structure) beneficial for some types of firms and detrimental for others – the empirical evidence may therefore be inconclusive, or skewed depending upon the matching criteria and sampling used by the relevant research.[30] Even those studies that match WVR-firms with similar OSOV-firms will not assist in this regard if the results from each matched sample are then simply aggregated. More recently, though, studies have started to target the impact of WVR-structure on the performance of firms with specific qualities in an effort to identify whether, for certain firm qualities and types, WVR-structure promotes better performance, firm value or stock returns – this line of study will likely be more instructive going forward in ascertaining whether evidence can prove the normative argument that WVR-structure will be advantageous to the performance of those firms where expropriation of inferior-shareholders is either unlikely or likely to be substantially surpassed by improved performance. As discussed below, trends can be observed in relation to high-growth firms, firms with low free cash-flow, and young firms, amongst others. However, whereas studies can control for the diversity of firm-types, it is far more challenging to control for the diversity of controllers. Some characteristics, such as founder-controlled versus corporate-controlled firms, are easy to identify, but others, such as whether the involvement of the controller

[26] Holderness (2003) (n 235 Chapter 3 60); also see: Edmans and Holderness (2017) (n 122 Chapter 1 553).
[27] By analogy to OSOV-controlling shareholder firms, upon control transfers, the identity of the controller can have an effect on firm value (M. Barclay and C. Holderness, 'Negotiated Block Trades and Corporate Control' (1991) 46 *J. Financ.* 861, 877).
[28] Ashton (1994) (n 127 Chapter 1 939).
[29] n 37 Chapter 5.
[30] nn 149 and 151 below, and accompanying text.

is viewed as critical to the success of the company, or the nature, characteristics and intents of the controller are difficult to identify, and may not be observable.[31] Even when considering sub-samples of firms or controlling for various firm-qualities, the nature and intents of the controller are also germane, making it difficult, especially with relatively small sample-sizes, to interpret such evidence as indicative that for certain types of firms WVR-structure is justified or unjustified. The empirical evidence should therefore be analysed in light of the diversity of firms and controllers that have implemented WVR-structure,[32] and the possibility that such diversity may result in the empirical evidence showing no correlation with capital-structures as a result of cancelling-out between those firms for which the specific structure is beneficial and those for which it is detrimental. The lack of profiling the 'nature' of the controller has been labelled the 'biggest missing factor affecting the probability of tunneling'.[33]

Although, future research may, in time, fine-tune the degree of knowledge of WVR-firms to a level that allows better decisions as to whether WVR-structure should be permitted on a firm-by-firm basis,[34] it is fair to retain healthy scepticism that incontrovertible lines can be drawn. As remarked by Smart and Zutter (2003): 'Discerning which managers are entrenched to capture private control benefits and which are entrenched in the interests of shareholders challenges the empiricist.'[35] In any case, with the evidence that currently exists, the scope of the reckoning should be, as is the scope of this thesis, whether the evidence is persuasive enough to warrant a prohibition of WVR-structure on the premium-listing tier, and, if not, whether any form of relaxation should be accompanied by distinct protections.

3. Event-Based Studies

Event-based studies explore the impact on the price of listed-shares, of recapitalisation events, where OSOV-companies that have already been listed create WVR-structure, or of unification events, where existing WVR-structure is collapsed into OSOV. Essentially, in relation to recapitalisations, the studies assess the price impact on OSOV-shares that are already listed, and, in the case of unifications, the impact on the price of inferior-shares after all shares become OSOV. Although this thesis is focused on the adoption of WVR-structure at the time of IPO, empirical studies related to recapitalisations and unifications may provide some evidence as to how the equity markets react to WVR-structure. Given the institutional shareholder opposition to WVR-firms,[36] one may presume that the market will react adversely to WVR-structure, reflecting investors' predictions with respect to the future behaviour of the controller. One could argue that event-based studies are a pure indication of market reaction since they assess that reaction immediately, or close to immediately, after the relevant change in capital structure; however, as will be discussed further, the very fact that they provide only a snapshot in time means that the results can be contaminated by extraneous events occurring in and around the event. Furthermore, it should be noted that event-based studies only

[31] Dallas (2016) (n 119 Chapter 1 589).
[32] Similar points have been made by: Ashton (1994) (n 28 above 959).
[33] Chen et al (2018) (n 66 Chapter 3 1017).
[34] An appeal for such evidence was made as far back as 1996 in Böhmer et al (1996) (n 130 Chapter 3 116).
[35] n 6 above 103. Solomon (2017) expressed that it is impossible to discern whether a founder will utilise its superior skills to benefit all shareholders, or, instead, to extract controller benefits (n 89 Chapter 1 11).
[36] n 1 above.

gauge market-reaction to the events rather than whether, in fact, the new capital structure creates benefits or burdens for the company over time. As such, noteworthy studies and their implications will only be considered briefly below.

Overview

(a) USA

The pivotal US event-based study by Partch (1987)[37] explored recapitalisations by US listed-corporations between 1962 and 1984 creating limited voting stock, straddling the period during which many US-corporations were beginning to look to such structures as a form of takeover defence against hostile takeovers.[38] It was found that shareholder wealth was not affected by the announcement or creation of restricted stock.[39] Although, with respect to NYSE-listed firms, data from these periods may well have been distorted by the fact that any such firm, prior to the implementation of the NYSE's moratorium in 1984,[40] would have been risking delisting by the exchange which may have had an adverse effect on share price, masking any positive effect of the recapitalisation,[41] similar results were found by a number of subsequent studies which covered periods that extended Partch's sample period to post-1984 time-frames.[42] In contrast, Jarrell and Poulsen (1988)[43] in sampling recapitalisations between 1976 and 1987, found that recapitalisations into WVR-structure had a negative effect on share price, driven by those firms that had recapitalised after the NYSE introduced its moratorium. However, such firms were dominated by NYSE-listed firms which were generally larger firms than those sample-firms listed on other US-exchanges, and had greater institutional investor, and less inside, ownership prior to the recapitalisation.[44] With lower inside ownership, the authors postulated that such firms were more likely to have adopted WVR-structure in response to hostile takeover activity, since such insiders would not have been able to block takeovers prior to the recapitalisation, and the radically altered takeover probability created a negative market reaction.[45] Alternatively, another, simpler, explanation of Jarrell and Poulsen's (1988) results could be that investors were somewhat callow when pricing-in rare recapitalisations pre-moratorium, and became more adroit over time in assessing the risks of WVR-structure post-moratorium.[46]

The extraneous events surrounding the relevant recapitalisation and the method by which it is implemented also have direct impacts on market reaction. For example, studies have found that negative reactions were only observed for firms recapitalising into WVR-structure that subsequently issued further

[37] Partch (1987) (n 165 Chapter 3).
[38] See: Chapter 2.
[39] n 37 above 333.
[40] See: Chapter 2.
[41] This distortion was acknowledged in Jarrell and Poulsen (1988) (n 165 in Chapter 3 134).
[42] Bacon et al (1997) (n 148 Chapter 3 12); Dimitrov and Jain (2006) (n 165 Chapter 3); Cornett and Vetsuypens (1989) (n 155 Chapter 3) (although the authors found that recapitalisations had a positive effect on share price, they acknowledged that the results were driven by outlier companies in the sample (ibid 181)).
[43] n 41 above.
[44] Ibid 143.
[45] Ibid 149.
[46] Gompers (2010) (n 21 Chapter 1 1061); n 50 below 16.

equity,[47] that did not offer dividend sweeteners,[48] or where a stockholder had voting control prior to the recapitalisation (and was therefore able to compel the recapitalisation, and the potential to create a Wedge, without the votes of the minority stockholders).[49]

Interestingly, Kim and Michaely (2018), in one of the very few modern event-based studies (looking at recapitalisations into WVR-structure between 1971 and 2015), divided their sample into young (less than 12 years-old) and mature (more than or equal to 12 years-old) firms. They found that significant positive (negative) abnormal returns accrued to WVR-recapitalisations of young (mature) firms.[50] The authors postulated that market reaction is favourable when young firms switch to WVR-structure since it can insulate such firms from market pressures in a manner that is beneficial, but, for mature firms, the market recognises that the benefits of the structure are more limited and therefore overshadowed by the substantial potential costs.[51] The authors did not empirically test whether there were variations in findings correlated with the period during which the relevant firms recapitalised into WVR-structure (such as prior to the NYSE's moratorium on WVR-structure or during a period of significant hostile takeover activity), but did control for potential temporal changes in market reactions by clustering standard errors at the year-level.[52]

Looking at recapitalisations from the opposite perspective, one may predict emergent patterns where firms with WVR-structures, unify their structures into OSOV. Indeed, Smart et al (2008) found that, for firms that completed US-IPOs between 1990 and 1998, on average, firms that unified their structures exhibited stock price rises.[53] The sample of unifying firms was small though, amounting to only 37 firms.

(b) Rest of the World

The only UK event-based study found that, between 1955 and 1982, during which WVR-firms were more common in the UK listed-company world, on average, abnormal positive reactions transpired upon both announcements of recapitalisations into WVR-structure, and unifications into OSOV-structure.[54] Since positive reactions were discovered upon recapitalisations, the authors explained that, rather than in order to entrench management or enable subsequent nefarious behaviour, the recapitalisations were being created so that the insiders could act in the interests of the shareholders as a whole, and that WVR-structure could be representative of an intermediate form between closely-held and dispersed-ownership firms during which insiders were buying time in order to operate the company without interference from outside shareholders prior to resolving asymmetric information issues.[55] The contention was that, once such asymmetrical information issues had been resolved later in the life of the company, reunification would occur, and the positive returns upon unification indicated that this was also beneficial to shareholders as part of the natural

[47] Lehn et al (1990) (n 155 Chapter 3 577).
[48] n 77 Chapter 1 28-29. In fact, dividend sweeteners were generally implemented indirectly by imposing dividend discounts on those shares converting to superior-shares.
[49] Ibid 29.
[50] Kim and Michaely (2018) (n 49 Chapter 3 16)
[51] Ibid 16.
[52] Ibid 16.
[53] Smart et al (2008) (n 44 Chapter 1 113).
[54] Ang and Megginson (1989) (n 22 Chapter 1 317).
[55] Ibid 317.

life-cycle of the firm. Although the paper could provide useful evidence of the benefits of WVR-structure in the context of the UK-focus of this thesis, a number of potential flaws exist in the study that could reduce its saliency. For example, the study also assesses slightly longer-term returns of up to 12 months post announcement, and it is not clear whether, post-recapitalisation into WVR-structure, the study is assessing returns on the inferior-shares, the superior-shares or both. Seemingly, the study is analysing the returns on the shares as a whole before and after the recapitalisations (although the currently prevailing trend is for firms to only list the inferior-shares, this study only analysed firms listing both classes of shares post-recapitalisation); in this case, the results could be skewed by excess returns being ascribed to the development of a premium on the superior-shares.[56] It is also not clear in relation to unifications whether returns were recorded on erstwhile inferior-shares or superior-shares, and the results may be influenced further by the fact that, in the vast majority of cases, compensation was paid to all holders of superior-shares[57] (which the study found, in relation to firms that had previously recapitalised into WVR-structure, were held by both inside and outside shareholders).

In Canada, upon recapitalisations into WVR-structure, no decisive trend has been determined, with one study finding weak negative abnormal returns,[58] one also finding negative abnormal returns, generally, but with the effect reversed if accompanied by dividend increases,[59] and a further study finding significant positive returns.[60]

In Germany, it was found that unifications from WVR-structure into OSOV resulted in significant positive abnormal returns that may have been underestimated since the unifications were partly anticipated.[61] The nuance to this study, though, is that, in Germany at the time, only non-voting shares and OSOV-shares were permitted, and non-voting shares were more akin to preference shares in the UK, since they were entitled to a minimum dividend prior to any distributions being made to the voting shares (after the voting shares have received the same dividend as the non-voting shares, the non-voting shares are then entitled to participate in any further distribution);[62] this renders the positive abnormal returns lower than they would have been had non-voting shares not been entitled to preferential dividends.

Interpretation

The principal studies on WVR-recapitalisations referenced above display an inconclusive picture, with perhaps a partial bias toward negative market reaction to WVR-structure. However, caution should be applied in using event-based studies to assess the merits and detriments of WVR-structure. Foremost is that

[56] In a sister paper, one of the same authors found that an average premium of 13.3% was attached to the superior-shares of UK WVR-firms (W. Megginson, 'Restricted Voting Stock, Acquisition Premiums, and the Market Value of Corporate Control' (1988) *University of Georgia Working Paper* (cited ibid 303)).
[57] n 54 above 313.
[58] V. Jog and A. Riding, 'Price Effects of Dual-Class Shares' (1986) 42 *Financ. Anal. J.* 58, 61.
[59] E. Maynes, 'Reallocation of Voting Rights and Shareholders; Wealth' (1992) 25 *Can. J. Econ.* 538, 561.
[60] L. Kryzanowski and H. Zhang, 'Introduction of Dual-Class Shares: Some Evidence on Canadian Pro-Rata Distributions' (1992) 1 *IRFA* 95, 102.
[61] Dittmann and Ulbricht (2007) (n 44 Chapter 1 182).
[62] Ibid 171.

the sample-sizes in all such studies are small, and in some cases, extremely small.[63] It is also vital to note that such studies are evidencing the market's reaction to WVR-structure, rather than gauging the true performance of WVR-structure. Investors in the secondary market are simply pricing-in risk. Investors may underestimate risk or apply unjustified discounts based upon ideological concerns. The historically small number of such events could mean that investors are not experienced enough in judging them to be able to price effectively.[64] Investors may also apply discounts across the board without evaluating the individual circumstances of the company. Significantly, a large number of the studies straddle the period when WVR-recapitalisations were prohibited on the NYSE – therefore, for those companies that underwent IPOs prior to the NYSE relaxing its prohibition of WVR-structure (or at least prior to its moratorium on such structures), the possibility of a subsequent WVR-restructuring would not have been factored into price, and the subsequent unexpected recapitalisation, to the extent that the market generally views such events unfavourably, will have caused a greater downward shock in share price as compared to where the probability of a recapitalisation occurring had already been incorporated into price.[65]

Further, although some studies use techniques to ascertain when pricing-in of the relevant event commenced, most studies only test share price movements over the course of a short window of the nature of only a few days prior to and after the announcement date. The size of the window used is sometimes arbitrary and there is a great deal of uncertainty as to when pricing-in commenced.[66] Additionally, event-based studies only provide a snapshot in time, rather than an indication of share price performance over extended periods – a perhaps more essential element in evaluating such structures which is revisited in sections 4 and 5 below. The market's perception of a company's WVR-structure may morph over time. For example, the qualities of a structure that are initially viewed as beneficial, may gradually erode.[67]

Also, there are inherent biases in the event-based approach, which may positively or negatively affect share price. One of these is that the relevant event may be endogenous, such that the event is being implemented since the relevant board anticipates a positive effect on operating performance going forward; therefore, in such a scenario, the market would view the event positively.[68] Any changes in market sentimentality may also be indicative of its perception of a firm that was previously cash-strapped recapitalising to raise further finance through the WVR-issuance, rather than indicative of the change of structure itself.[69] It has also been conjectured that managers may implement WVR-structure for protection, both in terms of insulating themselves from removal and negative shareholding wealth-effects, in contemplation of impending poor performance,[70] or there may be an external prompt for the implementation,[71] meaning that the market is reacting to other events rather than purely the recapitalisation.

[63] HKEX Concept Paper (2014) (n 24 above IV-II); Dimitrov and Jain (2006) (n 42 above 345).
[64] Dimitrov and Jain (2006) (ibid 345).
[65] n 48 above 26.
[66] n 31 above 585.
[67] See: Chapter 6.
[68] Adams and Ferreira (2008) (n 6 above 64) – the authors presented this criticism as a reason for why positive abnormal returns were discovered in the UK for both recapitalisations and unifications by Ang and Megginson (1989) (n 54 above); n 53 112.
[69] n 61 above 167.
[70] K. Lins, 'Equity Ownership and Firm Value in Emerging Markets' (2003) 38 *J. Financial Quant. Anal.* 159, 178; HKEX Concept Paper (2014) (n 24 above IV-2); Nüesch (2016) (n 6 above 532).
[71] HKEX Concept Paper (2014) (ibid IV-8).

Another bias is that the manner of implementation of the event can have a bearing on stock price – for example, where a recapitalisation is implemented by way of stock dividend, it is difficult to isolate the effect from the positive effect of stock dividends generally.[72] In the opposite direction, it is possible that the market speculates that a WVR-recapitalisation is indicative of greater potential for further equity issuances in the short-term;[73] the market may be reacting to this possibility rather than the recapitalisation itself, and often the market reaction is negative to further issuances.[74] Additionally, since insiders are not generally increasing their cash-flow rights in the relevant company upon a recapitalisation, investors may take this as a sign that the insiders believe that the stock is overvalued, again resulting in a negative price reaction.[75] In circumstances where a WVR-structure is being implemented as a form of takeover defence, results can be further skewed. On the one hand, downward share price pressure can result from the reduction in the probability of a takeover in the future that would otherwise generate a windfall for shareholders.[76] On the other hand, upward share price pressure can result from the proposed actions of the board indicating to outside shareholders that management foresees a bourgeoning takeover market for the company, particularly where management is attempting to increase its vote-ownership.[77] In essence, it is difficult to separate the recapitalisation or unification event from other changes to the company that accompany it.[78]

The lack of more recent event-based studies also affects their contemporary relevance. Since Google's IPO, WVR-structure has become, at least in the US, more prevalent, particularly in the technology sphere.[79] As discussed in more detail in relation to firm valuation studies below, investor perception of WVR-structure may shift over time. The narrow value and criticisms of event-based studies have limited, and will continue to limit, the number of modern-day studies. Additionally, in relation to recapitalisations, in the US, apart from the three years immediately following the NYSE's moratorium on delisting recapitalising firms, such events have been few and far between (possibly due to companies now being able to implement WVR-structure at the time of IPO).[80] The small numbers of recapitalisations will limit the utility of modern studies, and, after a recent Delaware decision on such recapitalisations,[81] it does not appear that there will be an upsurge in such events going forward.

Given the substantial criticisms directed at event-based studies, apropos, this Chapter will now turn toward the, possibly more decisive, empirical evidence that assesses WVR-firms over periods of time.

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[72] Rydqvist (1992) (n 6 above 53) – the author specifically notes that the UK-study by Ang and Megginson (1989) (n 54 above) mainly examined recapitalisations by way of stock dividends.
[73] n 47 above 566 and 576.
[74] As noted by Lehn et al (1990) (ibid 576) in quoting a number of studies that showed negative market reactions to announcements of common stock offerings. Also, see the citations in A. Pajuste, 'Determinants and Consequences of the Unification of Dual-Class Shares' (2005) *ECB Working Paper Series* No. 465 1, 34 - the author also viewed the phenomenon from the opposite perspective and determined that unifying firms issue stock at the time of unification in order to mask the negative market reaction to equity issuances with the positive market perception of removing WVR-structure.
[75] n 47 above 568.
[76] L. Dann and H. DeAngelo, 'Corporate Financial Policy and Corporate Control: A Study of Defensive Adjustments in Asset and Ownership Structure' (1988) 20 *J. Financ. Econ.* 87, 95 found that the implementation of defensive takeover structures generally caused a 2-3% share price decline.
[77] Ibid 114.
[78] Adams and Ferreira (2008) (n 6 above 84).
[79] See: Figure 2 and nn 36-38 Chapter 1, and accompanying text; Gurrea (2019) (n 109 Chapter 2 para. 5.1.3).
[80] See, for example: Dimitrov and Jain (2006) (n 42 above 348).
[81] Recapitalisations into WVR-structure by controlling shareholder firms have been held to be 'conflicted transactions' which are subject to greater governance scrutiny (*IRA Trust FBO Bobbie Ahmed v Crane*, C.A. No. 12742-CB (Del. Ch. Dec. 11, 2017)).

4. Firm Valuation Studies

Unlike event-based studies which ascertain market-reaction at a snapshot in time, theoretically, firm valuation studies, which ascertain the value of stock (by market capitalisation) over extended periods of time, could reflect the manner in which the firm is actually being managed. Market capitalisation can diverge from the value of a firm's assets, since, in an efficient market,[82] share price will be based upon investor predictions of future profitability which may bear little resemblance to the value of the firm's assets. Any negative market perception anticipating future expropriation or poor management at the time of IPO or recapitalisation should, if a sufficiently large sample is used over a robust period of time, be smoothed-out over time if expropriation does not actually occur, since one would, in an efficient market, expect investors to identify the potential for market-beating returns by investing in those firms, pushing-up the price and eliminating the downward bias in share price. Alternatively, if expropriation of inferior-shareholders dominates, or if the management team underperforms (in circumstances where, as is the case with WVR-structure, management is protected), one would expect that WVR-firms would underperform OSOV-firms on a measure of firm valuation.

A number of studies measure firm value using Tobin's Q. Tobin's Q is the ratio of market value of stock to replacement cost of assets, and was originally developed as a determinant of investment in the macroeconomics sphere. However, the concept was appropriated by researchers looking for determinants of firm profitability.[83] The concept was particularly attractive, since the use of market value in the numerator could reflect future expectations and assessments of risks.[84] Therefore, Tobin's Q is used in many studies as a proxy for firm value,[85] although, given the difficulties in ascertaining replacement costs of assets, Tobin's Q is usually reduced to the ratio of market value of stock to book value of assets. These studies commonly compare the firm value of OSOV-firms to that of WVR-firms. Although often not explicitly stated, for a majority of studies, the relevant quantification for market value of stock is the value of the inferior-stock (grossed-up at the same per-share value in order to encompass the proportion of equity represented by superior-stock), since this reflects the value accruing to outside shareholders[86] (and, in any case, often only the inferior-shares are listed[87]). Although such studies label this measure as 'firm value', in reality, firm value equates to the sum of market value of the inferior-stock and superior-stock. However, for the purpose of this Chapter, total firm value is not the vital determinant; rather the impact of WVR-structure on outside

[82] An efficient market is one where all public information is quickly incorporated into the price of securities (E. Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *J. Financ*. 383, 383). More nuanced versions of the Efficient Capital Markets Hypothesis (ECMH) have subsequently been developed – the weak form (where all information from past share prices is incorporated), the semi-strong form (where all public information is incorporated), and the strong form (where public and non-public information is incorporated) (for a discussion on the forms of ECMH, see: n 160 Chapter 1 56.

[83] An early use of the concept in this manner can be seen in: E. Lindenberg and S. Ross, 'Tobin's q Ratio and Industrial Organization' (1981) 54 *J. Bus.* 1.

[84] R. Bartlett and F. Partnoy, 'The Misuse of Tobin's Q' (2018) 1, 13 <https://ssrn.com/abstract=3118020>

[85] Technically, the numerator should also include the market value of the company's liabilities, and the denominator the book value of the company's liabilities, but it is common practice to assume that the two cancel each other out.

[86] Adams and Ferreira (2008) (n 6 above 63).

[87] Gompers (2010) (n 46 above 1056).

shareholders is the key consideration – the price of the inferior-shares will track predictions of future performance, whereas the price of superior-shares will also encompass the value of controller benefits.[88]

Tobin's Q can be a useful measure since it indicates whether the equity of a company is overvalued or undervalued compared to the value of its assets. If WVR-structure is harmful to outside investors, one may predict that WVR-firms will consistently exhibit weaker Tobin's Q than OSOV-firms, and, indeed, many studies discussed below find that WVR-firms are undervalued compared to OSOV-firms. In basic terms, an intangible asset is being valued higher in OSOV-firms, or an unspecified liability is being factored into price in WVR-firms. Intangible assets include elements such as goodwill, position in the market, patents held, future growth and good management.[89] If WVR-firms are compared to matched OSOV-firms with similar qualities and in similar industries, as is the case with most firm valuation studies, a common interpretation is that a lower Tobin's Q for those WVR-firms is due to the market discounting the value of their future cash-flow or earnings growth, likely as a result of anticipated expropriation by controllers (possibly predicted from actual expropriation on a continuing basis),[90] or the firm being encumbered with an entrenched underperforming management team.[91] Some authors have therefore described Tobin's Q as the 'capitalised value of agency costs'.[92] The measure can, though, be very noisy,[93] reflecting the nature of assets (such as investment opportunities attached to such assets) rather than merely whether the relevant assets are being managed well.[94] As will be discussed when interpreting the relevant studies below, it is not clear that, in all cases, firm value is less for WVR-firms than OSOV-firms, and, where it is, it is not indisputable that this represents expropriation or poor management and, in fact, market perception is still a large contagion.

Overview

Twenty-nine separate WVR-firm value studies have been reviewed for the purposes of this section. Of those studies, one US-study shows that WVR-structure is positively correlated with firm value.[95] Eleven studies (five US, and six evaluating non-US jurisdictions) found negative correlations between WVR-structure and firm value.[96] Five studies (one US-study, three rest-of-the-world studies, and one cross-country study which included the US) showed no statistically significant correlation between WVR-structure and

[88] ISS Report (2007) (n 205 Chapter 3 12).
[89] R. Morck et al, 'Management Ownership and Market Valuation' (1988) 20 *J. Financ. Econ.* 293, 296.
[90] Although as later discussed in this section, it may in fact be a leap to conclusively state that low Tobin's Q indicates the discounting of future cash-flow or earnings growth.
[91] n 89 above 294.
[92] Y. Bozec and C. Laurin, 'Large Shareholder Entrenchment and Performance: Empirical Evidence from Canada' (2008) 35 *J. Bus. Finance Account.* 25, 33.
[93] n 89 above 296.
[94] Mikkelson and Partch (1994) (n 92 in Chapter 3 188).
[95] n 34 above.
[96] n 46 above; C. Hoi and A. Robin, 'Agency Conflicts, Controlling Owner Proximity, and Firm Value: An Analysis of Dual-Class Firms in the United States' (2010) 18 *Corp. Gov.* 124; Amoako-Adu et al (2013) (n 36 Chapter 3); Anderson et al (2017) (n 44 Chapter 1); Smart et al (2008) (n 53 above); S. Claessens et al, 'Disentangling the Incentive and Entrenchment Effects of Large Shareholdings' (2002) 57 *J. Financ.* 2741; Lins (2003) (n 70 above); B. Maury and A. Pajuste, 'Multiple large shareholders and firm value' (2005) 29 *J. Bank. Finance* 1813; M. King and E. Santor, 'Family Values: Ownership structure, performance and capital structure of Canadian firms' (2008) 32 *J. Bank. Finance* 2423; Pajuste (2005) (n 74 above); B. Lauterbach and A. Pajuste, 'The long-term valuation effects of voluntary dual class share unifications' (2015) 31 *J. Corp. Finance* 171.

firm value.[97] Four studies (two US-specific) showed no correlation between firm value and WVR-structure,[98] and two studies (both US) showed a negative relationship between firm value and WVR-structure,[99] until sub-sampling, after which, the correlations/relationships varied in line with specific qualities. Two further studies (one US, and one non-US) found that founder-control[100] and family-control (including founder-control),[101] respectively, were positively correlated with firm value, but the positive correlation was reduced by the adoption of WVR-structure. Four studies (one US-specific) found that the correlation between WVR-structure and firm value fluctuated with differing firm-qualities or extraneous circumstances.[102]

Those who view WVR-structure as the harbinger of doom often interpret the empirical evidence on the relationship between WVR-structure and firm value as substantiating concerns that it is detrimental to outside shareholders.[103] Others, of a more positive demeanour, dwell on the inconclusiveness of the empirical evidence as substantiating a school-of-thought that there is no unequivocal proof that WVR-structure is injurious to shareholders generally, and, in fact, there may be benefits for certain firms and burdens for other in implementing WVR-structures.[104] Some have even suggested that the empirical evidence shows that WVR-status has a positive effect.[105] It would seem that the empirical evidence can be interpreted to form the testimony for preconceived predilections. However, when reviewing the empirical results from various studies *in toto*, as below, a more byzantine portrait is perhaps emerging.

Interpretation

A high-level review of the studies referenced in the overview above suggests that the empirical evidence swings toward a finding that WVR-firms exhibit lower firm values. A detailed evaluation illuminates more nuance. Gompers et al (2010)[106] (GIM) is the classic, much cited, US-study offering evidence of a negative correlation between the Wedge and firm value. Smart et al (2008),[107] examining 1990 to 1998, a similar period to GIM, also educed a negative correlation. However, Kim and Michaely's (2018)[108] study, which straddles the GIM sampling period of 1995 to 2002, found no significant correlation between WVR-structure and firm value. The authors, however, attributed this to the longer sample period

[97] Mikkelson and Partch (1994) (n 94 above); V. Jog et al, 'Impact of Restricted Voting Share Structure on Firm Value and Performance' (2010) 18 *Corp. Gov.* 415; Cronqvist and Nilsson (2003) (n 58 Chapter 3 695); B. Lauterbach and Y. Yafeh, 'Long Term Changes in Voting Power and Control Structure following the Unification of Dual Class Shares' (2009) 112 *Noto Di Lavoro* 1; La Porta et al (2002) (n 27 Chapter 3 1147).
[98] T. Chemmanur et al, 'Management Quality and Antitakeover Provisions' (2011) 54 *J. Law Econ.* 651; Kim and Michaely (2018) (n 50 above); Bozec and Laurin (2008) (n 92 above); Nüesch (2016) (n 6 above). It should be noted that Chemmanur et al evaluated antitakeover devices (including WVR-structure) generally, and only assessed Tobin's Q at the time of IPO.
[99] Jordan et al (2016) (n 92 Chapter 3); Cremers et al (2018) (n 76 Chapter 1).
[100] Villalonga and Amit (2006) (n 60 Chapter 3).
[101] Barontini and Caprio (2006) (n 60 Chapter 3).
[102] Anderson et al (2009) (n 219 Chapter 3); M. Bennedsen and K. Nielsen, 'The Principle of Proportional Ownership, Investor Protection and Firm Value in Western Europe' (2006) *ECGI Working Paper* No. 134/2006 1; M. Holmén, 'Foreign Investors and Dual Class Shares' (2011) Centre for Finance, University of Gothenburg Working Paper; Braggion and Giannetti (2016) (n 25 Chapter 2).
[103] For example, n 121 Chapter 1 1471.
[104] For example, Adams and Ferreira (2008) (n 6 above 65); and Anand (2018) (n 6 above 203).
[105] For example, Y. Allaire, 'The Case for Dual-Class of Shares' (2018) *Institute for Governance of Private and Public Organizations Policy Paper* No. 11 1, 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3318447>
[106] n 46 above.
[107] n 53 above.
[108] n 50 above.

(1971 to 2015) – when the GIM sampling period was replicated, the authors were able to corroborate the GIM results. Therefore, it would appear that the relevant sampling period is relevant – investor sentiment perhaps shifts over time. How that pattern has shifted over time is difficult to discern. Böhmer et al (1996)[109] found a positive correlation for a much shorter and earlier period (1984 to 1988), and Mikkelson and Partch (1994)[110] found no correlation for an earlier period of 1976 to 1987. In contrast, Jordan et al (2016)[111] affirmed the GIM results for a longer period that commenced at a similar time to GIM, but also encompassed later years (1994 to 2011). A recent study, isolating later years (2001 to 2015), by Anderson (2017),[112] found a negative correlation. It is difficult to discern hard and fast rules from a small number of studies that examine time periods of differing, often overlapping, lengths. Further research in this area would be welcome, since there are several reasons why there may be significant differences in the Tobin's Q reaction over different historical periods. Investor perception of WVR-firms may have changed which could be a product of the investor landscape changing, through, for instance, increased institutional investor pre-eminence. Alternatively, as discussed below in relation to abnormal stock returns during the Asian financial crisis, changing economic conditions, such as during the most recent global financial crisis, may alter the incentives for expropriation by controllers. The third reason could simply be that the design of empirical studies has gradually improved.[113] Fourth, the types of firms embracing WVR-structure may change over time, and WVR-structure may be more beneficial to certain types of firms as compared to others - for example, the number of tech-firms implementing WVR-structure has increased since Google's IPO, whereas pre-Google, WVR-firms were dominated by media companies.[114] Beyond the possible time-range effect, differences in the techniques used by individual studies to match WVR-firms to similar OSOV-firms may also explain the divergences in results between individual studies.

Outside of the US, definitive evidence is more elusive, and often the studies cover multiple, often overlapping, jurisdictions. The studies comprise a mix of those assessing the pure effect of WVR-structure, those assessing the effect of a Wedge (no matter the implementing mechanism), and those assessing the long-term effect of unifications into OSOV. Having expressed those caveats, generally it would appear that WVR-structure in emerging markets, East Asia and Western Europe is negatively correlated with firm value. The assertion is not indisputable, since both La Porta et al (2002),[115] in examining 27 wealthy economies, and Cronqvist and Nielsen (2003),[116] in isolating Sweden, found that a divergence between voting and cash-flow rights had no effect on firm value. The sampling period, and external shocks in specific years, may be decisive - Holmén (2011)[117] only found a negative correlation post-1992 after rules restricting foreign investment were relaxed. In Canada, the evidence is inconclusive - King and Santor (2008)[118] and Jog et al

[109] n 34 above.
[110] n 94 above.
[111] n 99 above.
[112] n 96 above.
[113] n 105 above 8.
[114] n 79 above.
[115] n 97 above.
[116] n 97 above.
[117] n 102 above.
[118] n 96 above.

(2010)[119] used similar initial samples and sampling periods, yet the former found a negative correlation and the latter found no correlation. A difference between the two studies is that the former study only included family (including founder) firms; however, the latter study controlled for family ownership, and, in any case, the vast majority of WVR-firms in Canada are family/founder-controlled.[120] The difference in results between the two studies is therefore somewhat puzzling, but could be owed to differences in methodologies and firm-matching criteria. In Israel, no statistical effect on firm value was found through unifications.[121]

A number of studies have, helpfully, sub-sampled firms and results, further emphasising that the specifics of the market, firms and controllers may heavily influence results, negating the possibility of formulating a universal dogma as to the effect of WVR-structure generally. An interesting aspect of the study by Bennedsen and Nielsen (2006) is that the negative correlation between WVR-structure and market-to-book value was only apparent in jurisdictions with high levels of investor protection.[122] This would, on first glance, seem counter-intuitive, since one may assume that investor protection regulations will protect inferior-shareholders and therefore reduce opportunities for expropriation. The explanation given by Bennedsen and Nielsen is that in high investor protection jurisdictions, managerial agency costs are less, and therefore the benefits of WVR-structure in palliating such costs are commensurately less, leading to the detriments dominating in terms of valuation.[123] However, the authors' explanation should be taken with care, since the construction considers investor protection as a uniform block, without acknowledging that there are many different varieties of investor protection that protect against distinct abuses. This is also a criticism of studies that try and equate investor protection in general terms with market benefits – different types of investor protection will have different consequences. It is acknowledged that investor protections that reduce OSOV-managerial agency costs will negate certain of the benefits of WVR-structure (to the extent the Wedge is large enough), but further investor protections related specifically to the protection of inferior-shareholders from expropriation by superior-shareholders will moderate the detriments of WVR-structure. In any case, the discussion above highlights an important qualification to empirical studies - what is found in one jurisdiction does not necessarily parallel effects in other jurisdictions.[124] Very little empirical work has been conducted in the UK, leaving the US-empirical efforts as the best guess scenario.

Two studies found that although WVR-firms show better firm value than OSOV dispersed-ownership firms, the positive effects were driven by family or founder ownership rather than the capital structure itself, with the relevant premia reduced when WVR-structure was adopted.[125] However, family-firms and founder-controlled firms, respectively, with control-enhancing mechanisms still showed better Tobin's Q than non-family OSOV-firms; this is an important point due to the preponderance of WVR-firms that are owned by family members or founders,[126] and the contention that WVR-structure can persuade such

[119] n 97 above.
[120] ibid 493.
[121] Lauterbach and Pajuste (2015) (n 96 above).
[122] n 102 above 18.
[123] ibid 19.
[124] HKEX Concept Paper (2014) (n 24 above IV-II); ibid 28; Jog et al (2010) (n 97 above 416); Adams and Ferreira (2008) (n 6 above 67); Gurrea (2019) (n 79 above section 7).
[125] n 101 above 703; n 100 above 406.
[126] n 243 below.

founders to list their companies.[127] Even if WVR-structure seemingly reduces firm value for family/founder-owned controlling-shareholder OSOV-firms, so long as the overall effect compared to OSOV dispersed-ownership firms is positive, WVR-structure can be beneficial in enabling the listing of more of such controlling shareholder firms.

Other studies have also shown the importance of separating various traits. Chemmanur et al (2011)[128] found that firms with high quality management displayed greater firm valuations if they implemented antitakeover provisions (which included WVR-structure), resonating with the normative bonding hypothesis benefit of WVR-firms discussed in Chapter 3. On the other hand, lower quality managers may be adopting antitakeover provisions primarily in order to protect themselves, and accordingly correlate with lower firm valuations. Mid-stream recapitalisations could allow lower quality managers to implement WVR-structure to protect themselves ahead of forthcoming poor performance foreseen by those managers,[129] and is therefore another reason why this thesis is not advocating, or assessing in any detail, a relaxation of the Listing Rules to permit such recapitalisations on the premium-tier. Jordan et al (2016)[130] found that the general finding of lower Tobin's Q for WVR-firms was not upheld when splitting firms into high- and low-growth. Only low-growth WVR-firms continued to show lower Tobin's Q than matched OSOV-firms, but for high-growth firms, WVR-structure had a positive effect on firm value. Again, the results resonate with the normative analysis in Chapter 3 – where a firm is in a high growth-phase with numerous investment opportunities, a WVR-structure enables the controller to pursue long-term investment absent of the influences of short-term shareholders. Two studies indicated that low WVR-firm Tobin's Q may be driven by those WVR-firms with high free cash-flows, suggesting that high free cash-flows result in greater opportunities for expropriation.[131] Since free cash-flow represents earnings after investment in assets, a company with a high free cash-flow could be one with high levels of profitability but which does not use those profits for further investment. As such, it may be possible to equate this study with Jordan et al (2016) - if the company is not in a growth-phase which requires long-term investment, profits are more likely to be diverted by the controller, making WVR-structure detrimental to other shareholders. Similarly, Nüesch (2016) found that WVR-firms, in Switzerland, showed positive correlation with Tobin's Q if cash-flow was not sufficient to meet investment opportunities.[132] The author provided a different explanation - a controller of a firm requiring further equity investment would be constrained by market forces from expropriating in order to reduce cost of capital[133] - and continued to suggest that, therefore, WVR-structure should be encouraged for fast-growing firms to promote firm-specific investment and stable management, but that low long-term growth firms should adopt OSOV to mitigate against the risks of expropriation.[134] Further research could assist by further investigating the reasons for high free cash-flow in those WVR-firms

[127] See: Chapter 1.
[128] n 98 above.
[129] An analogy can be drawn to one of the similar endogeneous factors noted above that could affect the rationale for converting to WVR-structure (n 70 above, and accompanying text).
[130] n 99 above.
[131] n 92 above; Amoako-Adu (2013) (n 96 above 196).
[132] n 6 above 542.
[133] Ibid 546.
[134] Ibid 547.

showing lower firm value. Additionally, Anderson et al (2009)[135] noted the significance of high quality disclosure. Using bid-ask spread as a proxy for asymmetric information among investors, and analyst errors as a proxy for information availability, transparent WVR-firms showed a positive correlation with firm value, with a negative correlation for those with opaque disclosure protocols. Greater levels of disclosure can make it more difficult to conduct the more egregious types of expropriation, including those that are fraudulent or represent disguised related-party transactions. As discussed in Chapter 6, greater mandated disclosure could, therefore, reduce the cost of capital for WVR-firms.

Two further studies also indicate that the fundamentals of the WVR-firm may play a part in firm value. While Cremers et al (2018)[136] found that WVR-firms showed higher firm valuations than matched OSOV-firms at IPO, the divergence narrowed over time to the extent that WVR-firms showed lower firm value than matched OSOV-firms six years after IPO. In a similar manner, after sub-sampling, Kim and Michaely (2018)[137] found that only older (12 or more years-old) WVR-firms showed worse firm valuations than OSOV-firms, and younger (less than 12 years-old) WVR-firms actually had better Tobin's Q values than young OSOV-firms. The two studies measure slightly different qualities - degradation in valuation over time post-IPO as compared to degradation in valuation over the entire lifetime of the firm. Nonetheless, the studies indicate a time-dimension suggesting that to the extent WVR-structure is beneficial for a firm, the net-beneficial position erodes over time (although the submission above that the market's perception of WVR-structure has a historical dimension could also impact the results). This could also tally with the findings above for high-growth firms, with the presumption that younger firms will, on average, have greater growth-rates than more mature firms. The policy implication, as discussed further in Chapter 6, is that inferior-shareholders may require greater protection as a firm ages, but for at least some part of a firm's life, a WVR-structure may be beneficial to all shareholders. The general proposition that variations of performance occur over time raises a criticism of the empirical studies on firm value, and, in fact, other measures of performance.[138] As noted by HKEX, studies attempt to deal with this issue by either assuming that such differences will even out over large samples, or by attempting to match firms with similar qualities, ages or time since IPO.[139] The former solution is often impaired by small sample-sizes (partly a product of WVR-firms forming only a minority of all listed-firms in many jurisdictions), and the latter suffers from differences between studies in methodology of selection of firms, identification of characteristics and description of qualities. Even if firms were adequately matched with respect to age, the issue subsists that any individual firm within a sub-sample assessed during a discrete period of time may be in the midst of poor or good performance for reasons unrelated to its structure.[140] Although some studies attempt to match firms on the basis of characteristics such as sales growth in order to compare firms in similar economic situations, the characteristics used are fairly crude and do not appreciate the level of complexity required to adequately

[135] n 102 above.
[136] n 99 above.
[137] n 50 above.
[138] n 23 Chapter 1 630.
[139] HKEX Concept Paper (2014) (n 24 above IV-2).
[140] Ibid IV-1.

compare 'apples-to-apples'. There may in fact be no way to attain the matching required without sample-sizes becoming unfeasibly small.[141]

The interpretations above should be further qualified. Although, unlike event-based studies, firm valuation studies do not focus on vicissitudes in and around the occurrence of specific events, they do still suffer from other endogeneity issues. Certain types of company or certain qualities may lend themselves to the choice of WVR-structure,[142] which in turn have their own effects on firm value independent of capital structure.[143] As an example, if high-growth companies are more likely to select WVR-structure,[144] positive abnormal firm valuations for a WVR-firm portfolio could be related to there being a greater prevalence of quickly growing companies in the portfolio. Most studies control for this type of endogeneity and match WVR-firms to portfolios of similar OSOV-firms, but it can be very difficult to isolate relevant qualities on a firm-by-firm basis. Typical control variables are firm size and sales growth.[145] Certain studies, particularly those that are cross-country orientated, control for jurisdiction and industry.[146] Others also control for family ownership and the ability to dominate voting,[147] as well as firm age.[148] Clearly, there are a large number of endogenous variables that influence the choice of WVR-structure, and, as noted by Adams and Ferreira (2008), many studies do not control for endogeneity properly.[149] Further research could focus on ascertaining whether there are any trends in the exact qualities of firms choosing WVR-structure - so far, studies have been inconclusive in identifying such trends.[150] Differences in controls and matching methodologies can explain some of the inconsistencies between separate studies, as can differences in how proportionality of cash-flow rights to voting rights is detected and measured.[151] It is even difficult to isolate the effects of the Wedge from the individual and separate effects of voting rights concentration and cash-flow rights concentration.[152] Categorical proof of causation between capital structure and firm value is therefore elusive. Additionally, it has been contended that, if capital structure choice is perfectly efficient, the best capital structure for the relevant firm will be chosen in each case;[153] this would lead to inconclusive empirical evidence, since, in such an event, no overall positive or negative correlation to capital structure will be found.[154] For example, for a firm where short-term signalling is more important, a OSOV-structure may be

[141] Cremers et al (2018) noted themselves that sample-size was significantly diminished by their use of extensive matching (n 99 above 17).
[142] Adams and Ferreira (2008) (n 6 above 62); Hu and Black (2006) (n 24 Chapter 1 852); Li et al (2011) (n 24 Chapter 1 10).
[143] Fisch and Solomon (2019) (n 263 Chapter 3 11).
[144] An example also noted by Cremers et al (2018) (n 99 above 31). Both Jordan et al (2016) (n 92 Chapter 3 307) and Lehn et al (1990) (n 47 above 571) interpret their empirical evidence as showing that firms with greater growth opportunities choose WVR-structure. The situation is, though, complicated, since a competing dynamic where a company has plentiful investment opportunities is a desire to ensure low cost of capital, which would be promoted by OSOV (Adams and Ferreria (2008) (n 6 above 67).
[145] Adams and Ferreira (2008) (ibid 76).
[146] For example: Bennedsen and Nielsen (2006) (n 102 above).
[147] For example: n 92 above.
[148] For example: n 50 above.
[149] n 6 above 85.
[150] Chapter 3 notes the inconclusiveness of studies seeking a correlation between WVR-structure and, for example, R&D investment and growth-rate.
[151] Adams and Ferreria (2008) (n 6 above 85); ISS Report (2007) (n 88 above 12); n 105 above 8.
[152] Adams and Ferreria (2008) (ibid 85). This difficulty in separating the individual effects of changing voting rights and cash-flow rights on firm value when evaluating the effect of the Wedge is highlighted by the fact that La Porta et al (2002) (n 97 above) found a positive correlation between cash-flow rights and firm value, whereas Cronqvist and Nielsen (2003) (n 97 above) found a negative correlation between voting power and firm value, but neither found any effect of the Wedge on firm value.
[153] Demsetz and Lehn (1985) (n 73 Chapter 3 1156); Lehn et al (1990) (n 47 above 566).
[154] Goshen and Squire (2017) (n 150 Chapter 3 814).

optimal, whereas a WVR-structure could be optimal for firms where long-term strategy is more conducive.[155] That said, efficiency of capital structure choice is certainly not a given, and the credibility of the concept can be questioned - for instance, the inferior-shareholders may not anticipate the intentions of a controller to implement a WVR-structure to enable the extraction of pernicious controller benefits. Additionally, subsequent to choosing a structure at IPO, whether that be WVR or OSOV, it is not simple from a corporate law perspective to switch capital structure, and the potential for such a switch to occur will also be subject to the ideological desires of those who are enfranchised to make the decision.[156]

Another potential criticism that can be levied against firm valuation studies is the use of estimates for Tobin's Q. As mentioned, as a result of difficulties in ascertaining the replacement value of assets, often 'book value' is used as a substitute in the denominator of Tobin's Q, meaning that such studies are not using a true Tobin's Q measure.[157] This can create discrepancies within studies since firms use varied techniques to book the value of assets, including different depreciation schedules and inventory accounting rules.[158] Furthermore, as above, a Tobin's Q that deviates from '1' can reflect the market's valuation of a variety of intangible assets,[159] not necessarily related to the market's assessment of the relevant capital structure of the firm. Certain intangible assets are 'unbooked assets' and not included in book value; for instance, complex products such as financial derivatives are not booked,[160] and, importantly, expenditure on R&D, knowledge and intellectual property are often not capitalised.[161] Extraneous divergences also exist between firms in relation to the booking of intangible assets – for example, differences can exist in the manner in which goodwill is booked between businesses that build, versus those that buy, intangible assets.[162] A high estimated Tobin's Q could be based upon the market's valuation of unbooked intangible assets rather than, as supposed by Morck et al (1988), necessarily based upon its assessment of the management team's qualities and level of entrenchment.[163]

In summary, taking the US, where the majority of research has been undertaken, and where the investor profile bears similarity to the UK, the prevailing inference is that WVR-structure is negatively correlated with firm value. However, the statement is equivocal and studies exist that show the opposite or no effect. The date-range over which studies are conducted seems to have an, albeit as yet indeterminate, influence. Furthermore, those studies that split firms beyond merely WVR and OSOV indicate that specific firm- and controller-characteristics may determine whether WVR-structure creates positive or negative impacts on firm value. If, as alluded to above, one of the drivers of low firm value is expropriation over time, it is possible that the data represents an environment where specific types of firms use WVR-structure for net-beneficial reasons, whereas other types of firms implement the structure for the purposes of detrimental expropriation. An alternative explanation could be that the market's perception of the structure

[155] Burkart et al (1997) (n 194 Chapter 3 718).
[156] Claessens et al (2002) noted that it would be extremely unlikely that firms would be able to nimbly change mid-stream capital structure in response to changing circumstances (n 96 above 2764).
[157] n 84 above 26.
[158] Ibid 27.
[159] n 89 above.
[160] n 84 above 27.
[161] Ibid 29.
[162] Ibid 29.
[163] n 89 above. Ibid 14.

upon IPO or recapitalisation endures long after the IPO or recapitalisation - if investors, on a firm-by-firm basis, categorically presuppose that the structure will be abused by the controller eventually (as suggested by negative reactions in event-based studies), investors would view the discount to be a reasonable reaction to having to assume that risk. Such behaviour could explain the overall negative correlation found in certain studies rather than there being an overall tendency toward detrimental expropriation. In a UK-study, for instance, it was found that the level of the premium attached to OSOV-firms was positively correlated with the level of negative media coverage of WVR-firms, even where such negative coverage was not associated with increased expropriation behaviour in WVR-firms.[164] In terms of those studies showing discrepancies between types of firms, the market may perceive specific types of firms (or controllers) to present either lower risks of expropriation, notwithstanding WVR-structure, or over-compensatory benefits as a result of WVR-structure. A key question, as with event-based studies, is determining the validity of WVR-firm valuations, and therefore ascertaining whether differences in firm valuations between WVR-firms and OSOV-firms truly represent the balance between beneficial and detrimental qualities of WVR-structure or merely represent the market's perception of WVR-structures. An answer can be garnered by scrutinising the actual performance of firms, from the perspective of both buy-and-hold stock returns and actual firm operating performance.

5. Buy-and-Hold Stock Return Studies

In the 1980s, WVR-structure was mainly appraised on the basis of event-based studies, and, in more recent times, judging by the preponderance of Tobin's Q studies, firm valuation has been used as a proxy for the sagacity of WVR-firms, with the presumption that such studies determine whether WVR-structure is beneficial or detrimental for public shareholders. However, that premise can be tested further by establishing whether public shareholders that invest in WVR-firms are, in fact, better or worse served than those who invest in OSOV-firms. Long-term buy-and-hold return studies can be conducive in this regard in that they ascertain whether a public shareholder investing in a notional portfolio of WVR-firm inferior-shares for a period of time will receive higher or lower returns than the same shareholder investing in a notional portfolio of matched OSOV-firms. Unlike event-based studies, the studies track longer-term shareholder returns which are uncontaminated by extraneous transitory influences. Although only a handful of studies track this performance measure, they provide useful further testament by augmenting firm valuation studies, and therefore enabling an assessment as to whether differences in share prices between WVR-firms and OSOV-firms correlate with the returns actually earned by shareholders. For example, if the market determines that a WVR-firm will not increase to the same value as a OSOV-firm over the same period of time, shares of the WVR-firm will be discounted; investors will acquire those inferior-shares at a lower price, and thereby receive a similar return to what they would have received had they invested in the OSOV-firm instead. Given the trend of firm valuation studies is toward a negative correlation between WVR-structure and firm value, if WVR-firms are being discounted correctly (and therefore embodying lower future firm

[164] Braggion and M. Giannetti (2016) (n 102 above 26).

performance), the differences in firm value between WVR-firms and OSOV-firms should reflect anticipated differences in performance over time, and, therefore, there should not be substantial differences between returns received by portfolios of WVR-firms compared to OSOV-firms.

Overview

In the US, four studies found that long-term[165] buy-and-hold returns were greater for WVR-firms than OSOV-firms[166] (although one of those studies provided a result, which was only economically and not statistically significant, where controllers had sold-down equity at the time of recapitalisation,[167] and one study showed that the results were heavily influenced by those firms that issued further equity after recapitalisation[168]). A further study found that firms adopting antitakeover devices (including WVR-structure) at IPO generated greater returns than those that had not.[169] Two US-studies did not find any abnormal returns,[170] and one was inconclusive finding negative stock returns for dual-class firms (relative to matched firms) in the first calendar year after recapitalisation into dual-class structure and positive returns in calendar years two through four[171] (none of the results for each of the four calendar years post-recapitalisation were statistically significant enough though for the authors to form a conclusion).

In Canada, one study found no statistical difference in long-term share performance between WVR- and OSOV-portfolios.[172] Also in relation to Canada, Allaire (2018) cited six studies that examined the stock performance of WVR-firms compared to OSOV-firms over 5, 10, 15 or 18 year periods, all of which suggested outperformance by WVR-firms.[173] However, as the author notes, such studies are flawed in their univariate nature - merely comparing all WVR-firms to all OSOV-firms does not take into account firm-level differences and other potential variables.[174] While a further old study by a Canadian asset manager found that TSX WVR-stock portfolios slightly underperformed OSOV-portfolios,[175] it also did not use matching (a critical oversight since the study recognises that WVR-structure is concentrated in specific industries[176]), and the authors acknowledge their bias against WVR-structure and the fact that they had not applied an academic-level of precision to the study.[177] In the UK, during periods of negative media coverage, discounts applied to firm valuations of WVR-firms[178] were accompanied by greater average monthly stock returns for

[165] The subset of studies on buy-and-hold returns generally assess those returns over periods of three to eight years after IPO or recapitalisation into WVR-structure. Two studies that were reviewed exercised longer time periods not necessarily commencing from IPO or recapitalisation – Anderson et al (2017) (n 96 above) examined 2001-2015, and Jog et al (2010) (n 97 above) examined 1996-2005.
[166] Dimitrov and Jain (2006) (n 42 above 347); n 34 above 109; Anderson et al (2017) (n 96 above 23); Bauguess et al (2012) (n 92 Chapter 3 1251).
[167] Bauguess et al (2012) (ibid 1251).
[168] Dimitrov and Jain (2006) (n 42 above 360).
[169] Chemmanur et al (2011) (n 98 above 681).
[170] n 53 above 106; Cremers et al (2018) (n 99 above 24),
[171] Mikkelson and Partch (1994) (n 94 above 191).
[172] Jog et al (2010) (n 97 above 425)
[173] n 105 above 10.
[174] Ibid 9.
[175] Burgundy Asset Management Ltd., 'The View from Burgundy: Second Class Owners?', September 1996 at 3 <https://www.burgundyasset.com/wp-content/uploads/Second-Class-Owners-September-1996.pdf>
[176] Ibid 2.
[177] Ibid 1.
[178] n 164 above, and accompanying text.

portfolios of WVR-firms compared to OSOV-firms.[179] A study spanning East Asia only showed abnormal negative returns for portfolios of WVR-firms during the East Asian financial crisis,[180] which were not apparent before the financial crisis.[181]

Interpretation

As with event-based studies and firm valuation studies, any studies that assess stock returns must be linked to pricing-in and discounts. If data suggests abnormal positive long-term buy-and-hold returns from WVR-firms, it would tend to suggest that investors are overestimating the risk of WVR-structure and therefore over-zealously discounting stock. Similarly, negative abnormal returns suggest over-optimism by investors on the part of investors.

There is certainly no robust evidence that outside investors are earning lower returns from WVR-firms than OSOV-firms, and, at least in the US, the fact that the trend, albeit from a small number of studies, is in the direction of positive abnormal returns intimates that investors are overly discounting WVR-structure. Therefore, at the very least, it would appear that investors are adequately protecting themselves from any risks inherent in WVR-structure, and may, in fact, be earning a premium from investing in WVR-firms. Firm valuation studies suggest that the market is mainly pricing WVR-firms at a lower price than OSOV-firms, yet such firms are producing better returns than OSOV-firms; this alludes to investors discounting WVR-firms out of fear of excessive expropriation, but those fears not materialising over time.[182] Alternatively, institutional investors possibly expect a premium over time just for taking the risk of investing in WVR-firms.[183] Although the fear of the risks that institutional investors apparently hold is not so considerable that they shun WVR-firms,[184] they will require a reward for doing so. If concerns regarding shareholder wealth-maximisation are dissuading regulators in the UK from embracing WVR-structure, such concerns are not borne out by the empirical evidence.[185] Unfortunately, the studies on long-term buy-and-hold returns do not often distinguish between types of firms in a manner that corresponds to the firm valuation studies above. It would be interesting to deduce whether for those types of firms which show a positive correlation between WVR-structure and firm valuation, abnormal returns are also garnered. If no abnormal returns are generated, it is possible that the market does not apply a discount that represents the risk of expropriation (or alternatively does not require a premium to compensate for risk) where certain types of firms implement WVR-structure. If there are positive abnormal returns, it could mean that the market is still discounting WVR-structure to a degree as a result of the relevant risks, but those risks are outweighed by the substantial

[179] Ibid 31.
[180] Lemmon and Lins (2003) (n 17 above 1455).
[181] Ibid 1465.
[182] Holmén (2011) (n 102 above 16) noted, in the context of an influx of foreign investors into the Swedish markets, that such investors applied a discount to WVR-structure independent of actual expropriation. Also, Braggion and Giannetti (2012) (n 15 Chapter 2 23) studied pricing differences between voting and non-voting stock and found that the discount applied to non-voting stock was unjustified by *ex post* returns, opining that the discount was applied simply as a result of investor preference for OSOV. Lauterbach and Pajuste (2015) noted that the market over-estimated the agency cost benefits of controlling shareholders unifying their share structures (n 96 above 173).
[183] Anderson et al (2017) (n 96 above 19).
[184] n 44 Chapter 1.
[185] Anderson et al (2017 (n 96 above 8).

benefits that WVR-structure can confer on those types of firms, hence the positive correlation with firm value.[186]

The study by Lemmon and Lin (2003) is, though, apposite.[187] It shows that in certain circumstances, discounts may in fact be justified, since significantly negative abnormal returns were developed by WVR-portfolios during the Asian financial crisis. The logic extolled was that when investment opportunities evaporated during the crisis, it either became more lucrative for WVR-controllers to expropriate inferior-shareholders rather than cause the relevant company to invest in the business, or the detriments to the controllers in expropriating inferior-shareholders were lessened where the potential equity upsides were vanishingly small with an absence of investment opportunities for the relevant company. Overall, therefore, it seems that, in the usual course, expropriation is not widespread, but where circumstances emerge where expropriation becomes the preferable option for a controller, WVR-structure enables that expropriation. Therefore, consideration should be given to ensuring that inferior-shareholders enjoy protections to prevent the most egregious types of expropriation, or even to implementing a system where such investors are granted greater protections upon certain events developing. This is discussed to an extent in Chapter 3, and further discussed in Chapter 6. A constructive area for further study would be to assess stock returns of WVR-firms in periods or circumstances where expropriation is potentially incentivised in order to ascertain scenarios where greater investor protection is required.

The conclusion applied to buy-and-hold studies above should be tempered by their possible limitations. Although sample-sizes are not small, not many studies have been conducted in this sphere. Buy-and-hold studies may also suffer from endogeneity, in a similar manner to firm valuation studies. As with firm valuation studies, these aspects of endogeneity can be moderated by controlling for various variables using appropriate matching between WVR-firms and OSOV-firms, but it is challenging to perfectly match against all potential variables without acutely reducing sample-size, and it has been noted that identifying causal effects on shareholder returns requires more robust regression specifications than usually employed.[188]

Finally, concurring with the discussion on diversity at the start of this Chapter, portfolios of WVR-firms group all WVR-firms together notwithstanding the fact that some controllers will have implemented the structure, from the perspective of shareholders as a whole, for beneficial reasons, and some for detrimental reasons. Whether long-term buy-and-hold stock performance is positive or negative will depend not only upon the environment in which the company operates (as shown by Lemmon and Lins (2003)), but also upon the intentions of the controller and the type of firm.

As already mentioned, event-based studies, firm valuation studies and long-run buy-and-hold return studies are all influenced by the market perception of WVR-structure. This Chapter now turns toward assessing whether the results of these studies are aligned with the actual operating performance of WVR-firms over time.

[186] See: nn 282-284 below, and accompanying text.
[187] n 180 above, and accompanying text.
[188] n 84 above 46.

6. Operating Performance Studies

Many studies have combined investigations of Tobin's Q with scrutiny of business operations, by comparing accounting measures of performance between WVR- and OSOV-firms. By combining measures of firm value with those of business performance, a more elaborate picture can be painted of the impact of WVR-structure and the reasons therefor. Several accounting measures of firm performance have been used by various studies, and, accordingly, such variations should be a consideration in comparing these studies (hence the greater detail in descriptions below). If WVR-structure is associated with a net-detrimental WVR-tradeoff, where, for example, the controller manages the company primarily to extract pernicious controller benefits, one may expect that operating performance will be similarly negatively correlated; however, as below, the evidence does not support that assertion.

Overview

(a) USA

A number of studies have shown WVR-firms to display better operating performance than OSOV-firms. Cremers et al (2018), using six-yearly snapshots between 1980 and 2015, found that WVR-firms had greater return on assets (ROA)[189] and return on equity (ROE)[190] than matched OSOV-firms.[191] Sales growth was not statistically different for such firms.[192] Böhmer et al (1996) found that WVR-firms, between 1984 and 1988, generated greater net operating income (effectively EBITDA) and ROA than OSOV-firms in the year after IPO and through three years after IPO, while sales and assets were not statistically different.[193] Therefore, WVR-firms were able to produce better operating results with similar sales and assets growth. Beyond three years post-IPO, the rate of decline of ROA, ROE, and the ratio of net operating income to sales was significantly less for WVR-firms compared to OSOV-firms.[194] Arugaslan et al (2010) also found that, for US-IPOs between 1980 and 2008, WVR-firms had higher profit margins[195] than industry-matched OSOV-firms in the year after IPO.[196] Chemmanur et al (2011) found that although all US-firms displayed, through the fourth year post-IPO, declining OIBD[197] over assets, OIBD over sales, ROA and profit margin, those that had implemented antitakeover provisions (which included WVR-structure) saw lower rates of decline.[198] Similar to their results in relation to firm value above, the authors also found that those firms with high quality management outperformed all other types of companies across nearly all tested years post-IPO if they had also implemented strong antitakeover provisions.[199]

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[189] Earnings (sales less costs and expenses) before interest, tax, depreciation and amortisation (EBITDA), divided by assets.
[190] Net earnings over equity.
[191] n 99 above 18.
[192] Ibid 19.
[193] n 34 above 112 and 114.
[194] Ibid 114.
[195] Ratio of the difference between sales and earnings after interest and tax to sales.
[196] n 92 Chapter 3 177.
[197] Operating income before depreciation *plus* interest income.
[198] n 98 above 675.
[199] Ibid 676.

A further set of studies have shown that WVR-firms display better operating performance in certain circumstances. Bauguess et al (2012) found no correlation when grouping all firms recapitalising into WVR-structure,[200] but statistically significant increases in industry-adjusted ROA were found for those firms where the recapitalisation also entailed the incumbent controller selling-down equity.[201] The authors suggested that increased operating performance was a product of controller-diversification, through WVR-structure, leading to the business being managed in a manner beneficial to both outsiders and insiders. As discussed in Chapter 3, such diversification supports risk-taking and greater core-industry focus by WVR-firms which may drive the increased operating performance.[202] Dimitrov and Jain (2006) found similar ROA and ROE and greater growth-rate for WVR-firms post-recapitalisation compared to matched OSOV-firms, where those WVR-firms subsequently issued equity after the recapitalisation, suggesting that WVR-firms could grow in a way that their competitor firms could not, while maintaining steady profitability.[203] With higher growth and similar profitability, the authors opined that total profits must be growing at the same rate as the growth-rate, meaning that WVR-structure likely allows those firms to take advantage of investment opportunities in a value-enhancing manner, which manifests itself in the higher abnormal returns over time for investors.[204] Lehn et al (1990), examining recapitalisations between 1977 and 1987, found that EBITDA divided by sales significantly increased in the periods of one year before, to one year, two years and three years after recapitalisation into WVR-structure,[205] but that the positive results were concentrated within those firms that issued further equity (the results were statistically insignificant for those that did not).[206] It should be noted, though, that the studies by Lehn et al and Dimitrov and Jain could have been affected by endogeneity in terms of the further issuances driving better performance, rather than the structure itself. Kim and Michaely (2018) found no statistical difference overall in ROA and operating margin[207] between WVR-firms and matched OSOV-firms through a long sampling period of 1971 to 2015,[208] but found that young (less than 12 years-old) WVR-firms had statistically better operating margins than young OSOV-firms, and mature (greater than or equal to 12 years-old) WVR-firms had statistically worse operating margins than mature OSOV-firms.[209] The authors stated that this evidences that WVR-structure can improve operating margins in young firms, but that such margins decline at a greater rate than OSOV-firms.

A smaller set of studies have found no significant difference in operating performance between WVR- and OSOV-firms.[210] One study[211] measured return on invested capital (ROIC),[212] which gauges how

[200] n 166 above 249.
[201] Ibid 251.
[202] See: '*Risk-Taking*' and '*Diversification*' in Chapter 3.
[203] n 42 above 358-359 and 363.
[204] Ibid 363.
[205] n 47 above 577.
[206] Ibid 578.
[207] Operating income before depreciation over sales.
[208] n 50 above 11.
[209] Ibid 17.
[210] Smart et al (2008) (n 53 above 107) in investigating ROA and EBITDA over book equity in the 5-years post-IPO, and Mikkelson and Partch (1994) (n 94 above 190) using a ROA proxy in the 4-years post-recapitalisation in trying to replicate the Lehn et al findings (the authors attributed the discrepancy to the earlier study to differences in matching criteria).
[211] G. Morey, 'Multi-Class Stock and Firm Value: Does Multi-Class Stock Enhance Firm Performance? A Regression Analysis' CII publication (May 2017) at 23.
[212] Operating income (adjusted for tax) divided by total debt and shareholder equity less cash.

efficiently a company uses its capital to produce returns by linking earnings to investment projects.[213] The author equated high ROIC with long-term firm performance,[214] and suggested that the results show that WVR-structure is not required in order to deliver long-term performance.[215] However, ROIC can also equate to short-term comportment - a company that substantially invests in long-term R&D may suffer low ROIC as compared to companies that invest in projects that will bear immediate returns.[216] Therefore, it is difficult to construe the results in terms of short- and long-termism. If anything, the results add another strand to the inconclusiveness of studies attempting to correlate capital structure with R&D investment.[217] The results do, though, suggest that, on average, the controllers of WVR-firms do not abuse their positions to cause such firms to invest in projects that are detrimental to outside shareholders to any greater extent than is seen in OSOV-firms.

(b) Rest of the World

In Canada, Jog et al (2010) found that WVR-firms had marginally better ROA than OSOV-firms[218] (although the statistical significance faded in the regression study[219]), while King and Santor (2008) found no statistically significant effect on ROA.[220] Bozec and Laurin (2008) also found that, generally, in Canada, a Wedge did not cause statistically significant differences in ROA, ROIC or ROE,[221] but when the sample was split into companies with high and low free cash-flow, the Wedge had a statistically significant negative effect on all three measures of performance for high free cash-flow companies.[222] The results were even more pronounced where the controller held less than or equal to 25 per cent of the cash-flow rights.[223] The authors concluded that weaker performance results where a controller has both the incentive (through a large Wedge) and the opportunity (as a result of high free cash-flow) to expropriate inferior-shareholders.[224]

In Israel, Lauterbach and Yafeh (2009) found WVR-firms that unified into OSOV to have statistically lower ROAs, before and after unification, than those that did not unify.[225] It would therefore seem that unifying firms had worse operating performance prior to unification than other WVR-firms, and if it were expected that unification would improve performance, this was not apparent in practice. Such firms were performing poorly for reasons other than their capital structure.

In Western Europe, Bennedsen and Nielsen (2006) did not find any correlation between disproportional ownership and ROA,[226] but, in Sweden, Cronqvist and Nielsen (2003) found a negative

[213] D. Benoit, 'The Hottest Metric in Finance: ROIC' *Wall Street Journal* (3 May 2016) <https://www.wsj.com/articles/the-hottest-metric-in-finance-roic-1462267809>
[214] n 211 above 2.
[215] Ibid 31.
[216] n 213 above.
[217] See: Chapter 3.
[218] n 97 above 422.
[219] Ibid 425.
[220] n 96 above 2469.
[221] n 92 above 39.
[222] Ibid 39.
[223] Ibid 44.
[224] Ibid 44.
[225] n 97 above 20.
[226] n 102 above 26.

effect,[227] and Holmén (2011) found a weakly negative effect.[228] In Switzerland, Nüesch (2016) found that ROA was positively correlated with WVR-structure, but only for those firms that required external financing (the correlation was negative for those that did not).[229] Pajuste (2005) found that sales growth for Western European firms unifying WVR-structure into OSOV would significantly improve post-unification, while ROA and ROE did not significantly change.[230] However, when comparing those firms to non-unifying WVR-firms with matched investment opportunities, no significant differences were found in sales growth, ROA or ROE.[231] Unifying firms also had lower leverage, and tended to issue equity in the year after unification.[232] The authors ascertained that WVR-firms unify not because eliminating the WVR-structure will improve the operating performance of the firm, but in order to lower the cost of capital where equity financing is required to finance investment opportunities (which has become expensive due to discounting by investors).[233] The history of WVR-shares in the UK shows conformity with Pajuste's theory.[234]

Interpretation

Firm performance studies, at least in the US (where the majority of research has been undertaken), are overwhelmingly in favour of a positive correlation with WVR-structure. The picture is more inconclusive for the rest of the world (where fewer studies have been conducted), but, intriguingly, there is certainly no trend suggestive of a pattern that WVR-structure firms operate worse than OSOV-firms. Only in Sweden[235] did firms with a Wedge perform worse than those without. Although certain studies suggest that the better operating performance of WVR-firms is driven by those that have higher quality management,[236] have implemented the structure in conjunction with the controller selling-down equity to diversify wealth,[237] have low free cash-flows,[238] and which issue further equity at the same time or subsequent to the implementation of WVR-structure,[239] even when such qualities were not distinguished, the studies found either weaker positive correlations with WVR-structure or no statistical difference between WVR-firms and OSOV-firms. It is likely, as with other types of studies, that certain firm characteristics allow some WVR-firms to significantly outperform OSOV-firms, but, even when taking all WVR-firms as a whole, overall the studies suggest that there is either no difference in performance or those WVR-firms with characteristics that enable them to outperform OSOV-firms carry the whole sample to an overall positive correlation.

[227] n 97 above 712.
[228] n 102 above 11.
[229] n 6 above 541.
[230] n 74 above 33.
[231] Ibid 34.
[232] Ibid 34.
[233] Ibid 35. This also chimes with the findings of Lauterbach and Yafeh (2009) in Israel where unifying firms were, prior to unification, underperforming other WVR-firms - it is possible that such firms required further equity financing due to poor performance and unification was required to reduce the cost of capital (n 97 above).
[234] n 29 Chapter 2, and accompanying text.
[235] nn 227 and 228 above.
[236] n 199 above.
[237] n 201 above.
[238] n 222 above.
[239] nn 203 and 206 above.

Reverting to the WVR-tradeoff, the empirical evidence does not resonate with a net-detrimental WVR-tradeoff position, where excessive expropriation or poor performance by an entrenched management team prevail, and seemingly adduces that WVR-firms perform at least as well as OSOV-firms. It therefore does not appear that the management of WVR-firms (as compared to OSOV-firms) overall either manage those firms less assiduously[240] or make investment decisions that are worse for outside shareholders,[241] both of which would be reflected by poorer operating performance. Just taking operating performance studies in isolation, WVR-controllers, notwithstanding the fact that they may retain total voting control, do not use their privileged (and entrenched) positions to make business or investment decisions that prioritise their interests over those of inferior-shareholders to the extent that it (net) negatively affects the profits of the company. The positive correlation between operating performance and WVR-structure does not exclude the possibility that detrimental expropriation is still taking place, but any expropriation taking place that could affect the generation of operating profits is overshadowed by the positive effects on profitability engendered by WVR-structure.

A number of issues identified in relation to other types of studies above may also apply to operating performance studies. For example, even with extensive matching, endogeneity can contaminate the results. A company that implements WVR-structure may be a firm that is already high-performing. Indeed, in order to persuade investors to forsake their voting rights and still invest in the company at a reasonable price, the investors may need to know that the company is high-performing compared to other firms where there are less governance risks. As an example, in Israel, firms that unified their WVR-structure into OSOV were performing worse than other WVR-firms before the unification[242] - perhaps those firms unified since they were no longer able to raise equity capital at a reasonable price once performance had declined. Another endogeneous aspect to consider is whether better operating performance is being driven by the fact that WVR-firms are mainly family (including founder) owned.[243] There is some evidence that family-controlled firms show better 'financial firm performance' than non-family-controlled firms,[244] invest more in R&D where the controller is the founder,[245] and show better operating performance than non-family-controlled firms (with the positive effect attenuated by WVR-structure).[246] Surprisingly, very few WVR-studies control for family-ownership.[247] Further research on the effect of WVR-structure on family-controlled firms would be a valuable contribution to the discussion, although not essential for the purposes of this thesis - so long as WVR-firms, which are overwhelmingly family/founder-owned, show improved operating performance compared to OSOV-firms generally, WVR-structure should be welcomed in the context of enabling founders

[240] Arugaslan et al (2010) (n 196 above 177). The ability to shirk could also be considered to be a controller benefit. Although managers in OSOV-firms could also shirk, the tendency is reduced in OSOV-dispersed-ownership firms by the use of performance-related remuneration packages, and in OSOV-controlling shareholder firms by the large equity exposure of the controlling shareholder to poor management performance.
[241] n 34 above 115.
[242] Lauterbach and Yafeh (2009) (n 97 above).
[243] For example, Anderson (2017) found, in examining Russell 3000 WVR-firms between 2001 and 2015, that only 1.1% were not family/founder-controlled (n 96 above 3); Amoako-Adu et al's (2013) sample of WVR-firms consisted of 83.2% family-controlled firms (n 96 above 185).
[244] Essen (2015) (n 60 Chapter 3).
[245] nn 217-220 Chapter 3.
[246] King and Santor (2008) (n 96 above 2424); n 101 above 703.
[247] Family-ownership is included as a controlled variable in the non-US studies of Pajuste (2005) (n 74 above), Bozec and Laurin (2008) (n 92 above) and Jog et al (2010) (n 97 above).

to retain control as explained in Chapters 1 and 3. A repercussion, though, is that consideration should be given to situations where superior-shares are transferred to third parties, or even where ownership is passed from the original founder to other family members.[248] This is discussed further in Chapter 6. Finally, the diversity of firms may also affect results, since grouping all WVR-firms together, as most of these studies have done, does not distinguish between different types of firms, nor the intentions, agenda and inclinations of the controller.

Two salient issues should be further considered. Firstly, a number of the studies only assess operating performance within a relatively short period of time from IPO or recapitalisation (usually within five years), potentially masking longer-term performance deficiencies. Kim and Michaely (2018) identified that older WVR-firms may, in fact, underperform compared to older OSOV-firms.[249] Therefore, it is possible that the better performance of WVR-firms is finite and may recede over time, and further studies in this area would be welcome. Second, the possibility remains that expropriation could also be taking place after profits have been generated. This factor, together with a discourse on what an amalgamation of the event-based, firm value, buy-and-hold stock returns and operating performance empirical evidence tell us about WVR-firms, are encountered in the following concluding section.

7. Conclusion

The general trend in event-based studies and firm value studies is that WVR-structure leads to discounted share prices, although when splitting-out particular qualities, it does appear that the market's distaste for such structures is ameliorated for certain types of firms. In contrast to the negativity surrounding event-based and firm value studies, it seems that the trend in buy-and-hold stock return and firm performance studies is certainly not negative, and, arguably, positive, with many studies showing WVR-firms to generate better returns for investors coinciding with better operating performance compared to OSOV-firms. It is challenging to make robust conclusions when taking the different forms of empirical studies separately. However, when analyses of the trends are combined, a more coherent whole can be constructed. Given the highlighted issues with diversity, endogeneity and reverse causation, the most useful studies are those that research more than one aspect of firm performance, since they amalgamate the aspects over the same samples of companies. Smart et al (2008),[250] Bennedsen and Nielsen (2006),[251] King and Santor (2008),[252] Pajuste (2005),[253] and Smart and Zutter (2003)[254] are intriguing in this regard, and representative of the overall trends. They all seem to show that although WVR-firms display lower firm values compared to OSOV-

[248] nn 60-61 Chapter 3, and accompanying text.
[249] n 209 above. It should also be noted, though, that Böhmer et al (1996), using different measurements of performance over a shorter and earlier time period, found that WVR-firm performance declined less than OSOV-firm performance in the period 3-years post IPO (n 194 above).
[250] n 53 above.
[251] n 102 above.
[252] n 96 above.
[253] n 74 above.
[254] n 6 above 105.

firms, this is not due to lower operating performance after the structure is implemented. Two explanations can solve the conundrum as to why better, or at least similarly, performing firms are valued less.

One explanation could be that expropriation is occurring after-operations.[255] In effect, the company is operating at a level comparable to OSOV-firms, but having generated similar or better operating profits, the controller simultaneously or subsequently extracts pernicious controller benefits, resulting in a lower firm valuation, since profits that would otherwise have accrued to the outside shareholders are expropriated by the controller. However, many types of pernicious controller benefits through, for example, the controller abusing its entrenched management position to invest in pet or inefficient projects, extract high levels of remuneration, shirk or dedicate time to other unrelated enterprises, make decisions that benefit the reputation or self-image of the controller more than the interests of the company, or make poor acquisitions, would likely affect profitability.[256] The fact that operating performance seems to remain robust for a period of time after implementation of WVR-structure concords with either such extraction not taking place, or taking place at such low levels that it is overshadowed by the operating performance benefits conveyed by the structure. Certain types of pernicious controller benefits could, though, be extracted after-operations. Potentially, in low investor protection jurisdictions, if related-party transaction regulations, legal enforcement and accounting standards are lax, profits could be tunnelled to the controller or its related-parties; particularly, if such tunnelling involves outright stealing, operating performance may continue to appear robust even though expropriation of the public shareholders is occurring. However, in developed jurisdictions, such as the US where most of the studies have been conducted, it is unlikely that such widespread stealing could occur.[257] As referenced in Chapter 3, instances of prohibited or fraudulent extraction by controllers of WVR-firms in developed jurisdictions are rare.[258] In relation to other forms of controller benefit extraction after-profits, it is difficult to contemplate how such extraction could occur without harming profits in future years, which would, in contradiction to the empirical evidence, be reflected by a negative overall correlation between operating performance and WVR-structure.

For strong investor protection jurisdictions, a second explanation is therefore more likely - that outside investors apply a discount to protect against potential expropriation that may cause profitability to decline in the future in circumstances where they are powerless to remove inside management.[259] This explanation is further supported by the trend in the empirical evidence that portfolios of WVR-firms earn greater stock returns than portfolios of OSOV-firms, due to inordinate discounting. Investors may view such immoderate returns as compensation for taking the risk that excessive expropriation may occur at some point in the future.[260] The studies by Dimitrov and Jain (2006)[261] and Anderson et al (2017)[262] showed that WVR-structure correlates with greater stock returns but with negative event-based reactions and lower firm-value

[255] Bennedsen and Nielsen (2006) (n 102 above 26).
[256] Cronqvist and Nielsen (2003) (n 97 above 714).
[257] Ibid.
[258] nn 28-32 Chapter 3.
[259] Smart et al (2008) (n 53 above 113).
[260] n 183 above, and accompanying text.
[261] n 42 above.
[262] n 96 above.

discounts, respectively. Equally, Bauguess et al (2012)[263] showed that the increased operating performance of 'controller equity sale' recapitalising firms corresponded with large economically significant (although not statistically significant due to the small sample-size) buy-and-hold returns over the same period of time. Therefore, buy-and-hold investors were able to benefit from the increased operating performance, seemingly corroborating the theory that such firms were unjustifiably discounted. At least during periods of good operating performance, only benign controller benefits, or minimally pernicious controller benefits that are not so great as to adversely affect operating performance as compared to OSOV-firms, would appear to be extracted.

The question therefore remains as to whether the discount applied to firm value is in fact justifiable. Taking the empirical evidence as a whole, it does not appear that those discounts are warranted, since, overall, the operating performance of WVR-firms seems to be greater than that of OSOV-firms, and returns accruing to WVR-stock are at least as large, if not larger, than those accruing to OSOV-stock. In certain circumstances, though, the risks attached to WVR-firms seem to be higher. The study by Kim and Michaely (2018), for example, suggests that after a certain period of time during a WVR-firm's life-cycle, operating performance starts to diminish to the extent that such firms underperform OSOV-firms[264] (although it should be noted that a much earlier study with a shorter sampling-period showed WVR-firm operating performance declining at a lower rate than OSOV-firms[265]). Additionally, other studies suggest that in certain situations, whether that be as a result of general financial conditions (such as during an economic financial crisis)[266] or as a result of firm-specific conditions (such as where the firm has high free cash-flows),[267] the incentives and / or opportunities for pernicious controller benefit extraction increase, which may lead to decreased operating performance. Either discrete shocks lead to an environment in which pernicious controller benefit extraction in WVR-firms becomes more likely, or at some point in a WVR-firm's life-cycle, the benefits of the structure that drive operating performance are dominated by the detriments. Where expropriative behaviour is incentivised, discounts may be justified, and perhaps it is for those situations that investors will only invest at discounted prices in case a firm slips into a position where expropriation is incentivised.[268] This can be punitive for those WVR-firms that will never actually shift into a negative trade-off position, which, judging by the empirical evidence, appears to be the case for the majority of WVR-firms. The only study showing worse WVR-stock returns than OSOV-returns isolated a period covering a financial crisis.[269] Pertinently, a survey of 445 worldwide institutional investors with over $4.9 trillion of assets under management found that 80 per cent of such investors routinely expect a discount on any company employing Wedge-creating mechanisms.[270] Additionally, the finding in Sweden that valuation discounts were only applied to WVR-firms after foreign investment rules were relaxed, even though there were no commensurate changes in

[263] n 166 above, and accompanying text.
[264] n 209 above, and accompanying text.
[265] n 194 above, and accompanying text.
[266] n 187 above, and accompanying text.
[267] n 222 above, and accompanying text.
[268] In some jurisdictions, lower firm value may result from WVR-firms being forsaken by a large proportion of individuals, driving down share price. However, at least in the US, it appears that institutional investors do not shun WVR-firms (n 184 above), and, therefore, lower firm valuation reflects the lower price at which investors are willing to purchase stock.
[269] n 180 above.
[270] ISS Report (2007) (n 88 above 88).

operating performance, is indicative of large institutional investors seeking indiscriminatory WVR-firm discounts.[271]

To a degree, the market seems to recognise those firms that present lesser risks. For example, studies have indicated that WVR-firms may show either greater or similar firm valuations than OSOV-firms where those firms have better quality management,[272] constitute the rare cases where they are not controlled by family controllers,[273] are high-growth firms,[274] have low free cash-flow,[275] require external financing,[276] are more transparent in their disclosures,[277] are younger,[278] or have only recently undergone IPO.[279] However, outside of those firms the market appears to significantly discount WVR-firms in a manner generally unjustified by performance and stock returns. It is acknowledged that investors may additionally apply a discount to WVR-firms due to the ability of the controller to effectively veto takeovers that could otherwise earn investors a windfall to market price; however, again, such a discount is not empirically justified, since the empirical evidence is inconclusive as to whether takeovers of WVR-firms are in fact less prevalent than OSOV-firms,[280] and, to the extent that takeovers do occur, the windfalls to investors are generally greater.[281] Even where the market recognises the benefits of WVR-structure, it may still be applying a discount; for example, Böhmer et al (1996)[282] found that WVR-firms were both valued more than OSOV-firms and produced larger buy-and-hold stock returns than OSOV-firms, and Nüesch (2016) found that the positive correlation between WVR-structure for firms requiring external finance and firm performance was much greater for ROA than Tobin's Q.[283] Similarly, in relation to antitakeover mechanisms (including WVR-structure), Chemmanur et al (2011)[284] showed that positive abnormal buy-and-hold stock returns attach to high-quality management firms with antitakeover devices that also showed valuation premia. Therefore, positive or neutral WVR-correlations with firm value may not fully respect the significant outperformance shown by many of those types of firms. The discount may just not be sufficient to mask the positive effect of performance on firm value.

So what does the empirical evidence mean for the potential for WVR-structure on the premium-tier? Firstly, even though there are certainly flaws in much of the empirical evidence, no broad pattern has emerged that suggests that WVR-structure harms outside investors from the perspective of both buy-and-hold stock returns and operating performance. On the contrary, there is some evidence that WVR-structures are beneficial to outside investors. Even if the policy priority is simply the protection of public investors, it does not seem that those investors require 'saving-from-themselves' so to speak, since, to the extent that there are potential risks in WVR-structure, generally, investors apply a discount to WVR-firms, purportedly to protect

[271] n 117 above.
[272] n 98 above.
[273] Anderson et al (2017) (n 96 above) and Claessens et al (2002) (n 96 above).
[274] Jordan et al (2016) (n 99 above).
[275] n 92 above.
[276] Nüesch (2016) (n 6 above).
[277] Anderson et al (2009) (n 102 above).
[278] n 50 above.
[279] Cremers et al (2018) (n 99 above).
[280] n 92 Chapter 3.
[281] n 154 Chapter 3.
[282] n 34 above.
[283] n 6 above 542.
[284] n 98 above.

themselves.[285] In fact, it has been suggested that in jurisdictions with high levels of sophisticated investors, those investors are well-placed to protect themselves through discounts, and, therefore, so long as additionally buttressed by robust investor protections, the justification to permit WVR-structure is stronger.[286] Although in individual circumstances, the discount applied may underestimate risks,[287] on average it seems that investors are pricing-in their risk, and, if anything, the average discount applied by outside investors is not justified. As with OSOV, WVR-structure has benefits and detriments. Even though with both structures there will be cases where the structure results in failing companies, if WVR-structure is not more harmful than OSOV-structure, and, to the extent that WVR-structure presents risks, investors price-in such risks by discounting WVR-firms, there is little justification to prohibit them from the premium-tier.

Secondly, if prohibitions were relaxed to permit the admission of WVR-structure to the premium-tier, it is likely that such firms would have lower firm values than OSOV-firms, but, since the UK notionally has relatively strong investor protection rules[288] (particularly in relation to premium-listed companies), would, on average, perform as well, if not better, than OSOV-firms from the perspective of profitability. In a variation on the 'market for lemons' theme, if investors are not able to ascertain where on the WVR-tradeoff see-saw an individual firm will place, they will seek protective discounts no matter the quality of the firm and even if the controller only intends to extract benign controller benefits.[289] In a pure 'market for lemons' the 'good' sellers of equity will be deterred from entering the market, leaving a market dominated by 'bad' actors. In the context, of WVR-structure, a vicious circle could develop, since high cost of capital could even motivate greater extraction of pernicious pecuniary controller benefits post-IPO in an attempt by the controller to compensate itself for having previously sold equity at IPO at a lower price than would have been the case under OSOV.[290] Clearly, though, given the empirical evidence on buy-and-hold returns and operating performance, unlike a pure 'market for lemons': (i) not all 'good' WVR-firm controllers are deterred from listing, meaning that, in many cases, the value to the controller of benign controller benefits outweighs the lower valuations of equity; and (ii) the market may be organically protected from the worst WVR-firms to a degree by rejecting some 'bad' WVR-firms – those firms will abandon WVR-structure if it appears that institutional investor interest in the flotation will be low.[291] However, since the market does not seem to sufficiently identify 'good' controllers (considering the large discounts applied), the possibility remains that some 'good' potential WVR-firm controllers will eschew flotations if cost of capital is high. Additionally, if already listed as a WVR-firm, continued high cost of capital could result in the controller unifying the share structure to OSOV at a time when it may be more beneficial to long-term success to continue with a WVR-structure (especially if the relevant company is seeking equity finance to grow).[292] In a world of premium-listed WVR-firms, regulation, judiciously applied, could be used to assuage concerns of

[285] The validity of a policy goal to prohibit WVR-structure as a result of lower firm value when operating performance is not weaker was questioned by Bennedsen and Nielsen (2006) (n 102 above 28).
[286] Gurrea (2019) (n 79 above para. 7.2).
[287] Such as during the East Asian financial crisis (n 269 above).
[288] n 27 Chapter 3.
[289] G. Akerlof, 'The Market for "Lemons": Quality, Uncertainty and the Market Mechanism' (1970) *Q.J. Econ.* 488; n 160 Chapter 1 130.
[290] n 77 Chapter 1.
[291] nn 136-137 Chapter 3, and accompanying text.
[292] n 233 above.

investors that they are participating in the lemons-trade, and therefore reduce the cost of capital for WVR-issuers.

Therefore, using the empirical evidence as a basis, it is hereby advocated that WVR-firms be permitted to engage in premium-listings in the UK, but that restrictions be implemented to give inferior-shareholders a degree of protection from egregious expropriation, which should also reduce the cost of capital for controllers since the level of discount required by inferior-shareholders will be necessarily less. Ideally, those restrictions should be shaped around the indicators of greater expropriation incentivisation or likelihood. Formulating those restrictions is challenging given the available empirical evidence. Even with respect to the time-dimension, and giving investors greater protection as a firm ages, it is highly unlikely that a WVR-firm's performance declines merely because it is becoming older. It is likely that changes, such as shifts from founders to heirs, diminishing investment opportunities and waning CEO powers, are occurring for which time is simply a proxy.[293] As studies become more sophisticated (particularly in relation to sub-sampling), a more complex picture may emerge, assisting in the determination of whether brightline rules can be developed to delineate between types of firms for which, or contexts in which, WVR-structure will generally be overall beneficial or detrimental to outside shareholders,[294] and how those qualities shift over time. However, the desire for further research should not delay the adoption of WVR-structure by premium-listed firms. Restrictions could be fine-tuned over time, and, as has been the course followed in jurisdictions such as Hong Kong and Singapore, WVR-structure could be permitted with broad restrictions, since more granular empirical evidence that is specifically relevant to the jurisdiction in question will only be available once WVR-firms have become more widespread locally. Any restrictions must tread a fine line between protecting inferior-shareholders and maintaining the attractiveness of such structures to controllers, and Chapter 6 will scope-out a balanced protection package for inferior-shareholders in WVR-firms. Prior to that discussion, the next Chapter will outline, and scrutinise the effectiveness of, the already existing UK-regulations and constraints that could protect inferior-shareholders if WVR-structure were permitted on the premium-tier.

[293] Johnson et al (2018) (n 146 Chapter 3 5).
[294] Adams and Ferreira (2006) also suggest further work in this field (n 6 above 84). Further research would be welcomed on the effect of external economic shocks, transparency, growth opportunities and levels of free cash-flow.

CHAPTER 5:
THE EXISTING CONSTRAINTS

1. Introduction

In the previous Chapter, it was noted that the empirical evidence does not support the prohibition of WVR-firms from the premium-tier. WVR-firms, on average, appear to operationally perform at least as well as OSOV-firms, and a number of studies suggest that investment in WVR-firms can result in greater returns than investment in similar OSOV-firms. The receipt of greater returns is partly a manifestation of the market overly discounting WVR-firms which generate better operating performance than OSOV-firms. Excessive discounting, and the corresponding increase in the cost of capital, can create indirect injurious effects, deterring the listing of WVR-firms, incentivising pernicious controller benefit extraction in listed WVR-firms, and encouraging premature unifications of WVR-structure into OSOV at a time when the company is seeking growth through equity issuances. Furthermore, it is unfair for benign controllers to suffer for the sins of pernicious controllers by the application of uniform discounts across all WVR-firms. Some empirical evidence suggests that the discount applied by the market may be tempered for certain types of WVR-firms, but the research is in its nascent stages, and it is currently not conclusive that the market is adept in identifying which firms will be net-beneficial and which net-detrimental to public shareholders, Even in those cases where the market has seemingly applied a premium to particular WVR-firms compared to OSOV-firms, research has shown that based upon returns and operating performance, the premium is not sufficient and, therefore, the market may in fact still be discounting WVR-firms due to the risks perceived therein.

It was further discussed in the previous Chapter that the excessive discounts applied to WVR-structure could be reduced if the fears that investors have regarding being expropriated or lumbered with an underperforming entrenched management team could be assuaged. By constraining the abilities of a controller to expropriate inferior-shareholders or by granting governance rights to inferior-shareholders, those fears could be moderated. Not only would inferior-shareholders be protected from the worst potential excesses of controllers, but also the cost of capital for WVR-firms would be reduced. However, before suggesting possible regulations and constraints, it is apposite to consider the adequacy of existing aspects of the UK's legal, regulatory and market environment in potentially constraining the actions of WVR-controllers if such firms were permitted on the premium-tier. The relevant constraints are outlined below in the context of WVR-structure, divided into three main types: (i) legal/regulatory restrictions; (ii) market constraints; and (iii) 'psychological' constraints.

2. Legal/Regulatory Restrictions

Laws and regulations already exist in the UK that could curtail the powers of WVR-controllers, if such firms were permitted on the premium-tier, and, echoing the sentiment of Holderness and Sheehan in Chapter 3,[1] protect 'small' shareholders. Unsurprisingly, since those laws and regulations have not been specifically formulated with WVR-firms, and in some cases not even with controlling shareholders generally, in mind, a number of flaws are apparent in the context of WVR-structure.

Directors' Duties

In the UK, directors owe duties, and their application can, in theory, constrain the extraction of controller benefits. Directors who owe their appointments to the controller may not, in practice, conduct themselves in a truly independent fashion,[2] but if he/she were to act in a manner that primarily serves the interests of the controller to the detriment of the company, that director would be breaching his/her duties. The relevant duties that could be breached include the duties to act in a way that the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, to exercise independent judgment, to exercise reasonable care, skill and diligence, and to avoid conflicts of interest.[3] In the normal course, those duties are owed to the company,[4] and only in very rare situations do directors owe duties to shareholders.[5]

Since the duties are owed to the company, the company is the proper plaintiff in such actions,[6] and, therefore, decisions to make a claim against a director for breach of duty is in the hands of the internal management organ of company,[7] which, in most cases, is the board.[8] It is easy to suspect that directors serving on the same board may be reluctant to sue their own brethren, and, in many cases, the directors will have colluded together to cause the company to take the actions being challenged, making it even more unlikely that the directors would commence a claim against themselves. With those undercurrents in mind, shareholders have been imparted with a secondary avenue of enforcement through the statutory derivative claim procedure, pursuant to which shareholders can pursue a claim for negligence, default, breach of duty or breach of trust.[9] With a WVR-firm, since any shareholder in the company can commence a derivative claim, it would appear that inferior-shareholders could possess a significant method by which to constrain and deter directors from managing the company primarily to extract controller benefits on behalf of the superior-

[1] n 1 Chapter 3.
[2] nn 64-69 Chapter 3, and accompanying text.
[3] CA 2006, ss.172, 173, 174 and 175, respectively.
[4] CA 2006, s.170(1); also see: *Percival v Wright* [1902] 2 Ch 401.
[5] Such as where the director (i) is dealing directly with, and acting as the agent of, the shareholders (*Allen v Hyatt* (1914) 30 TLR 444); (ii) has been placed in a position of trust and confidence (by analogy to the New Zealand case of *Coleman v Myers* [1977] 2 NZLR 255); or, potentially, (iii) in a takeover context, has a special relationship with the relevant shareholder (by analogy to the Australian case of *Brunninghausen v Glavanics* (1999) 32 ACSR 294). See, also: *Vald Nielsen Holding A/S v Baldorino* [2019] EWHC 1926.
[6] *Foss v Harbottle* (1843) 67 ER 189; *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 210.
[7] Ibid; *John Shaw & Sons (Salford) Ltd. v. Shaw* [1935] 2 KB 113; *MacDougall v. Gardiner* (1875) 1 Ch. D. 13.
[8] n 18 Chapter 1.
[9] CA 2006, ss.260-4.

shareholders. However, a number of hurdles must be succumbed to progress the derivative claim procedure. Firstly, a two-step process must be respected prior to the substantive case being heard, commencing with the Court considering an application for leave, followed by a leave hearing. The application for leave will only be successful if the case identifies a *prima facie* claim based upon negligence, default, breach of duty or breach of trust,[10] and, at the leave hearing, the Court can dismiss the case on the basis of mandatory[11] and discretionary[12] factors. Second, although derivative claims have become more accessible from a procedural perspective since they took on a statutory footing,[13] from a practical perspective, for a shareholder with only a small interest in the relevant company, the potential benefits of making a claim will likely be far outweighed by the efforts and costs involved (since any successful remedy will accrue to the company itself[14]). If the inferior-shares are dispersed (which would likely be the case in the UK[15]) most shareholders will, individually, only hold small equity interests. Furthermore, it would be just as beneficial for that shareholder to 'free-ride' on the efforts of another shareholder,[16] and, additionally, it may be easier for the shareholder to merely sell its shares and exit.[17] Third, the Courts have historically shown significant judicial deference to the operational decisions of directors.[18] Finally, although the Courts have the power to cause a company to indemnify a shareholder for the costs of pursuing a derivative claim on its behalf,[19] an indemnity will only be granted if it is required to ensure that a strong case that would otherwise not be commenced is pursued.[20] Therefore, if the claim is weak or if the shareholder in question has sufficient resources, the Court may not grant such an indemnity. The lack of indemnification and the 'loser-pays' civil procedure rules apparent in the UK[21] can increase the potential costs for small, inferior-shareholders. For all these reasons, shareholders may be deterred from commencing derivative claims against directors.

The strict legal rules surrounding director liability should not be taken in isolation. It has been identified that the greater the costs of taking legal action, the greater the level of self-dealing in which a controlling shareholder can engage before being subject to legal action.[22] Therefore, not only the strict legal rules applicable need to be considered, but also the practicalities of enforcing such rules. As referenced in Chapter 6, the weak litigious culture in the UK does not buttress the effectiveness of the legal constraints on

[10] CA 2006, s.261(2); *Iesini v. Westrip Holdings* [2011] 1 BCLC 498.
[11] CA 2006, s.263(2).
[12] CA 2006, s.263(3).
[13] Prior to codification under CA 2006, derivative claims could only be pursued by shareholders under restrictive case law exceptions (see: *Foss v Harbottle* (1843) 67 ER 189).
[14] *Spokes v. Grosvenor Hotel Co.* [1897] 2 QB 124, 128.
[15] n 66 Chapter 2.
[16] n 12 Chapter 3.
[17] These practical deterrents may explain why, as of the date of this thesis, from a search on 26 March 2020 of the English case law database of Lexis Library using the terms 'derivative claim', 'plc' and 'Companies Act 2006', since derivative claims took on a statutory footing under the Companies Act 2006, there have only been three instances where a minority shareholder of a UK public company has applied for leave to commence a derivative claim, and in all of those cases leave was refused (*Bridge v Daley* [2015] EWHC 2121 (Ch); *Robert Glew & Denton and Co Trustees Ltd and another v Matossian-Rogers and others* [2019] EWHC 3183 (ch); *Kallakis v AIB Group plc and Others* [2020] EWHC 460 (Comm)).
[18] n 89 Chapter 3.
[19] *Wallersteiner v. Moir (No. 2)* [1975] QB 373.
[20] *Smith v. Croft* [1986] 1 WLR 580.
[21] See: Chapter 6.
[22] Commentary by M. Huson in Holderness and Sheehan (2000) (n 114 Chapter 3 174).

the actions of controllers, as compared to, for example, the US.[23] Additionally, even if derivative claims are commenced, directors may not overly fear them, since they are often protected from out-of-pocket expense by directors and officers (D&O) insurance policies and company indemnities.[24] Combined with the hurdles to commence derivative claims, it is therefore improbable that directors' duties will sufficiently deter the extraction of controller benefits by WVR-controllers.

Unfair Prejudice

Another theoretical English-law protection that would be available to inferior-shareholders is the action of 'unfair prejudice'.[25] If a controller is extracting excessive controller benefits, an inferior-shareholder could claim that the affairs of the company are being conducted in a manner that is unfairly prejudicial to that shareholder.[26] Historically, unfair prejudice was claimed on the basis of a non-observance of the legitimate expectations of a shareholder,[27] but a more recent and restrictive interpretation requires the existence of an understanding between parties and an exercise of certain rights which are subject to equitable considerations making such exercise unjust.[28] An inferior-shareholder could claim that the understanding when investing in the company was that the controller would not extract personal benefits, and excessive extraction is an unconscionable breach of that expectation. However, the Courts have generally been reluctant to entertain unfair prejudice claims against listed-companies due to a desire to protect the 'credibility' of the public markets by ensuring that investors can rely upon all investor rights being exhaustively delineated in publicly available documentation.[29] Therefore, short of discriminatory fraud against an individual shareholder or the development of opt-out class action suits,[30] it is unlikely that unfair prejudice will form the basis of effective inferior-shareholder protection in premium-listed companies.

Takeovers

On takeovers, public shareholders are well-protected. In relation to public companies registered and traded (or with central management and control) in the UK, the Isle of Man or the Channel Islands with securities traded on, *inter alia*, the Main Market, mandatory offer rules apply where any persons acting together in concert acquire shares carrying 30 per cent or more of the voting rights in that company; such

[23] Gilson and Black (1995) (n 235 Chapter 3) described how, in the US, minority shareholders are not, as a matter of strict legal law, well-protected, but in the context of corporate acquisitions, lawyers are risk averse, and generally advise clients to treat minorities fairly rather than to risk 'busted deals'.
[24] D&O insurance and indemnities in favour of directors by the company against legal costs and damages (subject to certain limitations) are expressly permitted under CA 2006, ss.232-4. See: B. Cheffins and B. Black, 'Outside Director Liability Across Countries' (2006) 84 Texas L. Rev. 1385; B. Black, 'The Legal and Institutional Preconditions for Strong Securities Markets', (2001) 48 UCLA Law Review 781.
[25] CA 2006, s.994.
[26] Ibid.
[27] *Re Saul D Harrison &Sons plc* [1994] B.C.C. 475 at 490.
[28] *O'Neill and Another v Phillips and Others* [1999] 1 W.L.R. 1092 at 1102.
[29] *Re Blue Arrow plc* [1987] Ch.D. 585; *Re Tottenham Hotspur plc* [1994] 1 BCLC 655; *Re Astec (BSR) plc* [1998] 2 BCLC 556 (note, though, that *dicta* suggests there may be scope to pursue an unfair prejudice claim in instances of serious abuse of powers (*Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 at 18 and 31) or serious mismanagement (*Re Macro (Ipswich) Ltd.* [1994] 2 BCLC 354 at 406)). Also, see: Cheffins (2013) (n 89 Chapter 1 528).
[30] See: Chapter 6.

persons must make an offer for all the remaining shares of each class in the company, at not less than the highest price offered for a particular class of shares in the 12-month period prior to the offer.[31] Where an incumbent major shareholder already holds more than 30 per cent, but no more than 50 per cent, of the voting rights, it must make a similar offer if it (together with persons acting in concert) acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which it is interested. For so long as the UK remains part of the EU, the rules also broadly apply to cover any companies registered in another member state of the EEA whose securities were first admitted to trading in the UK on, *inter alia*, the Main Market (and not admitted to trading on a regulated market in the member state of the EEA in which it has its registered office).[32] Therefore, with respect to a large majority of Main Market companies,[33] it would not be possible for a bidder to acquire a stake giving effective control of the company without making an offer on the same terms to all the shareholders in the company. The relevance of this critical regulation is discussed throughout this thesis. For example, it prevents inferior-shareholders being subjugated to a new controller without first having the option to exit at a presumably fair price. Furthermore, as discussed in Chapter 3, the regulation at the very least limits the level of any control premium that could be extracted by a WVR-controller.

Relationship with the Controller

Chapter 11 of the Listing Rules applies to transactions between a company and a 'related-party',[34] the definition of which includes a substantial shareholder (which, importantly in the context of WVR-structure, is based upon voting, rather than equity, ownership)[35] and its associates. Such transactions, above certain materiality thresholds,[36] must at least be confirmed by the company's sponsor to be fair and reasonable to its shareholders and disclosed upon the entering into of the transaction, or, if large enough, be pre-approved by shareholders independent from the related-party.[37] Premium-listed companies are required to appoint a sponsor to advise the issuer on its listing obligations, and to give assurances to the FCA that the

[31] Takeover Code, Rule 9.
[32] Ibid, Section A3.
[33] n 134 Chapter 1.
[34] See: LR 11.1.4R.
[35] Subject to certain disregarded interests, a 'substantial shareholder' is any person who is entitled to exercise, or to control the exercise of, 10% or more of the votes able to be cast on all or substantially all matters at general meetings of the company (or of any company which is its subsidiary undertaking or parent undertaking or of a fellow subsidiary undertaking of its parent undertaking) (LR 11.1.4R).
[36] Transactions in the ordinary course of business are excluded under LR 11.1.5R, as are transactions where the class test percentage ratios are below 0.25% (n 37 below). A detailed analysis of the class tests is beyond the scope of this article, but broadly follow a classification of the size of a transaction against the size of the company in accordance with a gross assets test, a profits test, a consideration test and a gross capital test pursuant to LR 10 Annex 1.
[37] Listing Rules, Chapter 11. If the transaction in question is of a size large enough such that, upon the application of 'class tests' (ibid), the 'percentage ratio' for any class test is above 5%, independent shareholder approval of the transaction is required prior to the company entering into that transaction (LR 11.1.7). If all such class test percentage ratios are below 5%, but one or more are above 0.25%, independent shareholder approval is not required, but prior to entering into the transaction, the company must obtain confirmation from its sponsor that the transaction is fair and reasonable to its shareholders and the transaction must be publicly disclosed as soon as possible upon entering into the transaction (LR 11.1.10R). If all class test percentage ratios are below 0.25%, the Listing Rules requirements do not apply (LR 11.1.6R and LR 11 Annex 1). It should be noted, though, that for 'sovereign controlled commercial companies' (where a State exercises or controls 30% or more of the voting rights), neither sponsor confirmation, nor shareholder pre-approval are required, even for large transactions (LR 21.5.2R).

issuer's responsibilities thereunder are being met.[38] The sponsor must be a person approved by the FCA to provide sponsor services, and who must be an authorised person (under FSMA 2000, s.31) or member of a designated professional body.[39] In certain circumstances,[40] the materiality thresholds are disapplied in the presence of a controlling shareholder,[41] further strengthening the effectiveness of the constraint. The regulations would protect inferior-shareholders from the most extreme varieties of tunnelling, since a WVR-controller holding the superior-shares will not be able to simply extract significant controller benefits by entering into personally beneficial transactions with the company, unless the inferior-shareholders consent. The application of the related-party transaction rules forms a more effective deterrent to tunnelling than directors' duties, since the FCA can directly sanction directors and companies for breaches of the rules.[42]

Additionally, under International Accounting Standards (IAS),[43] related-party transactions, regardless of size, must be disclosed by Main Market listed-companies in their annual reports.[44] Furthermore, under the Listing Rules and DTRs,[45] as amended pursuant to the EU's revised shareholder rights directive[46] effective as of 10 June 2019, listed-companies incorporated in England and Wales[47] must disclose details of all proposed material related-party transactions[48] no later than the date on which the terms of the transaction are agreed, obtain board pre-approval for the transaction, and ensure that no director who is an associate of the related-party is involved in the board pre-approval.[49] The definition of 'related-party' for these purposes follows the International Financial Reporting Standards, and includes any person who has control or significant influence over the company,[50] and a transaction will be 'material' if it exceeds 5 per cent on the basis of certain class tests[51] which are broadly similar to those set-out in the Listing Rules.[52] The Listing Rules separately extend the DTR requirements, except for the requirements in relation to board pre-approval, to foreign incorporated premium-listed companies.[53]

Although the related-party transaction regulations should provide inferior-shareholders with a degree of comfort that they will not be excessively expropriated in WVR-firms, two aspects should be considered in formulating WVR-policy. Firstly, in the context of OSOV-controlling shareholder firms, the regulations

[38] LR 8.2.
[39] LR 8.6.
[40] n 61 below, and accompanying text.
[41] For these purposes, subject to certain disregarded interests, a 'controlling shareholder' is any person who exercises or controls on their own, or together with any person with whom they are acting in concert, 30% or more of the votes able to be cast on all or substantially all matters at general meetings of the company (LR App 1.1).
[42] Breaches of the Listing Rules can attract censure and fines enforced by the FCA, or in serious circumstances, a suspension or cancellation of the issuer's listing (FSMA 2000, ss.91 and 77).
[43] Companies with their securities listed on a EU-regulated market must prepare their consolidated accounts in conformity with the IASs (Article 4 of EC Regulation No. 1606/2002). This requirement is reiterated in CA 2006, s.403.
[44] IAS 24. For these purposes, 'related-party transaction' is defined to be any 'transfer of resources, services, or obligations between related parties, regardless of whether a price is charged' (IAS 24.9). The definition does not differentiate between transactions that are 'in the ordinary course of business' or 'concluded on normal market terms'.
[45] The rules of the FCA's Disclosure Rules and Transparency Rules sourcebook.
[46] Directive 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.
[47] DTR 1B.1.10R.
[48] The definition of 'related-party transaction' is included in DTR 7.3.3R, and, for practical purposes, is similar to the definition under IAS 24 (n 44 above), except that it excludes transactions 'in the ordinary course of business' and concluded on 'normal market terms'.
[49] DTR 7.3.8R.
[50] IAS 24.9.
[51] DTR 7 Annex 1.
[52] n 36 above.
[53] LR 21.8.17BR.

have not prevented controversies at premium-listed companies such as ENRC, Bumi plc (Bumi), Exillion Energy plc (Exillion), Sports Direct and Ferrexpo.[54] Those controversies arose from either the related-party regulations not covering the relevant transactions or the nature of the transactions creating obfuscation as to whether the relevant thresholds had been satisfied, resulting in such transactions being unintentionally or, perhaps even intentionally, not treated as related-party transactions by the company in question. Additionally, loopholes emerged with respect to the limited breadth of the definition of 'associate' under the Listing Rules, which, in relation to a transaction between a company and a family member of the controlling shareholder only encompasses the controller's spouse, civil partner or child.[55] As such, as discussed further in Chapter 6, it may be prudent to bolster the related-party transaction regulations in the context of WVR-firms.

With the related-party transaction regulations portending a dysfunctional marriage, the 'relationship agreement' represents the 'pre-nup'. In 2014, following controlling shareholder controversies such as at ENRC,[56] the Listing Rules were amended to require that, in the presence of a controlling shareholder (which would include a controller of voting rights in a WVR-firm[57]), a premium-listed company must enter into a 'relationship agreement' with the relevant controller,[58] pursuant to which the controller must agree that: any transactions with the controller or any of its associates will be conducted at arm's length and on normal commercial terms; neither the controller nor any of its associates will take any action that would have the effect of preventing the company from complying with its obligations under the Listing Rules; and neither the controller nor any of its associates will propose or procure the proposal of a shareholder resolution that circumvents the proper application of the Listing Rules.[59] The requirement to implement a relationship agreement impacts the application of the related-party transaction regulations, since a breach of the obligation to put in place a 'relationship agreement' with a controller, or in the case where a relationship agreement has been implemented, a breach of the independence provisions therein, results in the disapplication of the usual thresholds[60] that trigger the related-party transaction regulations.[61] Therefore, for example, if a proposed related-party transaction with a WVR-controller were not on 'arm's length terms', constituting a breach of the relationship agreement, it would require pre-approval by the other shareholders no matter its size and even if the transaction were in the company's ordinary course of business. It should be noted, though, that arm's length term is likely to only require that a transaction has been negotiated by the relevant parties on an independent basis without duress, on terms that could be obtained in a commercial transaction between two unrelated parties, but not necessarily better than the deal that the company could have achieved by transacting with another third party.[62] Therefore, the requirement that transactions be

[54] n 67 Chapter 3 757 *et seq*.
[55] Ibid 751 and 760, in relation to Sports Direct and ENRC respectively.
[56] For example, in 2011, two independent directors were ousted from the board by controlling blockholders acting in concert, after their criticism of the company's corporate governance and questioning of the independence of the chair. One ousted director described the company as 'more Soviet than City'.
[57] n 41 above.
[58] LR 6.5.4R and LR 9.2.2ADR(1).
[59] LR 6.5.4R.
[60] nn 36-37 above.
[61] LR 11.1.1AR.
[62] n 67 Chapter 3 752.

conducted on arm's length terms will not provide complete protection from tunnelling through related-party transactions that do not otherwise exceed the thresholds triggering operation of the related-party regulations under the Listing Rules. Other than the impact on the related-party transaction requirements, the influence of relationship agreements may be superficial. Under the Listing Rules, the FCA does not possess any clear direct enforcement powers with respect to breaches of relationship agreements. It is purely a contractual arrangement between the company and the controller, and, therefore, *prima facie*, the company has the right and responsibility to enforce any breach. In a controlling shareholder scenario, though, the appetite of a board under the control of the controller to enforce a breach against the controller may be slight. Even the independent element on the board may be reluctant to impel enforcement.[63] It could be argued that a failure to enforce such a breach would be a breach of directors' duties,[64] but, as discussed above, there is little incentive for an inferior-shareholder with a small shareholding in the company to commence a derivative claim in relation thereto. With respect to unfair prejudice,[65] although such claims have been notoriously difficult in the publicly listed-company sphere,[66] there is cogency in the argument that an inferior-shareholder could have a personal claim for unfair prejudice against a company that does not enforce a breach of a relationship agreement,[67] but this would be a new, and as yet untested, aspect of unfair prejudice case law.

Notwithstanding the imperfections in the regulations above, the related-party transaction regime does provide existing safe-harbour for inferior-shareholders from the most egregious forms of tunnelling. However, such regulations do not prevent the controller from abusing its entrenched position to extract other controller benefits, as summarised in Chapter 3, which fall short of related-party transactions.

Independent Directors

In theory, not only could independent directors positively monitor executives in dispersed-ownership systems,[68] but they could also act as a monitoring mechanism curtailing the worst excesses of controllers in WVR-firms.[69] The UK CGC, which applies to premium-listed companies, urges that at least half the directors on the board, not including the chair, be non-executive directors that the board considers to be independent.[70] The chair must also be independent upon appointment.[71] In determining the independence of a director, a relevant consideration under the UK CGC is whether such director is a representative of a significant shareholder.[72] Therefore, if WVR-firms were permitted on the premium-tier, a WVR-company in full compliance with the UK CGC would, in theory, have implemented checks-and-balances to constrain the

[63] n 66 Chapter 3.
[64] Potentially breaches of CA 2006, ss.172, 173 and 174 (n 3 above, and accompanying text).
[65] n 25 above.
[66] n 29 above, and accompanying text.
[67] Cheffins (2013) (n 29 above 529) - since the terms of a relationship agreement are publicly available to existing and prospective shareholders, in theory, the credibility of the public markets (ibid) could still be preserved notwithstanding an unfair prejudice claim by a minority shareholder harmed by the non-enforcement of the terms of a relationship agreement by the company against its controlling shareholder.
[68] n 65 Chapter 3.
[69] n 196 Chapter 6.
[70] UK CGC, provision 11.
[71] Ibid, provision 9.
[72] Ibid, provision 10.

acts of its controller through majority board voting being carried by directors independent from the controller.

However, the UK CGC is applied on a 'comply-or-explain' basis, meaning that a company subject to the code is not mandatorily required to comply with the provisions. Under the Listing Rules, a premium-listed company is required, in its annual report, to disclose how it has applied the principles, and whether it has complied with the provisions, and to the extent it has not complied with the provisions, explain the reasons for non-compliance.[73] The success of 'comply-or-explain' rests upon the concept of disclosure - the UK CGC elicits disclosure to shareholders of corporate governance arrangements who can then take action to instigate change to the extent that they are dissatisfied. In the presence of a controller, though, disclosure is less critical, since the corporate governance arrangements will have been implemented at the behest, or with the tacit approval, of the controller. Although, absent such disclosure, the inferior-shareholders would be in the dark, there is very little power in the hands of those inferior-shareholders to instigate change once enlightened. The only factor that could compel the controller to cause the company to comply are equity market forces, but, as discussed below, equity market forces may not be especially potent in the context of WVR-firms. A second issue can, though, also prejudice the sanctity of compliance by a WVR-firm; that is the propensity for companies to merely 'box-tick' against the provisions, and therefore comply with the form, but not the substance, of the provisions and principles.[74] Although the company may be disclosing that it has appointed sufficient independent directors, the independence of which are determined in the sole discretion of the board, in practice the provenance of their acts and decisions may not be genuinely independent.[75] More controversially, a controller could appoint directors who are known and supportive of the controller, even though not directly tainted by the factors set-out in the UK CGC stated to potentially prejudice independence. Such issues also materialise in OSOV-controlling shareholder companies, and in response to such perils, the Listing Rules, in 2014, granted a modicum of privilege to minority shareholders of premium-listed companies in the appointment of independent directors. Where a premium-listed company has a controlling shareholder,[76] the election or re-election of independent directors must be separately approved by both the 'independent' (non-controlling) shareholders as well as the full body of shareholders.[77] If any such election or re-election is not approved pursuant to this dual-voting mechanism, and the company desires to persevere with the relevant election or re-election, a further vote must be held at a meeting at least 90 days but not more than 120 days after the original vote,[78] and the relevant director, if already an existing appointee, may remain on the board during the interim period.[79] The resolution will be passed at the subsequent meeting by a simple majority of votes exercised (including the votes of the controlling shareholder). If WVR-firms were permitted on the premium-tier, the same appointment requirements would apply, and the inferior-shareholders would have the right to opine on the suitability of directors designated by

[73] LRs 9.8.6(5)R and 9.8.6(6)R.
[74] For a summary of the concept of, and issues related to, 'box-ticking', see: B. Reddy, 'Thinking Outside the Box - Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code' (2019) 82(4) MLR 692.
[75] Ibid 713.
[76] n 41 above.
[77] LR 9.2.2ER.
[78] LR 9.2.2FR.
[79] LR 9.2.2DG.

the board to be independent. However, the fact that the controller can, ultimately, impose its will with respect to the appointment of the relevant director dilutes the efficacy of the rules, and, as discussed in Chapter 3, the legitimacy of independence of such directors can be tainted.

Amendments to the Articles of Association

The articles of a company incorporated in England and Wales may be amended by a special resolution of its members.[80] Therefore, in the first instance, if a WVR-controller were to hold at least 75 per cent of the voting rights in the company, it would be able to amend the constitutional documents to, potentially, include provisions that are personally beneficial to it and smooth the path toward controller benefit extraction. There are two caveats, though, that could, in some instances, potentially protect inferior-shareholders. If the proposed change to the articles embodies a variation of 'class rights', a special resolution of the class affected is also required (unless a different procedure is compelled by the articles).[81] This could protect against discriminatory changes being imposed by the controller to the rights attached to inferior-shares in a WVR-firm. In the context of a OSOV-firm, the nature of 'class rights' have been narrowly defined,[82] and, if the relevant change affects all the shares equally, it is unlikely to be a variation of class rights. However, if the proposed variation discriminately varies the rights of the inferior-shareholders and not the superior-shareholders, it is likely that class rights would be deemed to be varied.[83] Also, although, unlike in the US,[84] controllers do not formally owe duties as shareholders in the UK,[85] minority shareholders could possibly take comfort from a common law protection that requires decisions to amend the articles to be taken *bona fide* for the benefit of the company as a whole.[86] Therefore, a decision by a controller to exercise its votes to amend the articles in a manner purely personally beneficial to it could be challenged by the other shareholders. It should be noted, though, that there is a high bar to successful challenges to the *bona fide* standard, since the inferior-shareholders would have to show that no reasonable person would have come to the same decision.[87] Furthermore, there is broad scope for a controller to evidence that decisions on amendments to the articles that are beneficial to the controller will, in fact, also benefit the company.[88]

3. Market Constraints

Many of the market mechanisms that can discipline managers in OSOV-firms can also play a role in constraining the actions of controllers of WVR-firms; among these are the equity markets, debt markets, and

[80] CA 2006, s.21.
[81] CA 2006, s.630.
[82] For example: *White v Bristol Aeroplane Co* [1953] Ch.65; *Hodge v James Howell & Co* [1958] The Times, December 13; *Greenhalgh v Arderne Cinemas Ltd and another* [1946] 1 All ER 512; *Dimbula Valley (Ceylon) Tea Co Ltd v Laurie and another* [1961] Ch.353.
[83] *Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd* [1987] Ch. 1.
[84] n 48 Chapter 6.
[85] *Estmanco (Kilner House) Ltd. v Greater London Council* [1982] 1 W.L.R. 2 at [10].
[86] *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656.
[87] *Shuttleworth v. Cox Bros. & Co.* [1927] 2 KB 9; as confirmed in: *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286, *Citco Banking Corp. v. Pusser's Ltd.* [2007] 2 BCLC 483, and *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536.
[88] *Re Charterhouse Capital Ltd* [2015] EWCA Civ 536.

product markets. In contrast, as discussed in Chapter 3, the disciplining effect of the market for corporate control is eroded in the presence of a controlling shareholder.

Equity Markets

The equity markets can, in theory, act as a disciplining mechanism – if a controller of a WVR-firm regularly expropriates inferior-shareholders, the inclination for investors to invest as inferior-shareholders will significantly diminish, or to the extent investors are prepared to make equity investments, the price at which they will invest will be substantially lower.[89] Equally, with inferior-shareholders lacking the ability to change the management team, upon inferior-shareholder expropriation, share price can be further depressed as a result of such investors pursuing an exit option and selling their shares. Similar share price declines may follow actions that unnerve public shareholders by feeding their fears that the structure may be more susceptible to greater extraction of controller benefits, such as where the firm does not comply with the UK CGC. Declining share price can represent a significant constraining mechanism on OSOV-controlling shareholder firms where the controller owns a substantial equity tranche. Not only will a decline in share price substantially impair the shareholder's financial wealth, but it will also prejudice the ability of that shareholder to partially or fully exit at an acceptable price in the future. However, the effectiveness of the equity markets as a WVR-controller constraining mechanism in this regard can be seriously questioned. A WVR-controller will become less concerned as to how any decline in share price affects its personal assets (decreasing the constraining effect), as the Wedge increases and the equity ownership of the controller decays. One of the principal theoretical reasons for a controller adopting a WVR-structure is to diversify its wealth to allow it to operate the company free from concerns related to declining share price.

The equity markets will, though, continue to have a constraining effect on WVR-controllers in another sense, since there is an incentive to treat inferior-shareholders fairly in order to keep open the option to tap the equity markets for further finance in the future at low capital costs. The ability of the equity markets to constrain controllers can be blunted, however, due to difficulties inherent in the pricing-in of expropriation or risk. Underwriters[90] can impact upon share price, and the demand for shares by the controller itself (where the controller needs to subscribe to shares in order to maintain control upon a fresh issue of shares) can increase share price.[91] Additionally, the market may not be perfectly efficient, with asymmetric information issues preventing the market determining the correct price for stock in controlling

[89] As identified in a number of studies in relation to controlling shareholders generally: A. Shleifer and R. Vishny, 'A Survey of Corporate Governance' (1997) 52 *J. Financ.* 737, 749; La Porta et al (1997) (n 27 in Chapter 3 1149); n 95 Chapter 1 18; Bebchuk et al (2000) (n 97 Chapter 1 305).
[90] Wen (2014) (n 70 Chapter 3 1506).
[91] M. Giannetti and Y. Koskinen, 'Investor Protection, Equity Returns, and Financial Globalization' (2010) 45 *J. Financial Quant. Anal.* 135, 136 and 146. Additionally, since the FTSE-indices only up-date constituents and weighting quarterly, if the expropriation occurs prior to an up-date, passive index-trackers may still be required to invest in the relevant share issuance, bumping-up price (J. Fisch et al, 'Passive Investors' (2018) U. *Penn. Inst. Law & Econ. Research Paper* No. 18-12 1, 40).

shareholder companies.[92] This can be further exacerbated by the controller obscuring the nature and extent of expropriation.

Debt Markets

Debt markets can also have a disciplining effect. Jensen and Meckling (1976) noted the disciplining and monitoring effect of debt on management generally,[93] and there is no reason for the theory not to extend to WVR-firms. If, for example, due to nervousness on the part of investors to become inferior-shareholders, a firm is not able to raise further finance on the equity markets, it is possible that debt will be the only option to finance further growth. In such an event, debt covenants can prohibit firms from taking certain actions without debtholder consent, possibly constraining the ability of controllers to extract controller benefits. A debtholder may insist on working capital covenants, restrictive covenants limiting levels of distributions and indebtedness,[94] and even restrictions on transaction-size. The extraction of at least the more extreme types of controller benefits could breach the debt covenants. The constraining effect of debt on controller benefit extraction by controlling shareholders generally has been modelled, together with an inverse supposition that a controlling shareholder will reduce the level of debt in order to extract greater controller benefits.[95] Additionally, the controller of a firm reliant on debt financing may be hesitant to excessively abuse minority shareholders, since a reputation for expropriation could affect the creditworthiness of the firm, increasing the interest rates attached to debt and strength of covenants required by creditors upon excursions to the debt markets. However, in an extreme case, the controller of a WVR-firm may not fear a breach of debt covenants since the decrease in value of the firm caused by an acceleration of the debt will have less of an effect on the controller's wealth as its cash-flow interest in the company falls. Similarly, a potential increase in the cost of debt or imposition of unfavourable terms as a result of a decrease in creditworthiness caused by a reputation for excessive expropriation will have less of a constraining effect on a controller that only holds a small proportion of the equity.

Product Markets

Finally, in theory, the product markets can have a constraining effect on controlling shareholders, although, as below, that effect may again be diminished when WVR-structure is introduced. Product market competition has been labelled as a managerial monitoring mechanism in dispersed-ownership systems.[96] In a monopolistic market, OSOV-dispersed ownership firm managerial agency costs will be higher, since the

[92] L. Bebchuk, 'Foreword: The Debate on Contractual Freedom in Corporate Law' (1989) 89 *Colum L. Rev.* 1395, 1406; V. Brudney, 'Corporate Governance, Agency Costs, and the Rhetoric of Contract' (1985) 85 *Colum L. Rev.* 1403, 1423; also see: Fisch et al (2018) (ibid 43); Adams and Ferreira (2008) (n 92 Chapter 3 83).
[93] Jensen and Meckling (1976) (n 159 Chapter 1 338).
[94] Ibid 338.
[95] H. Bruslerie, 'Does debt curb controlling shareholders' private benefits? Modelling in a contingent claim framework' (2016) 58 *Econ. Model.* 263.
[96] C. Holderness et al, 'Were the Good Old Days That Good? Changes in Managerial Stock Ownership Since the Great Depression' (1999) 54 *J. Financ.* 435, 457.

value of the 'pot' into which managers can dip is larger, giving managers more 'slack'[97] - a competitive product market reduces those agency costs, since slackness or consumption of perquisites by managers readily reduces profits, exposing managers to the possibility of removal and the market for corporate control.[98] Although managerial entrenchment applies in the presence of a controller, other aspects of product market competition could also act as a monitoring mechanism that inhibits the extraction of controller benefits.[99] Firstly, if controllers extract substantial pecuniary controller benefits, it is possible that the quality of the firm's products will suffer, leading to a loss of market share and diminishing firm performance[100] (thereby reducing the value of the controller's equity stake). In extreme cases, the threat of insolvent liquidation can discipline not only managers of dispersed-ownership firms, but also controlling shareholders. Second, if controlling shareholders regularly and egregiously expropriate minority shareholders, this could cause a reputational issue making it more difficult for the firm to contract with third party suppliers and customers.[101] Third, increased product market competition increases the verifiability and transparency of prices, making it more difficult for controlling shareholders to extract resources by way of manipulated accounting without legal or reputational consequences.[102] However, the vigour of product market constraints may be stifled in WVR-firms as the Wedge increases, since the controller will be less concerned as to firm performance issues from a wealth perspective if that controller is diversified and has only a small percentage of its wealth invested in the equity of the firm. Nevertheless, although not related to pure monitoring or constraints, in competitive markets, the opportunities for expropriation may be less, since free cash-flow from which the controller can extract is less than in monopolistic markets.[103] The extraction of controller benefits by WVR-controllers should, therefore, be less in jurisdictions where product market competition is strong, and empirical evidence has suggested this to be the case.[104]

Interplay between Market Forces and Voluntary Constraints

Market forces can also influence the voluntary implementation by controllers of other constraints on their behaviour. By voluntarily implementing structural constraining mechanisms, the market may view the ownership structure more favourably, and, therefore, the cost of capital may be reduced. Those structural constraints may also smooth the firm's path toward debt financing, and instil greater trust in the product markets. In the US, some WVR-firms have, as noted in Chapter 6, voluntarily implemented inferior-shareholder protections that result in the structure reverting to OSOV upon the occurrence of certain events,

[97] M. Roe, 'Rents and Their Corporate Consequences' (2001) 53 *Stan. L. Rev.* 1463, 1468.
[98] Ibid 1473.
[99] Dyck and Zingales (2004) (n 72 Chapter 3 539).
[100] Ibid 577.
[101] Holderness and Sheehan (2000) (n 22 above 152); Gilson (2007) (n 145 Chapter 3 648) - although the author noted that this mechanism is dependent upon a strong financial press to report behaviour, and acknowledged that there is nothing to suggest that behaviours vis-à-vis minority shareholders are more effectively disclosed and communicated than simply the quality of the firm's products and behaviours directly toward suppliers and customers.
[102] n 99 above 576.
[103] n 97 above 1468; Maher and Anderson (1999) (n 95 Chapter 1 26).
[104] n 99 above 582 (equating strength of competition laws to strength of product market discipline). Conversely, though, it has also been noted that minority shareholders will be more concerned about controller benefit extraction in competitive product markets, since the total value of the 'pie' to share is smaller than in a monopolistic market (n 97 above 1489).

even though the provisions are not strictly required by law or regulation. This is an example of market forces in action, since the voluntary adoption of the relevant provisions can signal to investors that the firm is likely to sit on the net-beneficial side of the WVR-tradeoff,[105] which will attract investors, and reduce the firm's cost of capital.

4. Psychological Constraints

In Chapter 3, the extraction of non-pecuniary controller benefits was identified as a potential hazard to inferior-shareholders. However, those same controller benefits can also form constraints around more extreme pecuniary controller benefits. For example, even if, as above, the effectiveness of market constraints may be blunted in WVR-firms, a controller may otherwise be psychologically incentivised to maintain a good reputation if it values the fame and prestige garnered through controlling a high-profile company that could be lost if the controller becomes known for excessively expropriating the inferior-shareholders or leading the company into a precarious financial position. It has also been noted that reputation can bear heavily on the decisions of family firms, since the controller will be seeking to preserve the reputation and legacy of the family-name as well as his/her own reputation.[106] The presumed reputational constraints on family firms can give those firms a business advantage in jurisdictions with weak investor protection and commercial laws.[107]

Additional 'psychological' mechanisms that could reduce controller benefit extraction are public opinion and social norms.[108] Increased disclosure of egregious behaviour can constrain such behaviour through public outrage;[109] and social or moral norms in a country can constrain controllers on the basis that expropriative behaviour is simply not acceptable in the moral climate of the relevant jurisdiction. When assessing the constraints on controller benefits in particular jurisdictions, such psychological constraints should not be overlooked.[110] The UK enjoys independent, extensive media coverage and a well-developed financial press, which will reinforce psychological constraints of this nature.

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[105] The 'market for lemons' problem expressed in Chapter 4 (n 289 Chapter 4, and accompanying text) can be mitigated through such signalling mechanisms (n 160 Chapter 1 164).

[106] Flocos (1989-90) (n 6 Chapter 3 1777); Holderness and Sheehan (2000) (n 22 above 151); Gilson (2007) (n 101 above 643). However, R. Pollak, 'A Transaction Cost Approach to Families and Households' (1985) 23 *J. Econ. Lit.* 581, 587 cast doubt on whether reputation would be an effective constraining mechanism (other than in the case of gross expropriation or malfeasance) on individual family-member managers, since the family would not, in effect, ostracise a family member for mere shirking, slack performance or minor infractions.

[107] Gilson (2007) (n 101 above 643).

[108] n 99 above 539.

[109] See: n 40 Chapter 3.

[110] For example, M. Holmén and J. Knopf, 'Minority Shareholder Protections and the Private Benefits of Control for Swedish Mergers' (2004) 39 *J. Financial Quant. Anal.* 167, 168 found that although Sweden has poor corporate governance laws, the levels of expropriation by controlling shareholders is low – this was hypothesised to be as a result of the existence of extralegal institutions. Consistent with this, Sweden rates very low for crime rates (a suspected proxy for social norms - J. Coffee, Jr., 'Do Norms Matter?: A Cross-Country Examination of the Private Benefits of Control' (2001) *Columbia Law School, The Center for Law and Economic Studies, Working Paper* No. 183 2151, 2153), and is fifth in the world for newspaper circulation (a proxy for public opinion - n 99 above 577).

5. Conclusion

A plethora of legal and regulatory requirements exist in the UK, some of which have been specifically formulated to constrain the acts of controlling shareholders generally, and could, therefore, potentially constrain the acts of WVR-controllers. Although certain of the rules are generally applicable, a sub-set is only applicable to premium-listed companies, emphasising the greater levels of corporate governance expected of those firms. Even absent the legal and regulatory constraints, a WVR-controller would not have a free-hand to act nefariously. A variety of market and psychological constraints also potentially constrain behaviour. However, the potency of market constraints in WVR-firms will be diluted to an extent by the diminution of the controller's equity restraint. The lack of the constraining effect of a significant equity holding (as would subsist in a OSOV-controlling shareholder firm) can create a hole in the package of constraints that protects public shareholders, and therefore the flaws and lacunae evident in the legal and regulatory protections identified in this Chapter become more critical. In this light, the next Chapter will assess other possible types of constraints that could bolster the package. However, as alluded to previously in this thesis, and as emphasised in the next Chapter, any such constraints must be constructed with caution, since shifting the WVR-tradeoff into positive territory can not come at the cost of eliminating all the controller benefits that would otherwise encourage a founder to list with WVR-structure.

CHAPTER 6:
THE BALANCED PROTECTION PACKAGE

1. Introduction

In the previous Chapter the existing constraints on controllers that could protect inferior-shareholders were expounded. It was noted that certain flaws in the legal and regulatory environment exist, and that market forces are progressively dented as the Wedge increases. In this Chapter, a number of possible other forms of inferior-shareholder protection will be critically discussed, with a view to recommending an inferior-shareholder protection package for the UK if it were to relax its prohibition of WVR-firms from the premium-tier. A discussion of minority protections is critical in any consideration of WVR-structure, since it could be contended that OSOV is a pivotal restriction in jurisdictions where minority shareholder protections are weak, but where such protections are strong, an outright prohibition of WVR-structure unnecessarily precludes the benefits that WVR-structure can offer.[1] Any protections that are introduced must be adequate to guard against the most nefarious elements of controller benefit extraction, but, at the same time, not be so restrictive to prevent the extraction of all controller benefits. As iterated in Chapter 3, the WVR-tradeoff can be framed in the context of the categories of controller benefits, and, therefore, those controller benefits that are benign, whether pecuniary or non-pecuniary, should be encouraged, whilst even those that are mildly malevolent can be tolerated so long as the structure is overall beneficial. If all controller benefits were curtailed, the positive aspects of WVR-structure would be eliminated, and issuers would be discouraged from listing in the UK, making any such relaxation of the rules wholly worthless. As will be noted below, certain protections that eliminate, or reduce the risk of, pernicious controller benefit extraction, may be preferable from a theoretical or ideological basis, but they have not been proposed for adoption in the UK due to either intractable practical challenges in their real-world implementation,[2] or the danger that they will be so restrictive that issuers are unlikely to avail themselves of a relaxation of WVR-structure on the premium-tier.

Therefore, a proposal for a balanced protection package will be put forth and justified for premium-tier WVR-firms, that offers inferior-shareholders a degree of protection from actual and potential expropriation (such that the discounts that would otherwise be applied to WVR-firms will be significantly reduced), while creating an environment in which founders will be willing to list their firms with WVR-structure by retaining sufficient flexibility to allow controllers to manage companies in a manner that conforms to their long-term idiosyncratic visions.

2. The Rule-Making Challenge

A key challenge when formulating a package of investor protections is to determine the most effective manner of implementation. Rules could be implemented on: (i) a mandatory basis; (ii) a presumptive basis,

[1] For example: Lauterbach and Yafeh (2009) *(*n 97 Chapter 4 23); Cremers et al (2018) (n 76 Chapter 1 28); Winden (2018) (n 123 Chapter 2 909).
[2] In relation to the difficulties of the rule-making process, see: n 160 Chapter 1 285-291.

whereby default rules apply unless parties opt-out; or (iii) a permissive basis, whereby the rules only apply if parties opt-in.[3] In most cases, the presumptive approach will be advocated in this Chapter. It has been posited that the presumptive approach will generally be the most effective form of regulation, since parties save transaction costs by not having to formulate and negotiate a set of protections themselves in a scenario where they are widely accepted, but, invoking the no one-size-fits-all concept of corporations, parties can deviate when in their interests.[4] An example of presumptive rules in the context of protections, would be to require that the relevant protections be implemented unless the issuer (and therefore the controller) and investors (or at least a majority of public shareholders) agree. With WVR, in a way, such presumptive rules could be described as 'sticky default', or even pseudo-mandatory, rules since there is only a minimal chance that a majority of inferior-shareholders would waive their rights.[5]

Mandatory rules, however, do have an important part to play in particular circumstances, such as, for example, where the protection of third parties is vital[6] or where self-serving or ill-advised opt-outs are likely.[7] With WVR, if the relevant rules could be waived simply by the issuer, given the control that the issuer has over the constitutional documents of the company as of IPO, and the voting power of the superior-shareholders post-IPO, the chances of opportunistic opt-outs are high; therefore, in many cases, as described above, the presumptive rules outlined in this Chapter will be proposed on a pseudo-mandatory basis whereunder the relevant protections can only be waived if both the superior-shareholders and a majority of the inferior-shareholders agree. Disclosure requirements are also sometimes highlighted as an example of where mandatory rules may be germane, since the public may require information disclosure regarding a particular company in order to make salient decisions.[8] In the context of the investor protection package, disclosure is vital to give potential investors the information that they require to ascertain whether, to the extent that they have a choice, to invest in a WVR-firm. Mandatory rules also ensure conformity across the market,[9] which reduces transactional costs for institutional investors when analysing WVR-firms on a case-by-case basis.

To the other extreme, in the US, often the permissive approach is taken to WVR-investor protections. The permissive approach is particularly suited to fact-patterns where a minority of market participants desire to adopt certain rules, but do not do so due to legal uncertainties.[10] Permissive rules benefit such participants by confirming the validity of those rules, but save transaction costs for the majority of participants that would not desire to adopt them. In the US, as further described below, a number of WVR-firms do, voluntarily, implement sunset clauses which disassemble WVR-structure into OSOV when triggered; however, they are not particularly effective and can either allow controlling shareholders to maintain disproportionate control in perpetuity by avoiding the triggering of the clause, or result in the WVR-structure persisting long past its sell-

[3] Ibid 217-263.
[4] Ibid 259.
[5] A. Schwartz and R. Scott, 'The Common Law of Contract and the Default Rule Project' (2016) 102 *Va. Law Rev.* 1523, 1566.
[6] n 2 above 244.
[7] Ibid 242.
[8] Ibid 246.
[9] Z. Condon, 'A Snapshot of Dual-Class Share Structures in the Twenty-First Century: A Solution to Reconcile Shareholder Protections with Founder Autonomy' (2018) 68 *ELJ* 335, 363.
[10] n 2 above 250.

by date. They present a velour of altruism that, in reality, reflect the bare minimum limitations that should be implemented. In Canada, it was found that WVR-firms do not regularly establish substantial inferior-shareholder protections beyond those mandated by law.[11] Although, in Chapter 5, it was noted how market forces could influence the voluntary adoption of constaints,[12] it has also been modelled that asymmetric information present at the IPO-stage impedes the ability of the market to act as an effective constraint, meaning that, in the absence of presumptive or mandatory rules, efficient corporate governance arrangements are not voluntarily adopted by issuers.[13]

Reverting to the theoretical foundation, the permissive approach applies well to the concept of permitting WVR-firms on the premium-tier – by expressly confirming that such structures are permitted, the minority of issuers wishing to use such structures can do so – but in relation to investor protections, it is not clear that the balance of bargaining positions between all the players is sufficiently equal that they will be adopted voluntarily in cases where it is overall optimal to do so. *Caveat emptor* does not necessarily apply, since certain investors do not have any choice in entering into the relevant investment,[14] and even active investors may face what has been labelled a 'Hobson's choice',[15] where, in a competitive market between fund managers, investors will be reticent to miss-out on an investment in a company with potentially excellent growth prospects,[16] especially in a generally weak or small market for IPOs.[17] Notwithstanding the discounts that would be applied to WVR-firms, such potential investors should be further protected, with uniformly applicable mechanisms, from at least the risks of terminal expropriation, and, as a result, greater market confidence in WVR-firms will be instilled in the UK, as compared to an exchange where only a disparate group of WVR-firms voluntarily adopt the protections in a multiplicity of forms. Furthermore, the US-litigation culture and environment, as discussed further below, can act as a significant constraining mechanism on actions by controllers and thereby form a bedrock for the permissive approach, and in the absence of those constraints, a reliance on market forces becomes more imprudent. These considerations erode the justification for a purely permissive approach in the UK, and a rational argument therefore exists, particularly in the early stages of permitting WVR-structure in a jurisdiction, to regulate rather than anticipating that inferior-shareholder protections will organically be adopted as a result of market forces. Even in the US, some have suggested that the US should follow the approach of Hong Kong and Singapore and implement safeguards on a legislative basis.[18]

As such, a mixture of mandatory, presumptive and permissive rules may be appropriate. It is advocated that a presumptive approach be taken in most cases, since it gives institutional investors certainty that specific protections will be adopted, unless a majority of inferior-shareholders (and the controller) decline them (maintaining a degree of flexibility). Importantly, it should also have the effect of reducing

[11] Anand (2018) (n 253 Chapter 3 230).
[12] See: '*Interplay between Market Forces and Voluntary Constraints*' in Chapter 5.
[13] Bebchuk (2002) (n 76 Chapter 1 4).
[14] See: Chapter 1.
[15] ISS M&A Deal Note (North America), 'The Tragedy of the Dual Class Commons' (13 February 2012) 1, 1 <http://online.wsj.com/public/resources/documents/facebook0214.pdf>
[16] n 70 Chapter 3 1505; Winden (2018) (n 1 above 899).
[17] Anand (2018) (n 11 above).
[18] n 9 above 362-4.

discounts on inferior-shares across the board, since investors will be safe in the knowledge that all WVR-firms will incorporate the relevant protections unless public investors (or at least a majority of them) have determined that the risks inherent in dis-applying them are outweighed by the benefits. In some cases, the rules will be described in 'mandatory' terms, but with the ability of the FCA to waive the requirement in its discretion. No matter the approach, it is essential that any such protections are drafted such that they act as effectual restraints on controllers, but do not discourage beneficial listings nor unduly blunt the benefits that WVR-structure embraces.

Another challenge is determining what form rules should take – legislative, regulatory or soft-law. Legislative requirements, such as under the Companies Act 2006, benefit from statutory backing and legal enforcement, but, given that substance, can take a long time to develop, must be approved by Parliament, and will be subject to significant lobbying by interested parties.[19] Changes and amendments to legislation once on the books can similarly involve a protracted process, removing a level of flexibility in the rules to adapt nimbly to changing circumstances. The Companies Act 2006 also largely only applies to companies that have incorporated under the act in England and Wales; it is difficult to effectively draft legislation with extra-territorial applicability. Furthermore, since legislation has the full force of the law, it is imperative that it encompasses certainty without vagaries, and, therefore, covers as broad a set of scenarios as possible – trying to cover all bases can result in substantially complex and labyrinthine statutes. Soft-law, such as the UK CGC comply-or-explain regime, is the most flexible, and can provide broad rules with a great deal of leeway as to how companies implement them in practice. Although lobbying does occur, it is of a much lighter nature since issuers are able to deviate from the relevant rules so long as they explain why. A corollary, though, is that issuers may not take the rules as seriously, and, as discussed in Chapter 5, the efficacy of the comply-or-explain approach, particularly in the context of controlling shareholders, can be doubted. A happy medium is the use of regulatory rules that apply on a strict basis, but which are overseen by a regulator such as the FCA rather than comprising statutory law. Although new, and revisions to existing, regulations are usually preceded by consultation periods, the development time is far less protracted compared to statutory legislation, and the regulator has broad scope in the drafting and implementation of those rules. They do not enjoy the same strength of enforcement as statutory rules (although it should be noted that the FCA has statutory footing to enforce the Listing Rules), but can be regularly amended and refined over time. The Listing Rules are a good case-in-point,[20] and, since they relate to whether applicants will be admitted to the Main Market and the continuing requirements to remain admitted on the Main Market, they can encompass extra-territorial application.

Cognisant that many premium-listed companies are foreign-incorporated,[21] in the majority of cases, provisions will be implemented through the Listing Rules. As a condition of admission, the Listing Rules should specify that the FCA will expect that the constitutional documents of the relevant WVR-issuer will

[19] n 2 above 178 *et seq*.
[20] Since 1966, there have been dozens of versions of the Listing Rules (previously known as 'Admission of Securities to Quotations' or 'Admission of Securities to Listing'), and hundreds of inter-version amendments. That can be compared to only three versions of the Companies Act being in force between 1948 and the date of this thesis.
[21] n 134 Chapter 1.

include relevant protective provisions, whether or not that issuer is locally- or foreign-registered.[22] The provisions would need to remain in those constitutional documents, and complied with, in order to maintain a premium-listing.[23] Breach of the relevant protective provision would result in breach of the constitutional documents of the company, which could, presumably, create rights of claim in the relevant jurisdiction for shareholders,[24] and breach of the Listing Rules (which would allow the FCA to take administrative action).[25] The breach may also result in a contractual breach of the relationship agreement which must, under the Listing Rules, be mandatorily entered into between the controlling shareholder and the company.[26] Hong Kong, a jurisdiction with a significant number of listed foreign-incorporated companies,[27] has taken a similar approach to extra-territorial factors, requiring listed-companies to replicate numerous Hong Kong-specific regulatory requirements in their constitutional documents as a condition of listing.[28] The relevant UK-requirements should, generally, be included in a separate chapter of the Listing Rules that is only applicable to premium-listed WVR-firms, so as not to be confused with requirements that would be applicable to all (including WVR) firms. The concept of applying different listing rules to different types of companies is not novel. The Listing Rules already incorporate exclusions, exceptions and specific requirements for closed-ended investment funds,[29] open-ended investment companies,[30] and sovereign-controlled commercial companies.[31]

The role of the FCA in exercising 'primary market functions'[32] will be critical. As above, it will be suggested that many of the protective measures should be implemented through Listing Rules that require the relevant provisions to be incorporated in the applicant's constitutional documents. The FCA is already able to request copies of an applicant's constitutional documents for review.[33] With the proposed protection package, the FCA may determine that it will need to review constitutional documents of WVR-applicants in more detail – alternatively, the FCA may take a looser approach, as it does in relation to many of the current requirements, and merely require that the applicant's sponsor confirm that the constitutional documents of the applicant include the necessary provisions. The latter approach may alleviate the burden on the FCA, and is justifiable since the sponsor will be under a reputational and regulatory obligation to ensure compliance.[34] The issuer itself will also be eager to avoid the consequences of breaches.[35] Where it is proposed that the FCA retain discretion to waive what would otherwise be 'mandatory' requirements, this will impose a burden on the FCA, but it parallels the FCA's approach to the free-float rules, which can, and has, been waived for

[22] As an addition to LR Chapter 6. See, for example: LR 6.9.1
[23] As an addition to LR Chapter 9.
[24] Under English law, a breach of a company's articles will create a right of claim in favour of a shareholder if the relevant breach affects the shareholder in its capacity as a member (*Hickman v Kent or Romney Marsh Sheepbreeders Association* [1915] 1 Ch. 881; *Beattie v E. F. Beattie Ltd.* [1938] Ch. 708).
[25] n 42 Chapter 5.
[26] n 58 Chapter 5, and accompanying text.
[27] *A Financial Centre for Two Empires*, ed. D. Donald (Cambridge: Cambridge University Press (2014)) at 58 and 101) – as of 2014, only 13% of HKEX-listed companies were Hong Kong-incorporated.
[28] Ibid 103.
[29] Chapter 15 of the Listing Rules.
[30] Chapter 16 of the Listing Rules.
[31] Chapter 21 of the Listing Rules; also see: n 37 Chapter 5.
[32] n 108 Chapter 1.
[33] LR 3.3.7.
[34] n 39 Chapter 5, and accompanying text.
[35] nn 25-26 above, and accompanying text.

controlling shareholder firms.[36] The FCA should therefore be familiar with such a 'waiver process'. Additionally, it will be advocated that the FCA plays a discretionary role in whether to admit WVR-firms to the premium-tier on a case-by-case basis, grounded upon broad firm and controller qualities. It is acknowledged that the current expertise and resources of the FCA may need to be enriched. However, the FCA already, to an extent, takes this approach to admissions, since it already confirms eligibility requirements (in coordination with the firm's sponsor) and reviews prospectus documents.[37] The UK Listing Authority, historically, always had the discretion as to whether to admit applicants, as evidenced by its previous informal resistance to the listing of WVR-firms.[38] Listing authorities in other jurisdictions, such as Hong Kong, Singapore and Tokyo have taken a similar discretionary approach to WVR-firms (as discussed below), and it is hereby submitted that in a competitive environment for listings, a mature and developed market like the LSE should be able to boast a regulator that is able to opine on admissions in the same way as in those other jurisdictions. The extra costs and resources required are a small price to pay to enable WVR-premium-tier listings in a sensible manner, and, potentially, as discussed in Chapter 1, support the growth of tech-companies in the UK.

3. What's Not Proposed

In a variation of a political theme: 'they know what they do not want, but not what they want', this Chapter will first define what this thesis does not propose, before outlining what it does. Although the US embraces a permissive environment for WVR-firms with little in the way of regulatory interference, it benefits from a litigious environment that is friendly to plaintiff shareholders wishing to instigate claims against directors and controlling shareholders. No matter the merits of such claims, the ease with which they can be made can act as a deterrent to excessive controller benefit extraction; a point made by Hong Kong and Singapore academics when considering the admission of WVR-firms to the exchanges prior to the recent relaxations on those jurisdictions.[39] In the UK, 'loser-pay' rules[40] can have a chilling effect on litigation in the corporate sphere, especially where remedies flow to the company rather than the shareholder bringing and funding the relevant claim.[41] In addition, while contingency-fee arrangements, which are effectively no-win, no-fee constructs where the lawyer receives a percentage of the award if successful, have been permitted in the UK since 2013, they have not, yet, become as all-pervasive as in the US where law firms are more likely to offer clients such fee structures. Finally, the litigious culture in the US is fuelled by generous plaintiff's lawyer awards,[42] and opt-out class action suits pursuant to which one or more members of a class may sue or be sued

[36] n 93 Chapter 2.
[37] LRs 3.3.1 and 3.3.3.
[38] See: Chapter 2.
[39] For example, Chan and Ho (2014) (n 63 Chapter 1 16); Lan and U. Varottil (2015) (n 66 Chapter 3 589); HKEX Concept Paper (2014) (n 125 Chapter 3 Appendix V, V-I); SGX Consultation Paper (2017) (n 128 Chapter 3 8); J. Ho, 'Revisiting the viability to allow dual-class share structure companies to list in the financial market of Hong Kong' (2018) 1, 30 <https://ssrn.com/abstract=3167695>; Ho (2019) (n 34 Chapter 1 15).
[40] Civil Procedure Rules (CPR), Rule 44.2(2)(a).
[41] nn 14, 19-20 Chapter 5, and accompanying text.
[42] In the US, it has become common for the plaintiff's lawyer to be awarded attorney fees upon either a judgment or a settlement if there is 'substantial or common benefit' to the corporation (M. Loewenstein, 'Shareholder Derivative Litigation and Corporate Governance' (1999) 24 *Del. J. Corp. L.* 1, 2); 'substantial benefit' has been loosely defined, and often the fees awarded are

as representative parties on behalf of all members.[43] In the UK, class-actions (outside the competition law arena[44]) are severely limited, and are, generally, commenced as 'group litigation orders' (GLOs),[45] which requires claimants to initially commence individual claims,[46] and 'opt-in' to the GLO.[47]

Focused changes to the civil procedural rules in the UK could lead to a more US-style litigation system that could provide investor-shareholders with *ex post* remedies, and deter controllers from pernicious expropriation. However, this represents a sledgehammer to crack a nut. A wholesale change in civil procedure will not just affect the corporate dynamic, but could result in unintended consequences throughout society. There does not appear to be an appetite in the UK to open the door toward the opportunistic litigation that characterises the US. Even with a discrete change affecting corporate litigation only, the UK-corporate market would need to be prepared for a step-change in corporate culture. The deterrent-effect may also be overstated, since, with respect to directors' duties, the directors will not be overly concerned about personal liability if covered by company indemnities and/or third party D&O insurance. It is therefore not proposed that civil procedure rules be modified.

Additionally, in Delaware, controlling shareholders owe a limited form of fiduciary duty to the company and the minority shareholders,[48] which manifests itself in the requirement of an entire fairness review of related-party transactions. Commentators have, though, raised the prospect that, for WVR-firms, the Courts should move beyond assessing fairness of procedure for self-dealing transactions to assessing substantive fairness,[49] even in relation to operational decisions.[50] However, requiring the Courts to discern whether a transaction is substantively fair in every case no matter the process taken in relation to the decision can be onerous, requiring significant resource and expense to be incurred.[51] Even in the US, it has been suggested that, although perhaps doctrinally persuasive, the Courts have little appetite to second-guess business decisions, and are not well-placed to do so.[52] In any event, in the UK, even simply extending fiduciary duties to the controlling shareholder may not be particularly effective. For example, if the duty is only owed to the company, shareholders may be impeded by some of the same challenges that face dispersed-shareholders in enforcing directors' duties.[53] If the duty was owed directly to shareholders, the

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substantial compared to the actual benefit derived by the corporation (for example, in the 1996 case of *In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), where a fairly weak derivative claim was settled pursuant to which the board merely agreed to make modest corporate governance changes and no monetary relief was awarded, the plaintiff's attorneys were awarded $816,000 (and $53,000 in expenses) (ibid 5)).

[43] US Federal Rules of Civil Procedure (2019 edition) (US Fed CP), Rule 23(a). Many States also have class action procedures similar to the federal rules (The Law Reform Commission of Hong Kong, 'Report: Class Actions' (May 2012) at 58).

[44] Since 2015, opt-out class actions are permitted for breaches of competition law in front of the Competition Appeal Tribunal (Consumer Right Act 2015, Schedule 8, Part 1).

[45] CPR, Rule 19.10.

[46] CPR, Practice Direction 19B, para. 6.1A.

[47] Ibid para. 6.2.

[48] *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987). The Courts have equated the role of controlling shareholders to that of the board due to the level of influence they exert over the company and the board, hence the imposition of fiduciary duties (*Abraham v. Emerson Radio Corp.*, 901 A.2d 751, 759 (Del. Ch. 2006)). The extent of the fiduciary duty owed by controlling shareholders is not clear, and case law generally only recognises the duty in the context of conflicted transactions (K. Berchem et al, 'Duties of Controlling Stockholders – Murky Waters: Tread Carefully' (2012) *Akin Gump Strauss Hauer & Feld LLP Articles* (June 2012) 1, 2.

[49] n 121 Chapter 1 1508.

[50] n 134 Chapter 3 5; n 129 Chapter 3 81.

[51] J. Rosenberg and A. Lewis-Reisen, 'Controlling-Shareholder Related-Party Transactions Under Delaware Law' (2017) *Harvard Law School Forum on Corporate Governance and Financial Regulation* (August 30, 2017) 1, 7.

[52] Ibid 6.

[53] nn 10-20 Chapter 5, and accompanying text.

benefits of making a claim may still be outweighed by the potential costs for small, dispersed inferior-shareholders, unless there were also a correlating change in legal procedure to mirror the more litigation-friendly environment found in the US, which is not contemplated by this thesis. Further, adapting current statutory rules and judicial interpretation solely for WVR-firms, including the general deference given by the Courts to operational decisions of managers,[54] is a protracted and complicated process that may take disproportionate effort until such time that WVR-firms become more prevalent on the exchange. Moreover, a critical theoretical issue is that not every business decision will be a 'slam-dunk'. The purpose of WVR-structure is to give the founder the space to think creatively, take risks, and engage in a long-term approach. If the Courts could intervene in decisions at any stage, a founder could be sanctioned for one poor decision amongst many profitable decisions, undermining the benefits of WVR-structure. Equally, if a decision is made with a long-term perspective, it is beyond credulity that the Courts would be able to evaluate whether that poor interim performance is indicative of poor decision-making or whether the relevant decision will 'come-good' in the end; one of the reasons that the founder is implementing WVR-structure may be due to the long-term prospects of the business not being easily observable by the markets.[55] A drastic change in jurisprudence to develop such a duty is therefore not proposed.

4. Restricting the use of WVR-Structure to Specific Firms or Controllers

Before discussing the inferior-shareholder protections that could be implemented once a WVR-firm has listed, thought should turn toward whether only certain types of firms or controllers should be permitted to adopt WVR-structure on the premium-tier.

Type of Firm Restrictions

The SSE only permits WVR-firms on a segment dedicated to science and technology firms (the STI Board).[56] Similarly, with a view to attracting high-growth, early-stage, innovative companies, HKEX initially proposed a separate board on which WVR-firms would be admitted,[57] – it would only be open to 'new economy' companies, being biotechnology, health care technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware, and storage and peripherals sector companies. HKEX had previously dismissed an industry-defined limitation on WVR-structure,[58] and, eventually, the proposal for a new board and the definition of 'new economy' was abandoned by HKEX. Instead, WVR-firms became eligible for admission to the main board, provided that HKEX deemed them to be suitable. The concern, based upon comments by consultation respondents was that 'innovation' was not unique to particular industries and that by restricting WVR-structure to limited industries, HKEX would just be pursuing the listing of those companies in relation to which it was facing competitive pressure.

[54] n 89 Chapter 3.
[55] See: Chapter 3.
[56] Ho (2019) (n 34 Chapter 1 26).
[57] HKEX Concept Paper (2017) (n 24 Chapter 1 26).
[58] HKEX, 'Consultation Conclusions to Concept Paper on Weighted Voting Rights' (June 2015) at 29.

Furthermore, the danger would exist that the relevant classification could be arbitrary and subjective, and create difficult issues for those companies that straddle a number of industries.[59]

Although, WVR-structure was not eventually restricted to particular industries in Hong Kong, in guidance, HKEX has stated that WVR-firms will only be suitable for listing if they are 'innovative' companies. The term 'innovative' requires a company to possess at least two of the following characteristics: (i) new and differentiated technologies or innovations; (ii) R&D being a major activity of the business; (iii) the company's success being attributable to unique features or intellectual property; and/or (iv) market capitalisation/intangible asset value being disproportionately large compared to tangible asset value.[60] The intention is therefore to attract innovative firms to the exclusion of those companies which would find it more difficult to justify the need for WVR-structure.[61]

Even a restriction of WVR-structure to specific characteristics, such as 'innovative', rather than industries, is not without its perils - HKEX noted the difficulties in defining 'innovative' and that innovation may not necessarily be restricted to technology-related industries.[62] Also, the premise underlying HKEX's decision to admit WVR-firms is a desire to attract high-growth firms,[63] but it is by no means clear that only 'innovative' companies are high-growth firms. For example, high-growth, early-stage companies in the media, sport and fashion industries could also benefit from WVR-structure, but these are not necessarily 'innovative' companies for the purposes of the eligibility requirements. On balance, though, HKEX has determined that some form of definition is required to prevent riskier WVR-firms from the 'old economy' listing in Hong Kong. However, it seems that the decision is still being driven by focusing on the types of industries in which the Hong Kong exchange is struggling to compete, rather than a substantive consideration of micro-financial and historical details of the companies applying for quotation that could signify them to be high-growth companies, for which, as discussed in Chapters 3 and 4, the WVR-tradeoff would more likely be shifted in a net-beneficial direction. Additionally, as acknowledged by HKEX, the categorisation of a firm being 'innovative' will change from industry-to-industry, market-to-market, and even over time.[64] The SGX has introduced more flexibility than HKEX to its admission criteria by, instead, focusing on the business model of the company (including evaluating whether the company has a long-term plan that predicts high-growth), its operating track record, the level of participation of sophisticated investors, and any other features of its that may be benefitted by WVR-structure.[65] The TSE has taken an even more accommodating stance, stating that firms with WVR-structure will be admitted to the extent that, after examination, the Japan Exchange Regulator (JPXR) determines that WVR-structure is appropriate and necessary in the 'common interest of shareholders',[66] and will not approve WVR-firm admissions purely on the rationale that the structure provides stability to family-ownership[67] or otherwise provides protection from takeovers.[68] A non-

[59] Ibid 29.
[60] HKEX Guidance Letter HKEX-GL93-18, 'Suitability for Listing with a WVR Structure' (April 2018), para. 4.2.
[61] n 57 above 23.
[62] Ibid 23.
[63] Ibid 13, 18 and 23.
[64] n 60 para. 4.2.
[65] SGX, 'Consultation Paper: Proposed Listing Framework for Dual Class Share Structures' (28 March 2018) at 2.
[66] Tokyo Stock Exchange, 'New Listing Guidebook: 1st and 2nd sections' (2018) at 142.
[67] Ibid 143.
[68] Ibid 146.

exhaustive list of considerations is provided including the need for WVR-structure in the context of the controller's record and business performance of the firm, the period over which there is a need for WVR-structure, and the opinions of the firm's board and auditors on the need for WVR-structure.[69] Given the potential shortcomings of Hong Kong's approach as expressed above, it will be proposed ('*UK Proposals*' below) that the UK follows the more flexible approach of SGX and TSE, but with a greater focus on the identity of the controller rather than the type of firm.

HKEX also imposes a higher minimum market capitalisation requirement for WVR-firms than OSOV-firms (which can satisfy alternative criteria involving much lower market capitalisation requirements).[70] It is not proposed that the LSE increase its market capitalisation threshold for WVR-firms,[71] since the size of the company is no guarantee that the benefits of the WVR-structure will outweigh the detriments (and empirical evidence in relation thereto is lacking), and a threshold of that nature would exclude young companies that would benefit from equity financing and prevent public shareholders from sharing in the future wealth of such companies from an early stage. The NYSE and NASDAQ, for instance, incorporate alternative minimum criteria options for the listing of OSOV- and WVR-firms, of which market capitalisation is just one. The size of a company would not offer assurances that inferior-shareholders would be treated fairly,[72] and, conversely, it can be argued that abuse by controllers of larger market capitalisation companies will have a greater impact on the market, as a result of such firms attracting a larger number of investors, and being more likely to be members of indices in which passive investors are required to invest.[73]

If the policy priority is to attract the listings of high-growth companies, WVR-structure could, instead, be restricted to high-growth firms, requiring that any applicant conforms to a pre-IPO quantitative growth-profile threshold. After all, to reiterate, it has been argued in Chapter 3 (as backed-up by some of the empirical evidence[74]) that the WVR-tradeoff is more likely to be net-beneficial for high-growth firms. However, such an approach would exclude companies which have a projected high growth-rate, which has not yet crystallised, and, in any case, further empirical evidence would be required to accurately determine the optimum growth-rate conducive to WVR-firm performance. Additionally, defining 'growth' satisfactorily for listing purposes would be challenging, and issuers could be incentivised to manipulate figures in order to satisfy the relevant threshold. Such a requirement is therefore also not proposed for the UK.

Type of Controller Restrictions

Another type of restriction could limit the types of persons who may own superior-shares at the time of IPO. For example, a restriction could be implemented such that WVR-structure will only be permitted if

[69] Ibid 143.
[70] HKEX requires WVR-firms to have a minimum capitalisation of HK$40 billion (or HK$10 billion with revenue of at least HK$1 billion in the last audited financial year).
[71] Currently, the minimum market capitalisation of shares being listed by an applicant to the Main Market is £700,000 (LR 2.2.7R).
[72] SFC: 'SFC Statement on the SEHK's draft proposal on weighted voting rights' (25 June 2015) <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69>
[73] Ibid.
[74] nn 130-134 Chapter 4.

the owner of the superior-shares is a founder, given that, as discussed in Chapter 3, the benefits of WVR-structure to companies and inferior-shareholders are most likely to be evinced where the structure permits a founder to follow its long-term strategy. However, the possibility exists that the founder will have long gone, and a new management team is in place. Therefore, a better restriction would be to ensure that only persons substantially involved in the day-to-day management, and integral to the success, of the company may own superior-shares at the time of the listing. This would exclude the possibility of corporate owners and early stage VC-investors retaining superior-shares upon listing, unless, unusually, they were involved in the day-to-day management of the company. HKEX, in its June 2017 concept paper, identified restrictions on the types of persons who can hold superior-shares as a potential inferior-shareholder protection mechanism, but, at the time, it was still considering whether to take a disclosure-based or a mandatory-restrictions approach to public shareholder protections.[75] In its final decision on WVR-structure, HKEX provided, as part of its suitability requirements, that holders of superior-shares must have an active executive role and directorship at the time of IPO,[76] and such holders must have also materially contributed to the growth of the business. Post-IPO, the holders of superior-shares must merely remain as board members.[77] Similarly, the SGX requires that the holders of superior-shares remain as, not necessarily executive, directors,[78] and in considering whether WVR-firms should be admitted, assesses the role, contribution to the success of the business, and level of active involvement in the business, of the proposed superior-shareholders.[79] The SSE's STI Board requires that any holder of superior-shares must have made a 'material contribution to the development or business growth' of the company, but need only have been a director prior to IPO and continue to be a director post-IPO.[80] JPXR will consider whether the knowledge and skills of the controller are essential to achieving the business plan of the company in the common interest of the shareholders, including the involvement of holders of superior-shares in business development, R&D and recruitment.[81] As below, concentrating on the identity of the superior-shareholders could be an effective inferior-shareholder protection in the UK.

UK Proposals

Turning to proposals for the UK. Although, as above, it would be overly-restrictive to limit WVR-structure to specific industries, it is clear from the normative analysis in Chapters 1 and 3, and, to a degree, from the empirical evidence in Chapter 4, that WVR-structure will at least likely be beneficial to certain types of firms more than others, and that certain firms will present greater risks that the detriments will shift the WVR-tradeoff into negative territory. Restrictions linked to the type of the firm, rather than its industry, could form an effective protection measure, but in developing a framework within which to assess such companies, it must not be so rigid that it excludes otherwise worthy companies, and, at the same time, not be

[75] n 57 above 35.
[76] n 60 above para. 4.5(a).
[77] HK Listing Rules, Rules 8A.11 and 8A.17.
[78] SGX Mainboard Rules, Rule 210(10).
[79] n 65 above.
[80] STI Board Rules, article 4.5.3.
[81] n 66 above 143.

so nebulous to cause market uncertainty. In discussing the Far East exchanges above, several criticisms were raised in introducing too much specificity. Therefore, as below, a broader, balanced approach is proposed whereunder any applicant should be required to justify to the FCA why the WVR-structure is conducive to the success of the company.

It is also propositioned that the FCA should assess WVR-firms based upon the identities of the proposed superior-shareholders. A key benefit of WVR-structure, and closely aligned with the discussion in Chapter 1 on encouraging founders of technology firms to list in the UK, is that it enables a controller to diversify its wealth and raise equity finance while retaining the control that allows the continued pursuit of its idiosyncratic vision and the taking of a long-term approach. Assuming that such idiosyncratic, long-term approach has contributed to the success of the company pre-IPO, the listing gives public shareholders the opportunity to share in future success. Similarly, a further benefit of WVR-structure is that it can bond the controller to the firm, and so, to the extent that the controller is integral to the success of the company, public shareholders can garner benefits from them and other stakeholders knowing that the controller is bonded to the firm. If the holder of superior-shares is not a person integral to the success of the company, many of the benefits to the public shareholders espoused in Chapter 3 of giving that person a privileged, insulated and entrenched position in the company fall-away. Similarly, from the perspective of the controller, it becomes less likely that only benign controller benefits will be extracted, since such a controller is unlikely to derive satisfaction from steering and leading a company in accordance with a vision if that vision is largely created and progressed by other individuals. With a lower likelihood that the controller is extracting benign or acceptable non-benign controller benefits, the motives of the controller to maintain control can be questioned. The risks increase that the controller benefits that will be extracted will be excessively pernicious, and the incentive on the controller to ensure that the firm is managed in a way that intensifies the potential benefits of the structure are limited. Thus, the FCA should appraise the contribution of the proposed superior-shareholders to the success of the company. Relatedly, the FCA should also consider carefully whether the proposed superior-shareholders have been subject to compliance or conduct issues in the past (for example, previous convictions or disqualifications as directors), since such aspects could portend future poor behaviour.

In summary, the FCA should specify listing criteria based upon characteristics that limit WVR-structure to those firms with lesser risks that the detriments of the structure will outweigh the benefits. As asserted by the WVR-tradeoff expressed in Chapter 3, whether a WVR-structure will be net-beneficial is a firm-specific factor, and it should therefore be incumbent on the FCA to assess whether an applicant is suitable to premium-list with WVR-structure. It is noted that normative considerations discussed in Chapters 1 and 3, and empirical evidence discussed in Chapter 4, suggest that WVR-structure may be especially beneficial to high-growth and innovative companies. However, if other types of company were able to persuasively justify the benefits of, and need for, WVR-structure, it would be capricious to refuse admission on the basis that the company does not conform to pre-existing strict definitions. Therefore, it is proposed that a flexible approach be promoted. Although this can create uncertainty for potential applicants, over time, the FCA can develop more comprehensive guidance with greater experience of the types of companies

applying to list with WVR-structure. Greater certainty could be achieved if the FCA were to publish decisions to admit or not to admit applicants, together with reasons, but such a practice could deter applicants from seeking admission, since a particularly scathing report could either prejudice the likelihood of the applicant being approved on another exchange, or, to the extent admitted on another exchange, diminish the success of the flotation. The FCA should, though, at least express the aspects that it will consider when assessing suitability for admission with WVR-structure. On that basis, the following broad factors should be considered by the FCA, and guidance should be provided to potential applicants in this regard:

- tracing the directors' duty under s.172 of CA 2006, the applicant must justify why the success of the company for the benefit of its members as a whole will be promoted by insulating the management team from the ability of the public shareholders to determine their composition through the use of WVR-structure – the business model, product-cycles, growth profile, observability of assets and long-term profitability, and projected business strategy will all be considered;
- the applicant must show a clean track record to-date, both in terms of compliance (to the extent that the company was subject to any regulatory requirements pre-IPO), and with respect to the conduct of the proposed superior-shareholders; and
- the applicant must show that the skills, knowledge and talent of the proposed superior-shareholders are integral to the future success of the business, as well as their contributions to the success of the business to-date.

A possible, looser, approach would be to require firms to simply disclose the three broad factors above at IPO rather than the FCA being required to consider them when making admission decisions. That would curtail the need for the FCA to enrich its experience-base, as acknowledged above.[82] However, the advantage of delegating the assessment to the FCA, rather than to, essentially, the potential investors in a disclosure-based approach, is that the process can be a back-and-forth, with the FCA requesting clarifications and further details to the extent that the proposed issuer has not provided sufficient information. A disclosure-based approach could develop into a boilerplate process providing little in the way of useful information to potential investors.[83]

Although requiring that the skills, knowledge and talent of the proposed superior-shareholders are integral to the future success of the business could exclude a subset of WVR-firms from premium-listings, at least in the initial stages of a relaxation of the rules, WVR-structure should be restricted to those firms to which the least risks of excessive pernicious controller benefit extraction attach. Such a proviso will also exclude many WVR-firms where the superior-shares are to be held by corporates (other than entities or trusts established by natural persons for tax-planning purposes).

Of course, applying the listing criteria at the time of admission is no guarantee that the state of affairs will not change post-IPO. For example, a superior-shareholder may transfer the superior-shares to another

[82] See: 'The Rule-Making Challenge' above.
[83] For example, the UK CGC has been accused of degenerating into a box-ticking, boilerplate disclosure-exercise (n 74 Chapter 5).

person, or a superior-shareholder may decide to play no further part in the business of the company going forward. Therefore, the listing criteria must be combined with other inferior-shareholder protections as outlined below.

5. As the Sun Sets in the West, it is Rising in the East – Inferior-Shareholder Protections

In contrast to the US, where, as discussed in Chapter 2, the attitude toward WVR-firms, particularly amongst institutional investors, has seemingly hardened in recent times, HKEX, SGX and TSE have all relaxed their rules to permit WVR-firms to list. However, looking deeper, in fact, the West and the East are coming to somewhat of a shared understanding as to the risks and opportunities presented by WVR-stock. The universal thinking seems to be shifting to an environment where WVR-stock is permitted subject to the employment of mechanisms that protect minority investors. The US has, albeit by way of voluntary adoption, focused mainly on investor protections that are triggered at a time after IPO and which result in superior-shares converting into inferior-shares (so called 'sunset' provisions). HKEX, SGX and TSE have, on the other hand, taken a mixed approach, partly adopting sunset provisions on a mandatory basis, but also prioritising the mandatory application of provisions that protect inferior-shareholders *ab initio*, effective and in force at the time of the IPO (so called 'sunrise' provisions[84]). Solely relying on sunset provisions does not provide limits on a controlling shareholder from expropriating inferior-shareholders during the WVR-structure period. Equally, only depending upon sunrise provisions does not appreciate the shifting nature of the WVR-tradeoff, and the possibility that the purposes for which the structure was implemented and the benefits of the structure may eventually dilute, leading to the WVR-tradeoff falling into a negative position over time or after the occurrence of specific circumstances. It is therefore proposed that the UK, in relaxing its rules on WVR-structure, implement sunset and sunrise elements. This thesis shall, therefore, assess the potential impact of sunset and sunrise provisions from a UK-perspective.

6. The Balanced Sunset Clause

The sunset clause is a term for a provision that removes, or dilutes, a right or power upon the occurrence of a pre-ordained event. In the context of WVR-firms, it relates to the dismantling of a WVR-structure back to OSOV upon the occurrence of a specified event. Although often used generically, sunsets clauses come in a variety of shapes and sizes. Below, presumptive-rules governing transfer-driven, director-linked and ownership-linked sunsets will be recommended, and the challenges making the imposition of other event-driven sunsets and time-dependent sunsets impractical will be outlined:

[84] While the term 'sunset' has been widely used in the literature, the term 'sunrise' is beginning to be used to describe initial provisions found and effective in the constitutional documents of WVR-companies at the time of IPO (for example: Winden (2018) (n 1 above)).

Time-Dependent Sunsets

Perhaps the most basic type of sunset clause is one that is triggered upon the expiry of a period of time.[85] The constitutional documents of a WVR-firm may be drafted to provide that superior-shares (or all shares if non-voting shares have been issued) revert to OSOV a certain number of years after the IPO. Although time-dependent sunset clauses are rare,[86] they are topical, and the CII has lobbied the NYSE to mandate seven-year sunset clauses for companies listing with WVR-structure.[87] In some cases, the sunset clause may be subject to a vote of the inferior-shareholders, such that, usually at a time when the trigger of the clause is impending, a majority of the inferior-shareholders may waive the operation of the sunset clause for a successive period of time.[88]

The rationale for time-dependent sunsets is that the company requires a WVR-structure in the early years following an IPO to allow the controller to implement its vision for the company without fear of removal or other pressures from public shareholders if short-term profits are unexceptional.[89] As previously described, WVR-structure may be particularly beneficial to growth-phase companies. However, as the company matures, with product-cycles completing, and business plans and core activities becoming ingrained, the need for WVR-structure becomes less persuasive, and the opportunities for pernicious controller benefit extraction become more dominant,[90] particularly if the controller reduces its equity stake over time.[91] A sunset clause of this type gives the controller the ability to pursue its idiosyncratic vision in the early stages of the company's growth, but balances this against the rights of minority investors, giving them the comfort that at a specific time in the future, once the company has matured, they will possess equivalent voting rights that allow them to potentially, depending upon the equity stake of the erstwhile controller, determine the composition of the board, and therefore the management team.

The study by Cremers et al (2018) summarised in Chapter 4 is often put forth as justification for the use of time-dependent sunset clauses. To recap, the authors found that, on average, WVR-firms displayed a valuation premium over single-class firms at IPO, but the premium eroded over time, to the extent that it became insignificantly negative six to nine years after the IPO.[92] Kim and Michaely (2018)[93] also found that although young WVR-firms (less than 12 years-old) trade at a premium to, and are at least as efficient as, young OSOV-firms, mature WVR-firms demonstrate lower valuations, operating margins, labour productivity and pace of innovation compared to mature OSOV-firms. Additionally, in a recent speech, a

[85] Daniels and Halpern (1996) (n 66 Chapter 2 58).
[86] In the US and Canada, time-dependent sunset clauses are rare – (i) out of 139 WVR-firms from a sample of pre-2000 IPO S&P 500, S&P 400 and Russell-1000 stocks, and post-2000 IPO S&P 600 and Russell-2000 stock, only 25 had time-dependent sunsets (although there has been a significant increase since 2009) (Winden (2018) (n 1 above 870)); and (ii) out of 85 WVR-firms listed on the TSX as of 2015, 41 had sunset clauses, but only two included time-dependent sunsets (Anand (2018) (n 11 above 228).
[87] CII Letter to E. King, Chief Regulatory Officer, International Exchange Inc. (24 October 2018) <https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024_NYSE_Petition_on_Multiclass_Sunsets_FINAL.pdf> The lobbying may have had a market-driven effect, since, in 2017, 6 out of 23, and, in 2018, 5 out of 15, WVR-firm IPOs included time-dependent sunsets (CII (2019) (n 38 Chapter 1)).
[88] Helene Curtis Industries Inc. is an example of a US WVR-firm with a time-dependent sunset that is renewable every five years (Winden (2018) (n 1 above 872)).
[89] See: '*Long-Termism*' in Chapter 3.
[90] n 23 Chapter 1 605.
[91] Ibid 608.
[92] Cremers 2018 (n 1 above 30).
[93] n 49 Chapter 3.

commissioner of the SEC presented findings (albeit preliminary and non-peer-reviewed) that at IPO, and for two years thereafter, companies with and without sunset provisions showed similar valuation, but that seven or more years after IPO, those companies without sunset provisions traded at a significant discount to those with sunset provisions (which were presumably triggered in some cases).[94] However, caution should be applied to the empirical evidence. Firstly, the empirical evidence supporting time-dependent sunset clauses has been challenged on the basis that sufficient time has not passed to fulfil a thorough examination of modern WVR-structure, particularly in the technology sphere,[95] where WVR-firms are becoming increasingly prevalent.[96] Second, many aspects of the studies above examine firm value - as discussed in Chapter 4, firm value could simply reflect market sentiment rather than truly representing the actual performance of the relevant companies. Further research could more robustly investigate whether such changes in firm value over time are justified by operating performance. Finally, as discussed in Chapter 4, ascertaining causality is not simple, and the findings may not be a result of waning powers of the controller or increased controller benefit extraction, but simply due to the types of companies that choose WVR-structure – high-growth companies may be susceptible to more rapid deterioration over time.[97] Although some studies attempt to match WVR-firms to similar OSOV-firms, matching will never be perfect when sample-sizes are small and there are fundamental differences between the firms that choose WVR-structure and those that do not.

A key shortcoming of time-dependent sunsets is that the period is determined at IPO, and may be completely arbitrary in nature, and not reflect the optimum period of time.[98] The period may prove to be too long, with the detriments of WVR-structure outweighing the benefits long before the triggering of the clause, or it may prove to be too short, with the structure automatically falling away at a time when the company's long-term interests would be better served by the controller continuing to be able to direct its future with the freedom that WVR-structure presents.[99] The duration of the sunset is rarely born from a forensic examination of the characteristics of the company, such as maturity at IPO, age of the founder, or time required to bring products to the market.[100] In any case, it may be impossible at the time of an IPO to predict the exact point in time when the motivations of the founder will diverge from the interests of the inferior-shareholders.[101] Another potential drawback is that a forthcoming sunset expiry may amplify the incentives on the controller to extract controller benefits. The controller, fearing that the ability to extract significant controller benefits is soon to end, may determine that the rational course is to 'make hay while the Sun

[94] Commissioner Robert J. Jackson Jr. Speech, 'Perpetual Dual-Class Stock: The Case Against Corporate Royalty' (15 February 2018, San Francisco, California).
[95] Fisch and Solomon (2019) (n 263 Chapter 3 above 12).
[96] Figure 2 in Chapter 1.
[97] Loderer et al, 'Firm Rigidities and the Decline in Growth Opportunities' (2017) 63 *Manag. Sci.* 3000, 3005 - the authors find that Tobin's Q decreases with firm age, and speculate that this may be due to firms becoming more rigid over time, affecting their abilities to create, and take advantage of, growth opportunities - if the high valuation of high-growth companies is based upon imminent growth opportunities, the fall in Tobin's Q over time may be more acute as the firm becomes more rigid and less nimble, as compared to a firm that lists at a more mature stage with a robust and stable business.
[98] Winden (2018) (n 1 above 917); Lund (2019) (n 88 Chapter 1 739); n 95 above 16.
[99] Winden (2018) (ibid 917).
[100] n 95 above 17.
[101] Ibid 18.

shines'.[102] Time-dependent sunset clauses could also give large customers or strategic partners cause for concern that the protection of their close-relationships is only finite in time, attenuating one of the benefits for which WVR-structure was initially adopted.[103] Throughout the relationship, especially if the sunset duration is short, the counterparties may seek substitutes to the firm in the relevant business relationship, reducing the benefit that WVR-structure brings to the firm.

The weaknesses of time-dependent sunset clauses could, though, be mitigated. In relation to the sunset period being too long, there is an argument that in certain, more objective, circumstances, the sunset should be brought forward. This is further considered below in the context of other sunset clauses. In relation to the WVR-structure being unwound prematurely, as recommended by the Canadian Coalition for Good Governance (CCGG),[104] inferior-shareholders could be granted the right to vote in favour of extending the structure for a period after the initial sunset, if the structure is still beneficial.[105] The effectiveness of this mechanism can be questioned, though, since shareholders may not vote for an extension even though it represents the best course of action for the company[106] due to the almost principled apathy of institutional investors to WVR-structure (and the fact that individual institutional investors may value control[107]). Similarly, even though, at the time of the sunset-vote, the inferior-shareholders may be better informed as to the abilities of the founder and the direction of the company than they would have been at the time of IPO, commentators have suggested that public shareholders could be just as likely to take a short-term view at the time of the sunset-vote as they would in a OSOV-firm, and, therefore, not support the founder's long-term vision.[108] Additionally, as the sunset trigger approaches, short-term shareholders, such as activist hedge funds, may target the company and a potential windfall from a subsequent third-party takeover, banking upon the elimination of the WVR-structure, which removes the controlling shareholder's insulation from hostile takeovers.[109] If the shareholders of the company at the time of the sunset extension vote are mainly short-termist in nature, it is unlikely that the capital structure would be preserved, and this is a clear risk that may hinder the efficient operation of a voting mechanic to extend a sunset period. The potential, though, for a controlling shareholder to accelerate controller benefit extraction as the sunset closes-in, and, indeed, throughout the life of the WVR-structure, would be mitigated by the inclusion of an inferior-shareholder vote, since the controller will recognise that excessive extraction of pernicious controller benefits will discourage inferior-shareholders from voting to extend the sunset period (although, the danger then exists that the controller's primary focus will shift from its idiosyncratic vision to ensuring maintenance of the WVR-structure and, thus, control[110]). Texas Roadhouse Inc., MaxLinear, Inc. and Groupon are the only US-listed WVR-firms, as of the date of this thesis, with time-dependent sunset clauses that have expired.[111] All

[102] Cremers et al (2018) (n 1 above 40); n 93 above 28; ibid 18.
[103] In the context of takeover defences, generally: Johnson et al (2018) (n 146 Chapter 3 43).
[104] CCGG, 'Dual Class Share Policy' (September 2013) at 10.
[105] n 93 above 28; Anand (2018) (n 11 above 235).
[106] Cremers et al (2018) (n 1 above 41).
[107] n 95 above 19.
[108] Ibid 20; B. Sharfman, 'The Undesirability of Mandatory Time-Based Sunsets in Dual Class Share Structures: A Reply to Bebchuk and Kastiel' (2019) 93 *S. Cal. Law Rev. Postscript* 1, 9.
[109] Allaire (2018) (n 105 Chapter 4 18).
[110] Sharfman (2019) (n 108 above 9).
[111] CII, 'Companies with Time-Based Sunset Approaches to Dual-Class Stock' (February 2019) <https://www.cii.org/files/2-13-19 Time-based Sunsets.pdf>

of these firms were subject to automatic unification, unconditional on any shareholder vote. The share prices of Texas Roadhouse Inc. and MaxLinear, Inc. did not show any significant trend in the lead-up to unification, but, interestingly, the share price of Groupon plummeted in the lead-up to the unification in 2016. Of course, other business issues may have contributed to share price decline, but it is worth noting that share price has not recovered to pre-unification levels as of the date of this thesis.[112]

Overall, it is not proposed that time-dependent sunset clauses form part of the balanced protection package, and they should remain the preserve of voluntary adoption. Such sunset clauses are crude mechanisms, and, notwithstanding the empirical evidence, the WVR-tradeoff will shift into negative territory before or well-after any arbitrarily defined sunset time period. The turning-point will be firm-specific and will depend upon a variety of factors including the maturity of the company at IPO, the potential length of product-cycles, and the time horizons of the controller.[113] The proponents of time-dependent sunset clauses are attempting to create a proxy for other indicators that the WVR-structure has become net-detrimental. Time itself is not the relevant factor that blunts the benefits or amplifies the detriments, but rather specific qualities of the firm or controller are likely to change over time.[114] Harking back to the benefits of WVR-structure expounded in Chapter 3, over time, management teams may change, control may shift to different persons, the need for long-term relationships with specific customers or suppliers may recede, investment opportunities may decline, and the interest and skills of the founder may wane. All of these aspects are more likely to occur the longer the time that passes post-IPO, but it is not time *per se* that is causing firm performance to drop, and the time that it takes for those aspects to occur is very much firm-specific. A better formulated sunset protection, as further discussed below, would trigger upon events occurring that increase the risks that the structure will become net-detrimental or that materially change the terms on which the investors invested at the time of IPO. Such 'event-driven', including transfer-driven, director-linked and ownership-linked, sunsets are described below.

Transfer-Driven Sunsets

An alternative, or, sometimes, additional, type of sunset clause is one that is triggered upon the transfer of the superior-shares. As emphasised in Chapters 3 and 4, possibly the greatest influence on the WVR-tradeoff is the identity, nature and intentions of the controller. For those investors with freedom of choice, investors will have bought-into the founder's vision and would, perhaps reluctantly, be acquiescing to the WVR-structure on the basis that the founder, and not another person, has unadulterated control of the company, and they may well be investing on the basis of their assessment of the risks of expropriation by the individuals holding the superior-shares as of the date of IPO. If the primary contention in favour of WVR-structure is that it gives the founder the freedom to implement its long-term vision, the case falls away if the superior-shares are transferred to other persons, indicating a lack of commitment by the founder to his/her

[112] Historic share price data obtained from MarketWatch <https://www.marketwatch.com/>
[113] n 95 above 17.
[114] Johnson et al (2018) (n 103 above).

vision.[115] Therefore, it is proposed that the FCA should require the constitutional documents of WVR-applicants to include transfer-driven sunset clauses, such that any superior-shares transferred post-IPO should convert into inferior-shares, unless waived by a majority-vote of those holders of inferior-shares who do not also hold superior-shares (Independent Shareholders). In the US and Canada, it is not uncommon for WVR-firms to voluntarily adopt provisions in their constitutional documents that convert superior-shares to OSOV-shares if they are transferred by the initial superior-shareholders.[116] HKEX,[117] SGX,[118] TSE[119] and the SSE's STI,[120] require that WVR-shares automatically convert to OSOV-shares upon a transfer of those shares by the IPO-date holder.

The requirement for transfer-driven sunset clauses in the UK could be challenged on the basis that mandatory offer requirements apply under Rule 9 of the Takeover Code. Since transfer of control triggers a mandatory offer, inferior-shareholders who do not approve of the new controller can simply exit by accepting the mandatory offer by the new controller. However, transfer-driven sunset clauses would still serve a purpose where the Takeover Code does not apply. For example, the Takeover Code does not protect inferior-shareholders where, albeit rarely, the controller merely sells a proportion of the superior-shares such that no new controller, or group of connected controllers, acquires a greater than 30 per cent interest. In such a situation, the erstwhile controller could lose overall control of the company, with control being in the hands of a small, but unassociated, group of shareholders. The inferior-shareholders would still be in a position where they have no influence over the management team of the company, but that management team would now be selected by a group of shareholders, rather than the original controller in which the inferior-shareholders had placed their faith at the time of IPO. Family transfers could also be problematic, since gifts of shares that would result in a person acquiring more than 30 per cent of the voting rights in the company will not automatically trigger a mandatory offer – the Takeover Code specifies that the Takeover Panel should be consulted in such cases,[121] and even if the Takeover Panel were to demand a mandatory offer, it is not obvious what offer price would be stipulated. Therefore, transfer-driven sunset clauses are not redundant in the UK.

Various exceptions to transfer-driven sunsets are often included. For example, Google, Snap and Lyft include exceptions to their transfer-driven sunsets, permitting transfers between founders holding superior-shares as of the date of IPO, without the loss of privileged voting rights.[122] In Singapore, WVR-shares may be transferred with impunity between members of a permitted-holder group approved by the

[115] Winden (2018) (n 1 above 923).
[116] Facebook (Amended and Restated Certificate of Incorporation of Facebook, Inc. (adopted 20 June 2016) (Facebook Charter), Article IV, Section 3), Google (Amended and Restated Certificate of Incorporation of Alphabet Inc. (filed 2 October 2015) (Google Charter), Article IV, Section 2), Snap (Amended and Restated Certificate of Incorporation of Snap Inc. (filed 2 February 2017) (Snap Charter), Article V, section 6), and Lyft (Lyft Registration Statement at 196) implement provisions in their charters pursuant to which superior-shares will convert into inferior-shares upon transfers that are not 'permitted transfers'. In the US, transfer-driven sunset clauses have become more prevalent since Google's IPO, with only 20 out of 50 firms listing before Google including restrictions on transfers of superior-shares, and 70 out of 84 firms listing after Google including such restrictions (ibid 881). In Canada, such sunset clauses are the most prevalent type of sunset clause – 44.44% of the firms with sunset clauses in Anand's sample included transfer-driven sunset clauses (Anand (2018) (n 11 above 227).
[117] n 77 above, Rule 8A.18.
[118] n 78 above, Rule 210(10).
[119] n 66 above 145.
[120] n 80 above, article 4.5.10.
[121] Note 12 to Rule 9.1 of the Takeover Code.
[122] Google Charter, Section 2(f)(5)(iii)(1); Snap Charter, Article V, section 1.14; Lyft Registration Statement at 196.

listing authority pre-IPO, and the TSE has indicated in guidance that it would be amenable to exemptions relating to transfers between existing superior-shareholders.[123] Although the centre of power between those superior-shareholders could therefore shift over time, at least at the time of IPO, the investors can assess the finite possibilities of controllers in the WVR-structure over the lifetime of the structure (and, to the extent that the Takeover Code applies, the inferior-shareholders could still enjoy a certain level of further protection through operation of mandatory-offer rules as discussed below[124]). With multiple superior-shareholders, the ability to transfer superior-shares between themselves without loss of voting-rights may be important to fairly balance voting rights between the superior-shareholders when one superior-shareholder desires to sell shares to another, and it is proposed that such an exception should be incorporated in the UK. Exceptions for transfers to entities or trusts associated with the founder which may assist the founder from a tax-planning perspective are also acceptable,[125] although the superior-rights should not be protected unless the relevant entity or trust is fully controlled by the original founder. For example, Google and Snap permit unencumbered transfers to associated trusts and retirement plans, as well as entities controlled by transferors, and Lyft similarly permits transfers relating to estate planning and to charitable trusts to the extent that voting control remains in the hands of a founder or his spouse.[126] HKEX incorporates a similar exception which could be mirrored by the UK.[127] In the rare cases where the listing criteria permit a corporate superior-shareholder, that shareholder could also be permitted to transfer superior-shares to a parent, subsidiary or entity under common control (although any change of control of the superior-shareholder should trigger the sunset clause).

Other, more generous exceptions that are sometimes adopted in the US and Canada, could run a cart-and-horses through the relevant protection, and are not recommended. For instance, some US WVR-firms, including Viacom Inc. and CBS (the governance of which has attracted a great deal of controversy in recent years[128]), include the unfettered ability to transfer superior-shares to founder family members. Although a founder may believe that a family member will be able to continue his/her legacy and vision, studies have shown that firm performance deteriorates when family members assume management from initial founders.[129] There is no guarantee that an entrenched family member will possess the skills and abilities of the original founder behind whom the public shareholders had placed their faith by investing in a WVR-structure.

The use of transfer-driven sunset clauses can enable a controller wishing to further diversify its wealth to sell superior-shares in the market while more easily maintaining control, since any such superior-shares sold will be converted into inferior-shares in the hands of other shareholders. On the flipside, an unintended consequence is that a controller selling superior-shares which automatically convert into OSOV, will see the proportion of its voting rights reduce at a slower rate than the proportion of its equity rights,

[123] n 66 above 159.
[124] See: '*Takeover Code*' below.
[125] Winden (2018) (n 1 above 882-884 and 927).
[126] Snap Charter, Article F, section 1; Google Charter, Article IV, section 2; Lyft Registration Statement at 196.
[127] n 77 above, Rule 8A.18(2).
[128] CFA Institute, 'Dual-Class Shares: The Good, The Bad and The Ugly (August 2018) at 88.
[129] nn 60-61 Chapter 3, and accompanying text.

resulting in the Wedge increasing.[130] If the founder lists the company holding superior-shares only, while retaining substantially greater than 50 per cent of the voting rights, potentially the founder could, with a transfer-driven sunset clause in operation, sell a significant portion of equity while remaining above the 50 per cent level to retain absolute control, and therefore increase the Wedge. A similar issue can transpire where a WVR-firm lists with a disparate group of investors holding all the superior-shares, but where the founders, at the time of IPO, do not hold effective voting control. The scenario emerged with the recent IPO of Pinterest, which implemented a capital structure including superior-shares with 20 votes-per-share, OSOV inferior-shares, and a transfer-driven sunset clause.[131] At the time of IPO, the founders held 13.4 per cent of the voting rights and 11.5 per cent of the cash flow rights[132] – therefore they did not hold effective control and the Wedge was not particularly severe. However, the other superior-shares were held by existing VC-investors in the firm. As noted by Bebchuk and Kastiel (2019), VC-investors operate within an investment horizon that requires them to liquidate their position within a relatively short period of time.[133] As the VC-investors exit their investments post-IPO, their superior-shares will convert into inferior-shares in the hands of the purchasers of those shares, thereby commensurately increasing the proportion of votes held by the founders who retain their superior-shares. It has been remarked that, as the VC-investors exit, the founders will be able to hold over 50 per cent of the voting rights while holding less than 5 per cent of the equity.[134] However, the consequences of the Wedge increasing could be mitigated by combining transfer-driven sunset clauses with ownership-linked sunset clauses as described below.[135] Even though voting-control could shift, as described above, at least the inferior-shareholders will know, at IPO, the entire universe of possible superior-shareholders who may hold control in the future. In any case, with the UK-listing criteria proposed,[136] it would be unlikely that VC-investors would hold superior-shares on the premium-tier.

A further unintended consequence, is that the superior-shares become more liquid, since the controller can sell those shares to a third party without that person procuring control over 30 per cent of the votes and triggering a mandatory offer; therefore the 'bonding benefits' of WVR-structure diminish.[137] However, the substantive benefits of transfer-driven sunset clauses outweigh their marginal effects on the bonding hypothesis – the economic incentives on the founder to exit are, in any case, low if it only holds a small proportion of the equity (and has already substantially crystallised its investment in the company), and if the founder exited the company, with a transfer-driven transfer clause in operation, at least the ability to determine the composition of the board would revert to all the shareholders acting as a collective.

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[130] By way of analogy: n 49 above 1485.
[131] Amendment No. 2 to Registration Statement of Pinterest, Inc. filed on 8 April 2019 at 182.
[132] Ibid 173.
[133] L. Bebchuk and K. Kastiel, 'The Perils of Pinterest's Dual-Class Structure' Harvard Law School Forum on Corporate Governance and Financial Regulation (10 April 2019) <https://corpgov.law.harvard.edu/2019/04/10/the-perils-of-pinterests-dual-class-structure>
[134] Ibid.
[135] Another mitigating mechanism is a transfer-driven sunset clause that converts all superior-shares to inferior-shares, but only triggers when control would otherwise be transferred to another person. However, such a clause could prejudice non-transferring superior-shareholders, and, as above, the rationale underlying the proposal for transfer-driven sunset clauses is that superior-shares should only be held by the initial superior-shareholders at IPO.
[136] See: '*UK Proposals*' above.
[137] See: Chapter 3.

Director-Linked Sunsets

As well as the transfer-driven sunset providing, subject to exceptions, that superior-shares will only retain their enhanced voting rights in the hands of the original holders, superior-rights could additionally be linked to continued involvement in the company as either a manager or a director.[138] After all, even though the UK-listing criteria proposed above requires that holders of superior-shares must, at the time of IPO, be integral to the success of the company, if, post-IPO, the relevant founder is no longer involved in the company, after, for instance, resignation or retirement as a manager or director, there is little justification for that person continuing to hold superior-rights in order to ensure the pursuit of his/her idiosyncratic vision. It would not be unreasonable for the inferior-shareholders to argue that their acceptance of WVR-structure is based upon their trust in the founder to be intrinsically involved in the strategy of the company. Also, as discussed in relation to the UK-listing criteria above, if the controller is not actively involved in the company, the likelihood that the WVR-structure is being maintained to extract pernicious controller benefits increases. It is therefore proposed that any holder of superior-shares of a premium-listed WVR-firm must continue to serve as a director of the company (or in the rare cases where the listing criteria permits a corporate superior-shareholder, that shareholder must ensure that it maintains a representative on the board). Pursuant to new Listing Rules, WVR-firm constitutional documents should require that upon termination of the relevant directorship (whether by resignation, retirement, removal, death or incapacity), the superior-shares of such person will convert to inferior-shares unless otherwise waived by majority-vote of the Independent Shareholders.

A nuance to this theme is whether a holder of superior-shares should also be required to be involved in the day-to-day management of the company and not merely remain as a non-executive director of the company post-IPO. However, the founder may still play a significant role in the prospects of the business, such as in a chairmanship role, after retiring from management, and, in the US and Canada, management-linked sunset clauses of this type are rare[139] (although death and incapacity sunsets have become more common in the US in recent years[140]). HKEX,[141] SGX[142] and SSE[143] all require that superior-shareholders have been actively involved in the management of the company pre-IPO, but, post-IPO, only require such a holder to remain as a, potentially non-executive, director of the company. TSE has taken a stricter approach, although drafted in flexible terms – if the WVR-structure has been implemented to ensure the continued involvement of a person in the management of the company, then the structure in its entirety will convert to

[138] Winden (2018) (n 1 above 878).
[139] Only three of the firms surveyed by Winden included sunset clauses where superior-rights are tied to continued employment (ibid 878). In Canada, slightly more firms – 4 of Anand's sample (7.41%) included such clauses (Anand (2018) (n 11 above 227). Facebook requires that all superior-shares be converted to inferior-shares if the founder resigns or is terminated for cause as an 'approved executive officer' (Facebook Charter, Article IV, section 3).
[140] Winden (2018) (ibid 875) – although only 5% of Winden's sample of WVR-firms listed before 2000 had death/incapacity sunset clauses, the number rose to 22% for firms listed in the first decade of the twenty-first century, and 57% in the second decade. For example, Google (Google Charter, Article IV, section 2), Snap (Snap Charter, Article V, sections 5 and 6), Facebook (Facebook Charter, Article IV, section 3), and Lyft (Lyft Registration Statement at 196) include death and/or disability sunsets.
[141] n 77 above, Rule 8A.11.
[142] n 78 above, Rule 210(10).
[143] n 80 above, article 4.5.3.

OSOV upon that person ceasing to be a director and manager within the company.[144] The rationale behind the more stringent approach is that although it is appreciated that a non-executive director, particularly the chair, could make a significant contribution to the strategy and vision of the company going forward, there is no assurance that such a non-executive would not in fact take a passive or *laissez-faire* role and delegate the pursuit of the company's vision to the management team and remainder of the board. In such a case, the presence of the superior-shareholder on the board serves little purpose and ingraining disproportionate control in that individual could allow the WVR-tradeoff to tilt into negative territory. However, there are theoretical and practical challenges to this approach. Such a requirement could lead to a founder, unwilling to relinquish control rights, being more likely to remain in a CEO-position well after his/her entrepreneurial talents have waned. Further, from a practical perspective, it will be close to impossible to formulate effective rules. Presumably, the basic requirement would be for the superior-shareholder to be party to an executive employment contract with the company. Definitional issues will pertain, though, as to whether a particular individual is in a position of sufficient seniority, and giving an individual a title does not guarantee substantive active involvement by that individual. The controller can have sufficient control over the board such that the board does not dismiss the controller from its 'management' role, even if that 'manager' takes a completely passive role within the company. Given the significant consequences attached to the determination (in effect the controller would lose control of the company), precision is required so that it can be made on an objective basis. As a practical point, framing that level of precision, whomever is charged with making that determination, whether it be the regulator or independent directors, would be extremely difficult to legally construct without the risk of them being challenged by controllers prejudiced by their application. Showing that the superior-shareholder was intrinsically involved in the management of the company pre-IPO is simpler to implement, since the FCA, in ascertaining whether an applicant should be admitted, would be acting upon historic evidence supplied by the issuer covering a substantial period of time. Post-IPO, although not ideal, given the practical hurdles, provisions should be restricted to requiring that superior-shareholders remain as directors rather than also as managers.

From a separate perspective, ensuring that any superior-shareholder is also a director does co-opt other protective measures. Such a shareholder would, in a company incorporated in England and Wales, be subject to the duties of directors as codified by statute.[145] Even with respect to a foreign company listed on the Main Market, at least in most jurisdictions, directors owe some sense of duty to their companies.[146]

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[144] n 66 above 144.
[145] See: Chapter 5.
[146] See, for example: Practical Law Company, 'Corporate Governance and Directors' Duties: Global Guide' <https://uk.practicallaw.thomsonreuters.com/Browse/Home/International/CorporateGovernanceandDirectorsDutiesGlobalGuide?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk> In relation to Hong Kong and Singapore, see: HKEX, 'Research Report: Listing Regime Reforms for Dual-Class Share Structure and biotech Industry - Summary' (April 2018); and n 65 above 5.

Ownership-Linked Sunsets

Another possible variety of sunset clause would be a provision that links the maintenance of superior-rights to the equity-ownership of the founder, limiting the extent of the Wedge.[147] The importance of such a sunset clause is emphasised when the controller owns both superior-shares and inferior-shares, giving the controller an enhanced opportunity to sell-down equity whilst retaining control.[148] The provision could operate either by a total reversion of the founder's shares to OSOV upon the founder selling down too much equity, or by converting only such proportion of the founder's superior-shares to inferior-shares to ensure that the minimum equity-to-voting ratio is maintained (although, in the latter case, the risk persists that the controller will be able to retain effective control, even though less than majority-control, while only holding a nominal equity-level). The reasoning is explained by the normative consideration that with less 'skin-in-the-game' the greater the incentives to extract pernicious controller benefits.[149] Google has implemented an ownership-linked sunset provision contractually – each founder has contractually agreed that he will not dispose of Class C non-voting stock to the extent that such disposal will result in him holding a greater number of Class B shares (voting stock with ten-votes-per-share) than Class C shares.[150] A breach of the agreement automatically results in the conversion of such portion of the founder's Class B stock to OSOV Class A stock that will ensure that he does not hold more Class B stock than Class C non-voting stock. The provision endures until the founders together hold less than 34 per cent of the voting rights in the company. The intention of the provision is to ensure that while the founders have effective control of the company, they are not able to excessively increase the Wedge.

Another technique to ensure that superior-shareholders possess sufficient skin-in-the-game is to require 'minimum voting ratios' to limit the ratio of 'votes-per-superior-share' to 'votes-per-inferior-share'. This measure is closely related to ownership-linked sunset clauses, but is a sunrise clause that is instigated *ab initio* at the time of IPO. By limiting the ratio in this way, a cap is set as to the size of the potential Wedge. For example, AMEX once provided,[151] and Hong Kong,[152] Singapore,[153] the SSE[154] and a number of European jurisdictions[155] currently provide, that they will not permit WVR-firms to list unless such ratio is no greater than 10:1, preventing a controller from being able to own more than 50 per cent of the votes without

[147] AMC includes provision such that all the superior-shares will convert to inferior-shares upon the controller (together with its affiliates) holding less than 30% of all the share capital in the company.
[148] Even if the controller only owns superior-shares at IPO, the scenario could emerge after a scrip dividend of inferior-shares to all shareholders post-IPO (n 49 above 1483). A UK public company can authorise the directors to allot further shares in the company by way of ordinary resolution (CA 2006, s.551) meaning that a controller with over 50% of the voting rights can authorise a *pro rata* distribution of inferior-shares).
[149] See: Chapter 3.
[150] Transfer Restriction Agreements dated 2 October 2015 (see: Form 8-K of Alphabet Inc. dated 2 October 2015).
[151] Seligman (1985-1986) (n 77 Chapter 2 705, fn 90).
[152] n 77 above, Rule 8A.10.
[153] n 78 above, Rule 210(10)(d).
[154] n 80 above, article 4.5.4.
[155] For example, Sweden, Denmark, Hungary and Switzerland (n 49 above 1505). In the Netherlands, the superior-shares can have a maximum of six (three if the capital is divided into less than 100 shares) votes-per-share; in France, the maximum votes-per-share is two; in Poland, prior to prohibiting WVR-structure in 2001, superior-shares could not possess more than five-votes-per-share; and in Hungary, the superior-shares may not form more than 50% of the share capital (Shearman & Sterling LLP, 'Proportionality Between Ownership and Control in EU Listed Companies: Comparative Legal Study' (18 May 2007) at 12).

at least 9.1 per cent of the equity.[156] In Canada, the CCGG has recommended that WVR-firms should require superior-shareholders to have a 'meaningful equity ownership stake', which will depend upon the context, but would generally constitute a ratio of no more than 4:1 (which would require the controller with 50 per cent of the voting rights to hold at least 20 per cent of the equity).[157] The CFA, a global association of investment professionals, has recommended a preferred ratio of 3:1, or, at most, 5:1.[158] Figure 4 shows how minimum voting ratios correspond to minimum levels of equity that a controller would have to retain to ensure majority-control.

However, it does not necessarily follow that a 10:1 ratio will result in the controller only holding 9.1 per cent of the equity. Indeed, the controller may voluntarily retain a greater level of equity, or may even be contractually required to continue to hold a certain level of equity, as is the case with Google. Equally, the controller may be content to hold effective control (below majority-control) and thereby able to hold less than 9.1 per cent of the equity. Therefore, rather than basing the protection on the potential Wedge, a more effective approach would be to tailor the provision to the equity actually held by the controller, which is the approach taken by ownership-linked sunset clauses – if the percentage of cash-flow rights held by the holders of superior-shares falls below a threshold, the WVR-structure converts to OSOV. Hong Kong, for example, also require that the holders of superior-shares hold at least 10 per cent of the cash-flow rights in the company.[159] Therefore, if a restriction were to be imposed on the size of the Wedge, it would be better, and sufficient, to solely tie this to the level of cash-flow rights actually held by the controller from time-to-time. Determining whether the relevant threshold represents sufficient 'skin-in-the-game' to constrain the controller from disregarding the interests of the inferior-shareholders, though, is a rather ethereal consideration. Albeit with a small sample-size, Bebchuk and Kastiel (2019) found that the vast majority of companies studied that implemented such sunset provisions permitted the original superior-shareholders to sell down their equity to 10 per cent or less before the clause would be triggered.[160] The authors intimate that the incentives to extract controller benefits are significant at levels higher than 10 per cent,[161] and, therefore, controllers can sell-down equity to a dangerous level, from the perspective of extraction incentives, without the superior-shares converting into inferior-shares. For example, the founders of Snap[162] and Zynga, Inc.[163] are able to reduce their equity stakes to 2.8 and 0.15 per cent, respectively, before the relevant sunset clauses are triggered. In Figure 1 in Chapter 1, it was shown that for the ten largest US-WVR-firms, equity ownership by the superior-shareholders had declined since IPO to an average of 11.6 per cent. Therefore, even if the Wedge is not large at IPO, unless an adequate ownership-linked sunset clause is included, the controller can increase the Wedge significantly over time. An ownership-linked sunset clause should be set at the appropriate level so as to not permit the Wedge becoming so stretched that the controller can extract

[156] n 49 above 1478.
[157] n 104 above at 8.
[158] n 128 above 64.
[159] n 77 above, Rule 8A.12.
[160] n 49 above 1490.
[161] Ibid 1490.
[162] Ibid 1456.
[163] Ibid 1479.

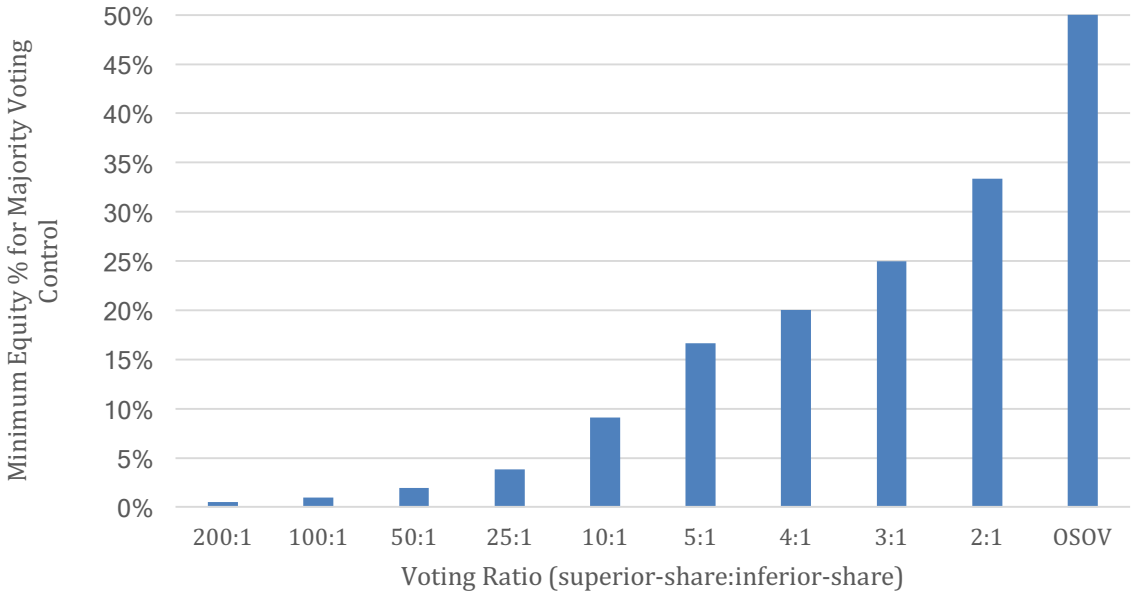


Figure 4 - Equity Ownership Required for Majority Control Varying by Voting Ratio

(*Author created*)

controller benefits without suffering sufficient equity-value pain, while at the same time not being so restrictive to prevent a controller from selling shares on the market in the future while retaining control (since such a restriction may discourage the founder from listing in the first place).

The market capitalisation of the company will be relevant - 10 per cent of a company with market capitalisation of £10 billion is obviously much more skin-in-the-game than 10 per cent of a company with market capitalisation of £1 million. HKEX has acknowledged this nuance by stating that the 10 per cent threshold may be lowered for companies with market capitalisation of HK$80 billion or more.[164] The extent to which an individual controller will be influenced by the threshold equity can also take on a more granular consideration – for example, if the controller has made substantial profits from the relevant company by significantly disposing of equity pre-IPO, and therefore possesses significant wealth, the equity threshold may have less impact on that controller compared to a controller crystallising its investment for the first time at IPO. Other business interests and investments of the controller may also be germane, and it becomes impossible to cover all bases when developing a brightline rule. Further complications are introduced by the fact that market capitalisation could vary over time. In particular, if the company were to undergo further, successive equity issuances in order to raise finance, the market capitalisation of the company would grow, yet the controller would still be required to hold the same threshold percentage of equity in order to prevent the sunset clause from triggering. Unlike Google's 'divestment' sunset clause, such 'dilution' sunset clauses could lead to a perverse incentive on the controller to pursue non-equity financing, such as debt, to avert a

[164] n 77 above, Rule 8A.12.

dilution of the controller's equity which could result in a loss of control upon the triggering of the sunset clause.[165]

These considerations make formulating a mandatory uniform *de minimis* equity holding challenging. Therefore, it is recommended that the FCA replicates its approach to the free-float rules.[166] The FCA should specify the relevant level required generally with a proviso that it can be lowered by the regulator on a case-by-case basis. Since the relevant threshold could be waived, it should be set relatively high, but not so high that issuers dismiss a premium-listing out-of-hand. It is hereby proposed that the minimum threshold be set at 20 per cent. Pertinently, as noted in Figure 1, few large US-WVR-firm superior-shareholders implemented a larger Wedge at the time of IPO, but, resonating with the concerns of Bebchuk and Kastiel above,[167] most have reduced their cash-flow rights to below 20 per cent post-IPO. The requirement would be imposed in the form of an ownership-linked sunset clause, such that the company will be required to implement provisions in its constitutional documents that automatically convert superior-shares to inferior-shares upon equity holdings falling below the relevant level, unless otherwise waived by a majority-vote of the Independent Shareholders. The restriction enforced on a particular WVR-firm should require the superior-shareholders to hold a specific proportion of the total equity as of IPO, based upon an estimated IPO-date monetary value, with the sunset clause triggering upon the relevant holder selling such number of shares that would result in it holding less than the number of shares corresponding to the relevant proportion of the IPO-date issued equity (as adjusted for future non-cash stock splits, bonus shares and reorganisations). This would therefore operate as a divestment sunset clause, and the superior-shareholders would not be subsequently disadvantaged by future cash-issuances of stock. In determining a waiver, the FCA would need to appreciate the balance between the mandated equity holding acting as a an adequate constraint over the actions of the controller, and not undermining the desire of a controller to crystallise value and diversify wealth, nor attenuating the long-termism benefits and the propensity for a controller to take risks and innovate. The FCA could assess evidence provided by the issuer relating to the expected market capitalisation of the company post-IPO and the existing wealth of the superior-shareholders. It is acknowledged that it would be likely that the FCA would, in most cases, lean toward lowering the minimum threshold and imposing an equity cap broadly equivalent to around 10 per cent cash-flow retention in order to remain competitive with the Hong Kong and Singapore markets, but, at least in theory, the FCA should consider applicants on a case-by-case basis. With multiple superior-shareholders, the FCA could also impose individual minimum thresholds for each superior-shareholder (which in aggregate would equal the total minimum threshold specified) so that triggering of the ownership-linked sunset clause should, in most cases, only result in conversion to inferior-shares of those superior-shares held by the relevant superior-shareholder.

[165] Yelp Inc. and Pure Storage Inc. are two US-listed companies which unified WVR-structure into OSOV as a result of dilution provisions (n 111 above; J. Aycock, 'Yelp caught in M&A chatter, up 2.6%; ends dual-class shares' *Seeking Alpha* (23 September 2016) <https://seekingalpha.com/news/3210618-yelp-caught-m-chatter-2_6-percent-ends-dual-class-shares>)
[166] n 93 Chapter 2.
[167] nn 160-161 above.

Other Event-Driven Sunsets

Transfer-driven, director-linked and ownership-linked sunset clauses are, in fact, subsets of event-driven sunset clauses, but sunset clauses could also be formulated such that they are triggered upon certain other events occurring. Some commentators have suggested that performance measures should be taken into account, such that superior-rights may be lost if, for example, profits, turnover or stock price remain depressed for an extended period of time,[168] or if the firm is consistently underperforming its industry peers over a period of five to ten years.[169] Such a sunset would flush-out those founders who do not add value through their idiosyncratic vision and have adopted WVR-structure primarily to expropriate inferior-shareholders.[170] However, formulating the relevant measures is easier said than done, and even if that could be accomplished, reducing the formula to robust regulatory language is challenging, and measures of accounting performance or turnover do not reflect the expropriation of inferior-shareholders after operating profits.[171] Stock performance or shareholder returns may be more appropriate measures, although the period over which any relevant decline should be assessed would be firm-specific. It may be impossible to categorically state that consistent industry-matched stock price declines over a period of, say, three years, is indicative of the WVR-tradeoff becoming negative in all cases. In some cases, it could merely be indicative of a company significantly investing in projects with horizons much greater than three years, the potential success of which is unobservable to the public shareholders. Another triggering event could be linked to a firm growth-rate threshold, since some empirical evidence, as discussed in Chapter 4, suggests that WVR-structure is more likely to be conducive to firm performance for high-growth firms, and it appears that pernicious controller benefits increase, as their growth slows down.[172] Measures such as low free cash-flow, sales-growth and high R&D intensity (all of which have been used as proxies for growth-rate, and correlated with better WVR-firm performance, in studies discussed in Chapter 4) could be used as indicators of growth-rate. However, the outstanding empirical evidence on such factors is not sufficiently substantial to develop specific thresholds. The onset of insolvency or the publication of qualified accounts have also been suggested as triggering events,[173] although, by that stage, it may be too late for the inferior-shareholders to take effective action. Chapter 4 also noted the tendency, in certain jurisdictions, for expropriation to be incentivised during periods of economic shock. It would be unfair, though, for event-based sunset clauses to be triggered on the basis of events occurring outside the control of the relevant controllers, but during such periods, further research could define whether there are clear financial indicators that WVR-controllers are extracting pernicious controller benefits. Ascertaining whether there are, generally, clear financial indicators prior to WVR-firms failing is the 'holy-grail' of sunset clauses, and further research would be welcome, but with the currently available evidence, it is difficult to recommend a form of mandated 'one-size-fits-all' event-driven sunset clause based upon financial measures. Additionally, such clauses would have to be

[168] Winden (2018) (n 1 above 928).
[169] n 6 Chapter 1 316.
[170] Ibid 316.
[171] However, as discussed in Chapter 4, the prospect of post-operating profit extraction by controllers is limited in a UK-regulatory context.
[172] n 93 above 24.
[173] M. Teen, 'Say 'no' to dual class shares' *The Business Times* (November 2015, Singapore).

drafted carefully to avoid pernicious incentives on the controller to engineer the finances in a manner that ensures that the performance-based provisions are not triggered,[174] and without greater certainty as to the relevant objective, measurable events, the ability of the controller to pursue a long-term vision could be undercut. Overall, therefore, it is not advocated that financial measure event-driven sunset clauses be regulatorily introduced in the UK.

It has also been suggested that inferior-shareholders could be protected if the superior-rights were lost upon the breach of fiduciary duty by the holder to the company or the shareholders.[175] In an English-law context, since shareholders do not, generally, owe any form of fiduciary duty to each other,[176] the clause would be triggered upon the breach of directors' duties – the clause would therefore only have teeth if the superior-shareholder were also a director, which would be the case with the imposition of director-linked sunset clauses as proposed above. There are obstacles to an approach based upon breach of director's duty. Firstly, shareholders would have to obtain a Court decision confirming the breach. Second, as set-out in Chapter 5, not only would the Court-process be time-consuming and potentially expensive, but shareholder incentive and motivation to pursue the derivative claims is often lacking, and courts generally show a degree of deference to managerial decision-making. On the other hand, it could be argued in the case of an event-driven sunset clause that shareholders may be more incentivised to act collectively, since they would not only be pursuing an award to the company, but also for the superior-rights to be unwound giving them the opportunity to remove an underperforming, significantly shareholder-wealth reducing, management team. Loss of superior-rights upon breaches of the Listing Rules or other regulatory provisions should be simpler to implement since regulators will generally make administrative decisions quicker than the courts, and implementing event-driven sunset clauses of this type could bolster the effectiveness of the Listing Rules as they pertain to WVR-firms, particularly in relation to the provisions relating to controlling shareholders. Overall, though, it is not advocated that the UK mandate event-drive sunset clauses triggered upon breaches of directors' duties or the Listing Rules. Above and beyond the hindrances created by the need to institute Court or administrative procedures to instigate their trigger, it would be concerning that even minor breaches could result in considerable consequences for the controller. Opportunistic shareholders may pursue claims for minor breaches in order to compel the triggering of the event-driven sunset clause. The rules could be formulated such that the sunset clause is only triggered upon 'material' breaches, but that precipitates issues regarding who should constitute a breach as 'material' and the objective basis upon which the determination would be made. No doubt an appeals-process would also need to be constituted, which would entail further administrative mechanisms. Therefore, although, normatively, event-based sunset clauses based upon breaches of directors' duties or the Listing Rules could be beneficial to inferior-shareholders, numerous practical hurdles would limit their application.

Another avenue for event-driven sunset clauses could be those that trigger upon the superior-shareholder being convicted of certain crimes that could portend poor behaviour in the context of the WVR-firm. Fraud and securities breaches could be relevant criminal offences, and precedent can be found in the

[174] Winden (2018) (n 1 above 929).
[175] Ibid 929; Fisch and Solomon (2019) (n 95 above 24).
[176] n 85 Chapter 5.

US, where the company Moelis & Co. voluntarily adopted such a clause.[177] However, in such cases, it is likely that the relevant person would be disqualified from acting as a director pursuant to directors' disqualification proceedings if the acts relate to companies[178] (subsequently triggering the director-linked sunset), and it is therefore not proposed to introduce such clauses to the UK's balanced protection package.

Consequences of Sunset Clauses

Above, transfer-linked, director-linked and ownership-linked sunset clauses have been proposed in the UK. One consequence of such sunset clauses is that, in order to ensure that there are always voting shares in existence, the mechanics must specify that if triggering of a sunset clause will result in only non-voting shares being in issue, immediately prior to the triggering of that clause, all non-voting shares will be enfranchised into OSOV-shares, so as to result in a simple OSOV-firm after all the superior-shares have been converted.

The application of sunset provisions could also have a bearing on whether superior-shares can be listed. Both Hong Kong and Singapore require the superior-shares to be unlisted. In the UK, the superior-shares would also need to remain unlisted, since under the free-float rules, at least 25 per cent of shares for which application for admission has been made must be in public hands;[179] taking the superior-shares as a separate class of shares, with a director-linked sunset clause, 25 per cent of the superior-shares will not be in public hands (since they would convert into inferior-shares in the hands of non-directors). Therefore, transfer-driven sunset mechanics should be structured so that superior-shares convert into inferior-shares immediately prior to the relevant transfer becoming effective, so that a superior-shareholder can offer listed inferior-shares to a third party market participant, rather than a chicken-and-egg situation occurring such that the superior-shares can not be sold on the market.

Another issue arises where an existing WVR-firm issues further shares. The issue of further inferior-shares could allow the holders of superior-shares to divest of further equity over time. However, ownership-linked sunset clauses should assuage concerns that such issuances can be used to ingrain greater abuse of inferior-shareholders. The issue of further superior-shares, though, could result in the proportion of votes held by the inferior-shareholders as a group forming a smaller proportion of the total voting rights in the company. Hong Kong requires that the proportion that the superior-shares bears to the total share capital can not change post-IPO, and Singapore requires that the ratio of the total voting rights attached to superior-shares to the total voting rights attached to inferior-shares may not change post-IPO. In effect, in both jurisdictions, superior-shares may only be issued in conjunction with an issuance of inferior-shares so as to maintain the relevant proportions. As far as the UK is concerned, an outright prohibition of further issuances of superior-shares post-IPO for cash could have the unintended consequence of either encouraging capital structures consisting of non-voting shares (or shares with heavily depressed votes), or deterring the issuance,

[177] Under the clause, the founder's superior-shares will convert to inferior-shares in the event that he is 'convicted of a criminal violation of a material U.S. federal or state securities law that constitutes a felony or a felony involving moral turpitude' (Amended and Restated Certificate of Incorporation of Moelis & Co. as filed on 21 April 2014, Article 4, section 2).
[178] Company Directors Disqualification Act 1986, s.2.
[179] LR 6.14.2R.

post-IPO, of inferior-shares which could generate further equity financing for the company, since they would dilute the control of the superior-shareholders if they do not have the resources to take up their *pro rata* share of any inferior-share issuance. Therefore, it is not proposed that further issuances of superior-shares for cash be prohibited, but the Listing Rules should require that the proportion that the superior-shares bear to the total shares in the company as of IPO can not increase post-IPO (and, of course, that new superior-shares only be issued to existing superior-shareholders so as not to circumvent the premise for the transfer-driven sunset). Such a provision would permit further issuances of inferior-shares without complimentary issuances of superior-shares, but not permit the issuance of superior-shares without an issuance of inferior-shares to ensure that the IPO-proportion of superior-shares does not increase. To avoid pricing challenges where the superior-shares are unlisted, the price per superior-share in any such issuance should also not be any less than the price per inferior-share, to avoid superior-shareholders attempting to increase their equity holding at a discount. The requirement that the proportion of superior-shares does not change post-IPO will also rule-out the use of loyalty share structures. However, as discussed in Chapter 1, the use of loyalty shares raises a sub-set of issues and challenges beyond those applicable to general WVR-structure evaluated in this thesis, and, in any case, a pure loyalty shares structure would not be compatible with director-linked sunset clauses.

A final consequence of the proposed sunset package is that it will preclude a multi-class Google-esque structure that consists of superior-shares held by founders, and listed-OSOV-shares and listed-non-voting shares held by founders and other shareholders. Under the proposed formulation, any shares with superior-voting rights compared to the lowest-voting shares must be held by directors. There are two main reasons for this approach. Firstly, without extending the director-linked sunset clause to apply to all shares with voting rights superior to the most inferior-shares, founders could, hypothetically speaking, issue themselves with superior-shares with ten-votes-per-share which have to be held by directors, and mid-tier shares with nine-votes-per-share which do not have to be held by directors. All other shareholders would hold OSOV-shares. The founders could then transfer the highest-voting shares to third parties, whereupon they would convert to OSOV-shares, leaving them with the mid-tier shares as now the highest-voting shares, but unencumbered by the director-linked sunset provision. Second, if non-directors were to own mid-tier shares, the risk exists that disproportional control could reside, or could eventually reside, in the hands of non-director shareholders. The restrictions proposed would not prevent a firm, at the time of IPO, constituting more than two classes of shares, so long as any enhanced-voting shares are subject to the required sunset clauses, and therefore unlisted. This would allow, for example, the founders of a firm to hold enhanced-voting shares with different levels of voting rights between themselves, but all of those shares would convert to inferior-shares upon the triggering of sunset clauses, and no shares with enhanced-voting rights would be available to the public.[180] Although the capital structure adopted by Google (and once proposed by Facebook) would not be permitted, the restriction increases the likelihood that the WVR-tradeoff will be shifted in a positive direction. Moving forward, the FCA could consider relaxing this restriction based upon better evidence of outcomes from the US (where Google-esque structures are

[180] Snap, for example, has issued three classes of shares, but only non-voting shares are available to the public, with the other two classes unlisted and owned by founders or initial investors (n 10 Chapter 1).

permitted), and Hong Kong and Singapore (where Google-esque structures are prohibited), but, in the first instance, the door to WVR-structure should be opened cautiously in the interests of clarity and protecting public investors.

7. The Balanced Sunrise Package

Sitting alongside sunsets, as per the approach in Hong Kong and Singapore, further protection could be imparted to inferior-shareholders by the inclusion of sunrise provisions, which are fully operational from IPO and safeguard against the more flagrant controller abuses without defenestrating the WVR-structure.

Majority of the Minority Provisions

One method of protection for inferior-shareholders would be to require that certain corporate actions be additionally approved by a majority of the votes (or possibly a supermajority if required by the underlying legislation) of the inferior-shares.[181] If the relevant corporate actions are framed carefully, this mechanism can prevent the controller from taking actions that could be substantially detrimental to the inferior-shareholders without their approval, curtailing certain types of controller benefit extraction. Hong Kong and Singapore have implemented protections such that all shares will be temporarily treated as OSOV upon votes on certain corporate actions.[182] Although such a provision does not constitute a true 'majority of the minority' provision, it has similar effect, and respects the OSOV-principle of decisions being passed by the majority of the equity. In many ways it is fairer than true 'majority of the minority' provisions, since it would otherwise be iniquitous to put a WVR-controller that has retained substantial equity in a worse position than a controlling shareholder in a OSOV-firm. Denmark and Finland also implement general meeting voting requirements that blunt the voting advantages of superior-shares in relation to certain corporate actions.[183]

However, the Hong Kong and Singapore provisions create a potential problem from a UK-perspective, since, if inferior-shareholders are able to propose resolutions (as discussed in '*Inferior-Shareholder-Proposed Resolutions*' below), unless the superior-shareholders hold sufficient equity to block the resolution, it could be unilaterally passed by the inferior-shareholders, critically cutting across the control rights for which the controller has adopted WVR-structure. Therefore, it is proposed that the voting requirements of CA 2006, IA 1986 or other legislation remain in place (which respect the enhanced voting rights of the superior-shareholders), but that the Listing Rules be amended to require, for certain resolutions, an additional voting approval where all the shares, even if they constitute non-voting shares (unless they are

[181] n 49 above 1509; Anand (2018) (n 11 above 215) (eight of 85 TSX-listed WVR-firms included 'majority of the minority' provisions (ibid 226).
[182] The relevant corporate actions in Hong Kong and Singapore are: amendments to the constitutional documents, variations of class rights, independent director appointments and removals, auditor appointments and removals, voluntary winding-ups, and, in Singapore only, effecting reverse takeovers, or de-listings.
[183] Shearman & Sterling (2007) (n 155 above 12).

preference shares), are treated as OSOV-shares. In that way, the holders of a majority of the equity must approve certain corporate actions, without giving them unilateral powers of implementation.

In considering which corporate actions should be subject to the additional OSOV-approval, it is crucial not to curtail the ability of the controller to manage the company in accordance with its long-term vision. The assessment to be made is whether the relevant action is of a nature such that the holders of a majority of the equity could be unfairly expropriated. Amending the company's constitutional documents is an obvious example. Although inferior-shareholders are relatively well-protected in English-incorporated companies,[184] foreign-incorporated companies may not be subject to equivalent protections. Even though requiring an additional OSOV-approval could limit the controller's ability to make minor constitutional changes (such as procedures applicable to general meetings, distributions or director authorities, that do not prejudice inferior-shareholder interests), the danger of a controller with a disproportionately low level of financial exposure amending the articles in a manner detrimental to the financial interests of the company justifies this treatment. Attempting to make a distinction between minor and major amendments would introduce a great deal of uncertainty, so it is proposed that the additional OSOV-approval mechanism be implemented in relation to any decision to amend the constitutional documents of WVR-firms.

Other corporate actions that primarily affect equity-holders include winding-ups and waivers of pre-emption rights. A voluntary winding-up of the company can cut short the projected investment horizons of investors, and should, therefore, entail an additional OSOV-approval in relation to the special resolution that is required to be passed.[185] The waiver of pre-emption rights should attract similar treatment, since any such waiver could result in the dilution of existing equity-holders. The provision should be introduced as a super-equivalence requirement applicable to premium-listed WVR-companies through an amendment to LR 9.3.12. In relation to auditors, currently, the audit committee is required to recommend auditors to the board,[186] and mandatory[187] and comply-or-explain-based[188] regulations dictate the composition of the audit committee. However, there is no proviso that the board selects the recommended auditor,[189] and the right for shareholders to approve the re-election of the external auditor at the annual general meeting (AGM) is an important protection.[190] If substantial pecuniary controller benefit extraction is taking place, the auditors will be best placed to identify tunnelling and quantify its extent, and should also be able to identify breaches of any related-party transaction rules, and potentially fraudulent transactions. The ability to approve the auditor protects those who have made financial investments in the company, and, therefore, the additional OSOV-approval should apply to the appointment and removal of auditors of premium-listed WVR-companies. Consideration could also be given as to whether reductions of capital should require additional OSOV-approval. Under current legislation, a reduction of capital by a public company requires a special resolution,

[184] See: '*Amendments to the Articles of Association*' in Chapter 5.
[185] IA 1986, s.84. It should be noted that the existing Listing Rules already require a decision to de-list a controlling shareholder premium-listed firm to be approved by independent shareholders (LR 5.2.5R(2)).
[186] CA 2006, s.489A(3).
[187] DTR 7.1.
[188] UK CGC, provision 24.
[189] CA 2006, s.489A(6).
[190] CA 2006, s.491.

protecting the interests of the shareholders, and Court approval, protecting the interests of creditors.[191] Reductions of capital are usually effected in order to create distributable reserves, reduce accumulated realised losses, or to return surplus capital to shareholders. However, any such reduction would be required to be applied on a basis *pro rata* to equity holdings unless differing capital return rights are attached to shares in the company, to which shareholders would have had to have agreed when investing in the company. It would be highly unlikely for a WVR-firm to implement different capital return rights between superior- and inferior-shares (and to the extent that certain shares could be cancelled in priority to others, a significant price differential would be applied by the market). Therefore, since all shareholders would be treated equally, it is not hereby recommended that the additional OSOV-approval be applied to reductions of capital, the approval of which would remain in the hands of the holders of sufficient voting rights, as further sanctioned, for UK-public companies, by the Court.

Related to inferior-shareholder voting rights, HKEX,[192] SGX[193] and SSE[194] have, additionally, mandated that the proportion of superior-shares to inferior-shares must not change post-IPO, and that at least 10 per cent of voting rights must remain in the hands of Independent Shareholders. Both requirements ensure that at least a sliver of control remains in the hands of public shareholders, allowing them to call general meetings and register their discontent with corporate actions by voting against the board on resolutions, and ruling-out a 'Snap-style' structure where the public shareholders only hold non-voting shares.[195] However, in practice, the difference in governance powers between a dispersed group of public shareholders holding 10 per cent of the votes, and public shareholders holding only non-voting shares, is marginal. As discussed further below, the same protections could be more efficiently and effectively implemented by requiring that the company discloses inferior-shareholder votes, and ensures that inferior-shareholders can propose resolutions at AGMs, so long as they hold sufficient equity. In that way, flexibility would be promoted, and non-voting shares would be permitted on the premium-tier.

Independent Directors

In a way related to majority of the minority provisions, another inferior-shareholder protection is the right to appoint a proportion of the board of directors. Commentators have noted the theoretical benefits of independent directors acting as a check-and-balance on the actions of controlling shareholders.[196] The conflict that needs to be monitored by independent directors shifts between OSOV dispersed-ownership firms and controlling shareholder firms - from between management and shareholders to between the controller and public shareholders. In a WVR-firm, independent directors could constitute an important monitoring

[191] CA 2006, s.641.
[192] n 77 above, Rules 8A.9 and 8A.13.
[193] n 78 above, Rules 210(10)(h) and 803A.
[194] n 80 above, article 4.5.7.
[195] The 10:1 minimum superior- to inferior-voting ratio requirement in Hong Kong and Singapore would also rule-out non-voting stock.
[196] Daniels and Halpern (1996) (n 66 Chapter 2 59) advocated that the board should take on more of a role monitoring any controlling shareholder, and that, therefore, regulations should provide for minimum numbers of outside directors who are sufficiently independent from both management and the controlling shareholder; J. Dahya et al, 'Does Board Independence Matter in Companies with a Controlling Shareholder?' (2009) 21 *J. App. Corp. Finance* 67, 76.

mechanism on the acts of the controller, as well as bringing the concerns of the public shareholders to the board. The empirical evidence on the effect of independent directors in controlling shareholder firms on firm performance is inconclusive,[197] and a plausible reason for such inconclusiveness is the level of scepticism directed at the independence genuinely exercised by such directors.[198] This emphasises the need to augment independent director appointment regulations by ensuring that those directors are truly independent in a WVR-structure.

As mentioned in Chapter 5, although the appointment of independent directors to the boards of premium-listed controlling shareholder firms are subject to a dual-vote process, the controller, ultimately, has the right to push-through appointments against the objections of public shareholders. Accordingly, even if a director has been designated to be independent by the board,[199] the independence of any such director can be doubted in the face of a controlling shareholder.[200] Reddy (2018)[201] has proposed that, in the presence of a controlling shareholder, independent shareholders should have a veto over the election and re-election of independent directors, such that their continuing tenures would depend upon both the controlling shareholder and independent shareholders being satisfied with credentials and performance. This should temper, to an extent, the tendency for such independent directors to display bias toward the controlling shareholder. Bebchuk and Hamdani (2017),[202] Pacces (2018)[203] and Gurrea (2019)[204] go much further, and advocate that at least a certain proportion of independent directors should be appointed exclusively by independent shareholders. With OSOV, disenfranchising the controlling shareholder in this way could be heavy-handed, given that the equity ownership of the controlling shareholder should act as a buttress against the most extreme forms of abuse.[205] With WVR-structure, though, the argument for such rights is stronger, since with a substantial proportion of the investment in the company being held by inferior-shareholders, it is unpalatable that independent directors can be appointed by a minority (in terms of equity) shareholder.[206] As such, without the equity constraint on controlling shareholder actions, some commentators have recommended a dis-application of the NYSE's exemption for controlling shareholder companies from complying with minimum independent director number requirements[207] where the controller does not own

[197] For example - Suggesting no effect on firm performance: C. Bacon et al (1997) (n 148 Chapter 3 21); S. Arcot and V. Bruno, 'Corporate Governance and Ownership: Evidence from a Non-Mandatory Regulation' (2018) 3 *JLFA* 59, 77. Suggesting improved firm performance: Y. Yeh and T. Woidtke, 'Commitment or entrenchment?: Controlling shareholders and board composition' (2005) 29 *J. Bank. Finance* 1857; B. Black et al, 'How corporate governance affects firm value? Evidence on a self-dealing channel from natural experiment in Korea' (2015) 51 *J. Bank. Finance* 131; J. Dahya et al. 'Dominant shareholders, corporate boards, and corporate value: A cross-country analysis' (2008) 87 *J. Finance Econ.* 73; L. Setia-Atmaja, 'Governance Mechanisms and Firm Value: The Impact of Ownership Concentration and Dividends' (2009) 17 *Corp. Gov.* 694, 705.
[198] nn 64-68 Chapter 3, and accompanying text.
[199] UK CGC, provision 10 provides guidance as to the situations where a director's independence may be prejudiced, including where such a director is a representative of a significant shareholder.
[200] n 198 above.
[201] n 67 Chapter 3 753.
[202] n 66 Chapter 3.
[203] A. Pacces, 'Procedural and Substantive Review of Related-Party Transactions: The Case for NCS (Non-Controlling Shareholder)-Dependent Directors' (2018) *ECGI Law Working Paper* No. 399/2018 1.
[204] n 66 Chapter 3 22.
[205] n 201 above 755.
[206] Winden (2018) (n 1 above 915).
[207] n 49 above 1510.

significant equity,[208] and that inferior-shareholders be given enhanced appointment rights for some independent directors as above.

The concept of granting inferior-shareholders enhanced director appointment rights (or, equally, limiting the director appointment rights of superior-shareholders) is not a new one. The CCGG proposed a limit on the number of directors appointable by superior-shareholders of TSX-listed WVR-companies.[209] AMEX, until 1993, required that WVR-firms grant the inferior-shareholders the right to appoint at least 25 per cent of the board of directors.[210] Italy requires listed-companies to entitle public investors to appoint at least one director to the board and to propose a slate of nominees for that position,[211] and, in Israel, public companies must appoint at least two independent directors to the board in relation to which independent shareholders have veto rights.[212] In Singapore[213] and Hong Kong,[214] the regulators have mandated that WVR-firms should temporarily revert to OSOV when voting upon the appointment and removal of all independent directors.[215]

Even if inferior-shareholders had the right to appoint a specific number of independent directors, the UK-convention involves the board proposing the slate of directors on which shareholders vote - the inferior-shareholders would always be choosing from a group selected by the controller. An obvious drawback is that the nominees, if effectively proposed by the controller (even if that controller does not have appointment or removal voting rights), may feel beholden to the controller in some respect.[216] If inferior-shareholders are to be given the right to exclusively appoint independent directors to the board, the provision would be more effective if it also entitles such shareholders to nominate the directors for election to those positions.[217]

It is therefore proposed that the holders of a majority of the equity in premium-listed WVR-firms should have the right to select up to two independent directors, who would be designated 'Inferior-Appointed Directors' and must submit for re-election on an annual basis. A simple majority of votes exercised (on a OSOV-basis) would be required to appoint, re-elect or remove any Inferior-Appointed Director. In the first instance, Inferior-Appointed Directors will be nominated by the controller for appointment or re-election at the AGM, and, in most cases, it is likely that the controller will enter into dialogue with major inferior-shareholders to ensure that any proposed candidates are acceptable in order to avoid deadlock.[218] However, to the extent that the appointment or re-election of nominees proposed by the controller is not approved, any shareholders holding between themselves at least 10 per cent of the equity should be entitled to nominate appointees to be voted upon by all the shareholders on a OSOV-basis at an extraordinary general meeting

[208] Ibid 1510; n 70 Chapter 3 1500.
[209] n 104 above 7.
[210] Seligman (1985-1986) (n 151 above 704 fn 90).
[211] Bebchuk and Hamdani (2017) (n 66 Chapter 3 1291).
[212] ibid 1292.
[213] n 78 above, Rule 730(B).
[214] n 77 above, Rule 8A.24.
[215] In Singapore, under the SGX Mainboard Rules (rule 210(5)(c)), at least two members of the board must be independent directors (to be increased to at least a third of the board, with a minimum of two members, by 1 January 2022 (Code of Corporate Governance (6 August 2018), footnote 7)). Under the Hong Kong Listing Rules, at least a third of the board, with a minimum of three members, must be independent directors (rules 5.05 and 5.05A). HKEX must approve any designation of independence (rule 5.07).
[216] n 68 Chapter 3; Winden (2018) (n 1 above 915).
[217] n 211 above 1291; G. Loureiro, 'Monitoring the Board: Should Shareholders have Direct Proxy Access?' (2012) 12 *Quant. Anal.* 943.
[218] n 201 above 756.

(EGM) to be held between 90 and 120 days after the AGM (replicating the time-frames for the current dual-voting process). It should be noted that this would be an option for Independent Shareholders, and the appointment of Inferior-Appointed Directors would not be mandated if the Independent Shareholders determine not to nominate appointees, or no appointee receives a majority of the votes (on a OSOV-basis) exercised at the EGM. It is important that the controller has the right to nominate appointees in the first instance, to reduce the risk that the process could be hijacked by activist investors. Studies have shown that WVR-firms that permit the inferior-shareholders to nominate and appoint a minimum number of directors to the board are frequently targeted by hedge funds and other activist shareholders.[219] One of the reasons for a controller to implement WVR-structure may be to avoid the potential for short-term activist shareholders to influence the company's business approach.[220] The rules would be implemented in the new Listing Rules chapter applicable to WVR-firms in a similar manner to the provisions relating to the appointment of independent directors in OSOV-controlling shareholder firms under LR 9.2.2.

Although, with only two Inferior-Appointed Directors, those directors could easily be out-voted by the remainder of the board, the purpose of WVR-structure would be undermined if inferior-shareholders were able to appoint a majority of the board and therefore seize control. Additionally, evidence suggests that the benefit of such a system lies in the qualities of the relevant independent directors and the information to which they are privy,[221] rather than their absolute numbers.[222] Accordingly, the Listing Rules should provide that any Inferior-Appointed Directors nominated should have financial and/or audit experience, and must be appointed to the audit committee of the board (this will assist in ensuring that those directors receive information of a higher quality).

Related-Party Transactions

As discussed in the previous Chapter, existing regulations require that related-party transactions exceeding certain thresholds be confirmed by the firm's sponsor as being fair and reasonable to the shareholders as a whole, and even larger related-party transactions be approved by shareholders independent from the related-party. However, it was also noted that potential flaws are present in the regulations that have created controversies in controlling shareholder firms. Reddy (2018) has proposed that in the presence of a controlling shareholder, any related-party transaction, no matter its size or whether such transaction is in the ordinary course of business, should be subject to confirmation by the company's sponsor that it is fair and reasonable to the shareholders as a whole.[223] The application of such a requirement to WVR-firms is even more justifiable than to OSOV-controlling shareholder firms, as the risk that the relevant related-party transaction is detrimental to the firm increases as the controller's equity constraint decreases, and, therefore, it is proposed that such a requirement be adopted in the Listing Rules for premium-listed WVR-firms. It is

[219] K. Kastiel, 'Against All Odds: Hedge Fund Activism in Controlled Companies' (2016) 1 Columbia Business Law Review 60, 90; Winden (2018) (n 1 above 916).
[220] Winden (2018) (ibid 892).
[221] Erickson et al (2005) (n 66 Chapter 3).
[222] Chen et al (2018) (n 66 Chapter 3 1007).
[223] n 201 above 760.

not, though, submitted that shareholder pre-approval should be implemented for all related-party transactions. Having to call an EGM[224] and obtain pre-approval, with respect to every related-party transaction, would be a relatively onerous requirement on controllers and encumber the ability of the company to act nimbly,[225] potentially leading to management teams foregoing efficient projects that are overall beneficial to the firm,[226] or even discouraging controllers from listing their firms in the first place. The controller would also be subject to the caprice of inferior-shareholders who may, themselves, have individual agendas not necessarily in-line with the long-term vision of the founder. The lighter proposal that sponsor confirmation of fairness and reasonableness be obtained in all cases would be less draconian but still provide inferior-shareholders with an exacting degree of protection. As previously discussed, the sponsor must either be authorised by the FCA or a member of a designated professional body,[227] and therefore has reputational and regulatory incentives to undertake its duties thoroughly. The process with the sponsor could also be streamlined by permitting regular interrelated transactions to be covered by an overall umbrella confirmation, rather than individual confirmations being required for each specific transaction, or by permitting a general confirmation to be given for transactions with specific counterparties within predefined financial limits. If any Inferior-Appointed Directors have been appointed to the board, they can play an important role on related-party transactions, by conveying any related-party transaction concerns to the sponsor. The Listing Rules should require the board to relate those Inferior-Appointed Director concerns to the sponsor. Such concerns should also be disclosed to the Independent Shareholders to the extent that the relevant related-party transaction requires Independent Shareholder pre-approval. Also, as referenced in Chapter 5, since, at least for companies incorporated in England and Wales, material related-party transactions must, on a mandatory basis, be approved by the board of the company (excluding associates of the relevant related-party),[228] Inferior-Appointed Directors, if appointed, would be privy to such discussions.

Consideration should also be given to the fact that, currently, the related-party transaction rules are largely dis-applied for sovereign-controlled companies.[229] For sovereign-controlled WVR-companies, it would be prudent for the rules to be re-asserted, since the mischief that could be derived from the existence of a Wedge becomes simple to achieve when there are no constraints around the transactions which the company can conduct with its controller.

Disclosure of Inferior-Shareholder Voting

As above, HKEX, SGX and SSE require at least a *de minimis* proportion of a company's voting rights be made available to the public[230] - it is contended that if a non-negligible proportion of voting stock is made available to outsiders, even if they are in the minority, it will grant them a voice and the ability to put

[224] CA 2006, s.307A.
[225] n 201 above 761.
[226] Gilson and Schwartz (2013) (n 119 Chapter 3 175).
[227] n 39 Chapter 5.
[228] DTR 7.3.8.
[229] n 37 Chapter 5.
[230] nn 192-194 above.

pressure on the controllers.[231] The FTSE Russell index, in fact, requires that five per cent of voting rights be held by outside investors for a company to be eligible for index-inclusion.[232] Although there may be other good reasons to ensure the issuance of voting stock to outside investors,[233] it is a heavy-handed method of ensuring that outside shareholder voice is heard. Instead, it is proposed that the same purpose could be served more judiciously pursuant to a Listing Rules amendment requiring that, upon any resolution, a WVR-firm should disclose not only the result of the vote based upon the voting rights of the shareholders, but also the result of the vote had all shares been treated on a OSOV-basis.[234] Although the resolutions will inevitably be passed, since the controller will be able to carry the resolution through exercising superior-rights, by disclosing the votes of the inferior-shareholders, at least any obvious areas of discontent of the inferior-shareholders will be publicly highlighted. This would also give the inferior-shareholders a method of expressing general levels of dissatisfaction with the performance of the company or its management team, and awareness of controlling shareholder conduct can be raised. This could act as an incentive for inferior-shareholders to propose resolutions[235] whereas, otherwise, they would be reluctant to do so since, without the benefit of voting-disclosure, no shareholder would likely expend effort in proposing resolutions that they will inevitably lose handily.[236] Although the resolution would still be lost, the disclosure of voting by inferior-shareholders could generate useful publicity.

Whether such publicity will ensure that a WVR-firm changes its practices is uncertain. In the OSOV-sphere, in some cases the loss of 'say-on-pay' advisory votes on directors' remuneration policy[237] has resulted in changes being made voluntarily,[238] and a custom has developed whereby boards tend to discuss payment practices closely with shareholders prior to any such resolutions being proposed for vote.[239] In contrast, with a OSOV-controlling shareholder, in relation to the two-vote system applicable to independent director appointments,[240] the disclosure of high levels of opposition by independent shareholders often in practice does not result in material changes being made to board composition by those companies.[241] Either way, at least the inferior-shareholders will possess a simple avenue with which to register discontent, and,

[231] Lund (2019) (n 98 above 744).
[232] n 125 Chapter 2.
[233] Lund (2019) (n 98 above 716 *et seq*).
[234] Anand (2018) (n 11 above 237); Allaire (2018) (n 109 above 22). 'The absence of investor voice is ultimately an issue of accountability' (Winden (2018) (n 1 above 913)).
[235] As below ('*Inferior-Shareholder-Proposed Resolutions*'), it is proposed that inferior-shareholders be able to propose resolutions at AGMs.
[236] Lan and U. Varottil (2015) (n 39 above 576).
[237] CA 2006, s.439.
[238] For example, the chair of the remuneration committee in 2009, and the CEO in 2012, resigned from Royal Dutch Shell and Aviva plc, respectively, after the respective companies lost directors' remuneration report advisory votes, and, in 2012, the CEO of Trinity Mirror plc resigned ahead of a planned shareholder revolt on pay. In 2016, the remuneration committee of BP plc used its discretion to reduce performance-related pay to which the CEO was otherwise entitled to avoid 'formulaic outcomes', after the company had lost the advisory vote on the implementation of the remuneration policy in the previous financial year. In 2017, the chair of Persimmon plc resigned after shareholder and public outrage toward the CEO's £110 million pay package.
[239] F. Ferri and D, Maber, 'Say on Pay Votes and CEO Compensation: Evidence form the UK' (2013) 17 *Rev. Financ.* 527, 546; R. Thomas and C. Van der Elst, 'Say on Pay Around the World' (2015) 92 *Wash. U. L. Rev.* 653, 730; CIPD Research report, 'Executive pay: Review of FTSE 100 executive pay packages' (August 2017) at 2; KPMG Board Leadership Centre, 'Guide to Directors' Remuneration 2017' (December 2017) at 11.
[240] See: Chapter 5.
[241] n 201 above 746.

even in relation to the appointment of independent directors, high levels of opposition can generate adverse headlines for the controller.[242]

'Say-on-Pay' is another area where inferior-shareholder voting rights should be considered, since, as discussed in Chapter 3, excessive executive pay could be an avenue of controller benefit extraction. With the disclosure of votes regime recommended, the inferior-shareholders would be able to at least voice their discontent on executive pay when pay policy[243] and pay implementation[244] are voted upon by the shareholders as a whole. It is not proposed, though, that the additional OSOV-approval process outlined in '*Majority of the Minority Provisions*' above be extended to 'say-on-pay'. Such a mechanism could be hijacked by activist investors looking to pressure a management team into taking actions favourable to the agenda of the activists.[245] Although the same tactic can be used in OSOV-firms, one of the purposes of WVR-structure is to insulate the management team from such tactics. Additionally, as contended in Chapter 3, allowing controllers to extract a non-egregious level of pecuniary controller benefits may be a tolerable price to pay to persuade founders to list and to realise the benefits of listed WVR-firms. It would be hoped that extortionate levels of directors' pay would be deterred by the potentially negative publicity generated by substantial symbolic votes against the relevant resolutions.[246] It is, therefore, not proposed that inferior-shareholders be given separate 'say-on-pay rights', but the point could be revisited after WVR-firms become more prevalent on the premium-listed tier.

Inferior-Shareholder-Proposed Resolutions

Complimentary to the notion of disclosing inferior-shareholder voting is a discussion on the ability of inferior-shareholders to propose resolutions at AGMs and to call EGMs. Both Hong Kong and Singapore require that, in a WVR-firm, shareholders holding 10 per cent of the votes, where all shares are treated on a OSOV basis, be able to call EGMs.[247] A similar right in the UK would allow inferior-shareholders to raise issues of concern and express discontent through a symbolic vote on the relevant resolutions (the votes would be symbolic where the controller possesses sufficient votes to defeat the proposal). However, the ability to call EGMs at any time could be used by activists to disrupt the business of the firm. Such agitations to a controller attempting to pursue a long-term vision could deter issuers from choosing the UK as a destination for WVR-structure. Therefore, an unconditional inferior-shareholder right to call EGMs is not proposed, but it is recommended that the Listing Rules require that the constitutional documents of premium-listed WVR-firms include provisions that treat all equity shares (including non-voting shares, but excluding preference

[242] Ibid.
[243] CA 2006, s.439A.
[244] CA 2006, s.439.
[245] Recently, there have been indications that activist investors, in pursuit of their agendas, are using governance-related issues as a means of attracting support from traditional investors and exerting personal pressure on directors (A. Mooney, 'Activists become wolves in sheep's clothing' *Financial Times* (21 July 2019) <https://www.ft.com/content/bf1e6037-bbdd-3465-ab0c-d111e301624e> In relation to executive remuneration specifically, see: J. Goldstein, 'Shareholder Activism and Executive Compensation' *Harvard Law School Forum on Corporate Governance and Financial Regulation* (18 June 2015); A. Ralph, 'Investors revolt over executive pay at De La Rue' *The Times* (26 July 2019) <https://www.thetimes.co.uk/article/investors-revolt-over-pay-at-banknote-printer-de-la-rue-6x3r87tws>
[246] n 238 above.
[247] n 77 above, Rule 8A.23; n 78 above, Rule 210(10)(g).

shares) on a OSOV-basis in relation to any shareholder powers to propose resolutions to be heard at AGMs under the laws applicable to those companies.[248] This would enable inferior-shareholders to raise concerns on an annual basis, without being able to continually interfere throughout the year.

Greater Disclosure

The importance of disclosure by WVR-firms is underlined by the enhanced disclosure requirements for WVR-firms imposed by Hong Kong and Singapore. A study by Anderson et al (2009) also found better performance by WVR-firms compared to OSOV-firms where such WVR-firms were transparent (as scored by an opacity index devised by the authors), with the opposite found for opaque WVR-firms.[249] In relation to financial information, at least in the UK, the company's annual report must be circulated to all members of the company,[250] voting or non-voting, and, in relation to general meetings of the company, all shareholders are entitled to notice of the relevant meeting and equality of information.[251] Inferior-shareholders could, though, benefit from more robust rules regarding cash-flow interests of superior-shareholders and the extent to which superior-shareholders are able to reduce those cash-flow interests while retaining control,[252] given that the degree of the Wedge can influence the extent of controller benefit extraction.

Current regulations should already elicit a degree of pertinent information regarding share ownership. Since, under the proposals in this Chapter, superior-shareholders will be directors, they will be subject to LR 9.8.6R(1), which requires the disclosure of directors' interests in the annual report; but the Listing Rules should be clarified to ensure that the information disclosed for WVR-firms is sufficiently clear and transparent to allow investors to ascertain not only the number of each class of shares owned, but also the percentage that they represent of the total voting and cash-flow rights in the company.[253] Superior-shareholders will also be subject to the disclosure requirements under article 19 of MAR, under which directors must disclose any changes in interests in shares (subject to an annual *de minimis* threshold) – this would include superior- and inferior-shares, so the investors will receive the relevant information on changes in superior-shareholder ownership.[254]

However, greater clarity should be included in the offering prospectus of any WVR-firm proposing to list on the premium-tier – the FCA's Prospectus Regulation Rules should be amended to require full disclosure of the capital structure (including details of the operation of sunset and sunrise provisions), the number and percentage of voting *and* cash-flow interests that will be held by substantial shareholders post-IPO, and details outlining the magnitude of Wedge theoretically possible under the proposed capital

[248] For a company incorporated under CA 2006, see: CA 2006, s.338.
[249] n 219 Chapter 3 215. See: n 135 Chapter 4, and accompanying text, for further details.
[250] CA 2006, s.423.
[251] CA 2006, ss.310 and 311.
[252] A quality that is not easy to discern from US-disclosures (49 above 1503).
[253] Ibid 1502.
[254] Any changes over the course of the financial year are also required to be disclosed in the annual report (LR 9.8.6R(1)). However, consideration should also be given to clarifying the DTRs to ensure that changes in the cash-flow rights of major shareholders are disclosed, rather than merely voting-rights as currently required. Although superior-shareholders, as directors, would be required to disclose the relevant information under MAR and the Listing Rules, substantial inferior-shareholders would only be covered by the DTRs.

structure. Such information will give potential investors vital information as to where voting power lies, the personal financial equity investment of those with voting control, and the extent to which controllers may reduce their equity involvement while retaining control. The Listing Rules should be amended to ensure that the same information is provided in the annual reports so that the information is up-dated for future investors.

8. Further Listing Rules and Takeover Code Amendments

LR 9.2.21R

Technically, the premium-listing principles do not prohibit a WVR-firm from listing inferior-shares on the premium-tier while superior-shares remain unlisted. Therefore, rather than amend the principles, the FCA would merely need to publicise its relaxation of the informal discouragement of WVR-firms noted in Chapter 2, and that it welcomes the admission of WVR-firms to the premium-tier so long as they adopt the measures described in this Chapter. However, LR 9.2.21R, which provides that certain matters relevant to premium-listings must be approved only by the holders of premium-listed shares, will need to be revised. In the context of a compliant WVR-firm, only those matters specified in this Chapter should require votes of inferior-shareholders, to prevent a WVR-firm with unlisted superior-shares being prejudiced by certain further actions requiring approval by the holders of the premium-listed inferior-shares.[255]

Takeover Code

As stated in Chapter 1, this thesis assumes that Rule 9 of the Takeover Code will apply to all WVR-firms. This is an important consideration, since, as iterated in Chapter 3, Rule 9 precludes the extraction of control premia and impedes inefficient takeovers. Currently, certain EEA-registered companies are subject to the provisions of the Takeover Code, but the FCA has indicated that upon the UK leaving the EU and the EU Takeover Directive[256] ceasing to apply, the Takeover Code will revert to its historical position of being limited to public companies with registered offices in the UK, Channel Islands or Isle of Man.[257] Foreign WVR-firms would therefore cease to be subject to the Takeover Code, but, in most cases, the application of transfer-driven sunset clauses will prevent the extraction of control premia and obstruct (at least to the same extent as in a OSOV-firm) inefficient takeovers. In a particular set of circumstances, though, the transfer-driven sunset clause could be circumvented - if multiple persons, in a premium-listed WVR-firm, hold superior-shares, a transfer of shares from one of those superior-shareholders to another would not, as a permitted transfer, trigger the transfer-driven sunset clause. This could prejudice inferior-shareholders since control could shift into the hands of a superior-shareholder who did not have, prior to the relevant transfer, individual control over the company; the inferior-shareholders could rightly consider this to be a material change in circumstances that justifies the making of a mandatory offer for the remaining shares. The

[255] n 59 Chapter 2.
[256] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.
[257] n 132 Chapter 1.

Takeover Code already acknowledges a similar scenario in the context of OSOV-firms, where members of a concert party sell shares between themselves, resulting in a change in composition of the concert party. Where such sales result in a single member of the concert party crossing a relevant threshold, a mandatory offer requirement is triggered, unless waived by the Takeover Panel.[258] In deliberating a waiver, the Takeover Panel will consider, amongst other things, 'whether the leader of the group or the member with the largest individual interest in shares has changed and whether the balance between the interests in the group has changed significantly' and 'the relationship between the persons acting in concert and how long they have been acting in concert'.[259] For a WVR-firm to which the Takeover Code applies, the same considerations would be made upon a transfer of shares between superior-shareholders, who, as owners seeking to retain control amongst themselves as a collaborative group, may well be considered to be a concert party by the Takeover Panel.[260] However, for a foreign firm to which the Takeover Code does not apply, a hole exists and a mandatory offer would not be triggered in this case. It is not, though, proposed that Rule 9 of the Takeover Code be extended to foreign companies, since the Takeover Panel has ruled-out extending the Takeover Code generally to EEA companies post-EU withdrawal on the basis of difficulties in extra-territorial enforcement of the rules and decisions of the panel, including the ability to seek compliance orders from the Courts,[261] and the potential for conflicts with local securities laws.[262] Although mechanisms could be developed to assuage the Takeover Panel's concerns regarding extra-territorial jurisdiction, the fact that the regulators are content for mandatory-offer provisions to only apply to locally-registered listed-companies suggests that the regulators are comfortable that a substantive public shareholder protective measure will not be available to many listed-companies. On that basis, it would be challenging to lobby for a different approach for WVR-firms specifically, which would require the formulation of complex mechanics and procedural rules. Furthermore, at least in jurisdictions subject to the EU Takeover Directive, mandatory-offer rules will have been adopted under local regulations.

For companies that are subject to the Takeover Code, certain amendments should be considered for the purposes of WVR-firms. Since superior-shares will remain unlisted, when a mandatory offer is triggered, the price to be offered for superior-shares and inferior-shares can not be calculated based upon middle-market quotation differentials between the two classes of shares.[263] The Takeover Panel should, therefore, clarify how inferior-shares will be priced in the context of a mandatory offer triggered by the acquisition of unlisted superior-shares, in order to ensure that such a price is 'comparable' as required by the Takeover Code.[264] As referenced in Chapter 3, many US-WVR-firms voluntarily adopt coat-tail provisions, limiting the levels of control premia in the US; however, if WVR-firms were to become prevalent on the LSE, in order to forestall uncertainty as to whether the Takeover Code already provides sufficient protection against

[258] Takeover Panel, Note 4 to Rule 9.1.
[259] Ibid.
[260] 'Persons acting in concert' comprise persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control of a company or to frustrate the successful outcome of an offer for a company.' (Takeover Code, Definitions).
[261] CA 2006, s.955.
[262] n 257 above 10.
[263] See: Chapter 3.
[264] Ibid.

control premia (negating the need for voluntary adoption of coat-tail provisions), greater clarity should be articulated. Guidance to the effect that the superior-shares and inferior-shares would be priced equally in such circumstances would be welcome – much in the same way that coat-tail provisions apply in Canada.[265]

Another interesting interplay with Rule 9 of the Takeover Code caused by the application of sunsets is the potential for a mandatory offer requirement being triggered by the conversion of superior-shares into inferior-shares. The Takeover Code does not expressly foresee such a scenario and should be clarified. Currently, the Takeover Code broadly follows an approach such that mandatory offers are not triggered where a person exceeds a triggering threshold through no action of their own. For example, if a person crosses a threshold as a result of the company redeeming or purchasing its own securities, or as a result of the enfranchisement of non-voting shares, that person is not normally required to make a mandatory offer, unless that person, at the time of acquiring the shares, had reason to believe that such a redemption or buy-back, or enfranchisement, would take place, or, in the case of redemptions and buy-backs, that person is also a director.[266] However, with respect to sunsets, the cogitation is more nuanced, and should be considered in light of whether the mandatory offer is imposed on superior-shareholders or inferior-shareholders.

There is cogency in the argument that inferior-shareholders should be protected if one or more superior-shareholders acquire control as a result of another superior-shareholder's superior-shares converting to inferior-shares upon the trigger of a sunset. Similar to transfers between superior-shareholders as discussed above, such a conversion could create a material change in the control dynamics of the superior-shareholder group. The superior-shareholders, if they are a close group of founders, would likely be aware of each other's intentions, or could ensure that they would be so aware by entering into contractual arrangements between themselves requiring the giving of adequate notice to each other of any actions that may trigger sunsets.[267] However, it is not hereby proposed that the Takeover Code abandons its 'no-fault' approach. Where one superior-shareholder's shares are converted to inferior-shares, all the remaining superior-shareholders will benefit from an increase in their proportion of the voting rights, rather than in the transfer scenario, where voting control could be manipulated into the hands of a specific superior-shareholder. Furthermore, if the mandatory offer rules were to apply in these circumstances, depending upon how votes are distributed, it could hinder the exit of a superior-shareholder without the other superior-shareholders having to either make an offer for all the shares in the company, seeking a waiver from the Takeover Panel (which would first require an approval by the Independent Shareholders[268]), or relinquish control by selling or voluntarily converting (if power to do so has been retained under the constitutional documents) their superior-shares. This could deter issuers from choosing the premium-tier to list with WVR-structure, and a change to the Takeover Code is not therefore proposed.

An inferior-shareholder could also cross a mandatory offer threshold as a result of superior-shares converting to inferior-shares, upon the triggering of sunsets, most probably as a result of a total conversion of all superior-shares into inferior-shares. Again, it is proposed that the Takeover Code retains its 'no-fault'

[265] n 110 Chapter 3.
[266] Takeover Code, Rule 37.1; Note 1 to Rule 37.1; Notes on Dispensations from Rule 9, Note 6.
[267] Such contractual arrangement would likely also include standstill and rights of first refusal provisions.
[268] Takeover Code, Note 1 to Rule 37.1.

approach, since, in effect, this mirrors the 'enfranchisement of non-voting stock' scenario already contemplated by the Takeover Code. Therefore, echoing the current treatment of non-voting stock-enfranchisement, a minor amendment to the Takeover Code should be made, in contemplation of WVR-firms, to provide that a mandatory offer would only be required, if the inferior-shareholder, at the time of acquiring inferior-shares, had reason to believe that such superior-share conversion would take place. This would cover a situation where, for example, the founders have announced their retirement dates as directors (and therefore a subsequent conversion of their superior-shares to inferior-shares pursuant to the director-linked sunset) and an activist investor, such as a hedge fund, acting upon such information, acquires inferior-shares prior to the retirement dates, in an attempt to acquire effective control without having to make a mandatory offer. The provision should only be triggered where all superior-shares are to become inferior-shares (which is likely to be the case if an inferior-shareholder crosses the threshold in these circumstances), otherwise the perverse situation could occur where an inferior-shareholder is required to make an offer for the remaining inferior-shares, and takes the company private, without the acquiescence of a remaining, potentially large, superior-shareholder.

9. Conclusion

If WVR-structure were permitted on the premium-tier, this Chapter has synopsised a clear package of protections that would provide safeguards for inferior-shareholders, combining regulatory restrictions with disclosure requirements, governance rights and an effective enforcement environment. The package comprises transfer-driven, director-linked and ownership-linked sunset clauses, additional approval, where shares are treated uniformly as OSOV, being required for specific resolutions, independent director appointment rights for inferior-shareholders, a stronger related-party transaction regime, disclosure of inferior-shareholder voting, and an enhanced disclosure environment generally. Additionally, the FCA would have discretion as to whether to admit WVR-firms based upon broad admissions criteria. Minor changes have also been proposed to the Takeover Code. The package gives inferior-shareholders greater comfort that they will not be egregiously expropriated, and that the WVR-tradeoff is more likely to swing in a positive direction. Accordingly, discounts applied to WVR-firms should be minimised, and cost of capital correspondingly reduced. The package should rarefy WVR-firm debacles, and support the listing of WVR-firms (that may otherwise not list) without compromising the reputation of the premium-tier.

The proposals outlined represent a balanced protection package for inferior-shareholders that treads the fine line between sufficient protection, on one side, and, on the other, excessive restrictiveness that could undermine the primary benefits for founders in issuing WVR-stock, deterring them from listing. Flexibility is preserved, since changes to statutory legislation are not proposed, with most of the proposals fulfilled by introducing provisions to the Listing Rules. The FCA can, periodically, keep under review the adequacy of the protections and the burdens that they impose on controllers. If the package slips across the fine line that is being negotiated, the FCA can make the necessary amendments to the Listing Rules in a more streamlined manner than would be the case with amendments to statutory legislation. Crucially, the proposals are not

significantly more onerous than those imposed in Hong Kong, Singapore, China and Japan, and, in many respects, are more flexible. WVR-firms have not been deterred by the restrictions imposed in those jurisdictions – for example, Hong Kong has attracted the blue-chip tech WVR-listings of Xiaomi and Meituan Dianping, as well as a 'homecoming' of sorts for Alibaba by way of secondary listing. Even some NYSE WVR-firms have voluntarily adopted a number of the proposals. Therefore, the package should allow the LSE to be competitive in the market for WVR-firms.

In fact, it is contended that the package will enhance investor confidence in the premium-tier for WVR-firms, and reduce the cost of capital for WVR-firms that would otherwise be higher if the package were not implemented. Therefore, rather than making it less likely for a WVR-issuer to choose the premium-tier, the package makes it more attractive. Overall, the opening of the premium-tier to WVR-firms, together with the implementation of the balanced package, should achieve the goal of attracting more quality-firms to the premium-tier that would otherwise not float. However, the FCA should monitor developments in other jurisdictions, and determine whether the restrictions that have been imposed on WVR-firms in those jurisdictions protect inferior-shareholders in practice, and/or the restrictions are so severe that applicants are rejecting those exchanges in favour of more permissive regimes, such as the NYSE. It will be interesting, in the years ahead, to observe whether the restrictions imposed by, for example, Hong Kong, result in lower cost of capital for WVR-firms compared to, say, NYSE, and whether that leads to NYSE-issuers voluntarily adopting inferior-shareholder protections to similarly reduce their cost of capital. These factors will be pertinent to the FCA's review of the protective measures going forward.

EPILOGUE

The search for the British Google has begun, with the FCA acknowledging a desire to support the growth of science and technology companies. However, Britain has a problem. When a UK-technology company grows to a certain size, a founder wishing to float the company on the UK's most prestigious tier, in order to crystallise wealth and grow the company further, will be on the horns of a dilemma. The founder can list and lose control as ownership becomes dispersed, leaving management beholden to the whims of public shareholders and the market for corporate control, and potentially prejudicing the ability of the founder to pursue its long-term idiosyncratic vision. Alternatively, the founder can retain control post-IPO but limit the diversification of wealth and generation of equity financing. Entering as a *deus ex machina*, WVR-structure would enable founders to achieve their diversification and equity financing goals, while continuing to maintain control. With the uncertainty of the UK's relationship with the EU, a plummeting pound, and competition from other exchanges which have long permitted, or have recently determined to permit, WVR-firms, the UK will be hamstrung if it does not remain nimble. Concerns appear to have played-out in the technology domain, with numerous large British tech-firms selling-out to international peers rather than listing in the UK. UK-public investors have not had the opportunity to share in the growth and success of such companies.

The key concerns in admitting WVR-firms to the premium-tier are that the structure could incentivise nefarious conduct by controllers, leading to the extraction of pernicious controller benefits that expropriate the public shareholders, and that an underperforming management team that does not manage the company in a shareholder-wealth maximising manner could become entrenched. Although similar issues are inherent in OSOV-controlling shareholder firms, with the implementation of a Wedge between the voting and cash-flow rights of the controller, the diminution of the equity-constraint on the controller accentuates the negative aspects of the ownership structure. However, the premium-tier prohibition of WVR-firms does not stem from a forensic analysis as to whether controllers are likely to act in a negative manner, but rather an inclination of the regulators to kowtow to institutional investors. Sympathy can be offered to the FCA given the influential position of institutional investors in the UK-public markets, but it is not credible that the admission of WVR-firms to the premium-tier would result in the mass exodus of institutional investors from the LSE. Institutional investors, however grudgingly, do invest in US-listed WVR-firms in significant levels, and Hong Kong and Singapore have not seen a flight of investors since they introduced WVR-firms. If the premium-tier prohibition is to continue, it would be better if it were based upon robust theoretical and evidentiary grounds.

Why would a founder be a 'control freak'? The answer can be framed around the notion of controller benefits. By retaining control, the founder can ensure that the company takes actions that create personal benefits for the controller. The theoretical benefits and detriments of WVR-firms can be painted in light of the types of controller benefits. Certain types of controller benefits are benign - they are overall either neutral to the public shareholders, or create consequential benefits for public shareholders - which manifest themselves as the positive aspects of WVR-firms. Controller benefits are, otherwise, pernicious,

overall negatively affecting public shareholders and therefore representing the detriments of WVR-firms. A tradeoff can be established such that where benign controller benefits outweigh pernicious controller benefits, WVR-structure will be beneficial for controllers and public shareholders. The tradeoff is firm-specific, and WVR-structure may be net-beneficial for some types of firms and net-detrimental for others. However, the same could also be said of OSOV. The regulator is shooting itself in the foot by ruling-out an option for listed-companies that represents the most beneficial capital structure for certain firms.

If the empirical evidence were to suggest that the WVR-tradeoff is, in fact, shifted into a substantially net-detrimental position on average, the justification to disallow WVR-firms becomes more convincing. However, WVR-firms show at least as good, and in numerous studies, better, operating performance compared to OSOV-firms. Although expropriation could be occurring post-profits, in a high investor protection environment such as the UK (and the US where the majority of studies have been conducted) the types of pernicious controller benefits that could be extracted post-profits are significantly limited. Many studies do, though, show WVR-firms to be valued less than OSOV-firms. This suggests that investors are discounting WVR-firms to protect themselves from the perceived risks of the structure. An argument that WVR-firms should be prohibited in order to protect investors quickly crumbles where the investors are organically protecting themselves by pricing-in their risk. Studies show that portfolios of WVR-firms earn investors returns at least on a par with, and in many cases greater than, portfolios of similar OSOV-firms. Investors are not, on average, harmed by WVR-firms. If anything, the discounts that investors are applying are not warranted by operating performance or returns. From the perspective of issuers, excessive discounting disproportionately increases the cost of capital for WVR-firms, even where the structure has been adopted for purely benign reasons.

Therefore, theoretical and empirical evidence does not support an outright prohibition of WVR-firms. However, especially in the early stages of any relaxation of the rules, simply opening the dam may not be the prudent approach. In such a case, WVR-firms would be significantly discounted, harming the equity financing of such firms, and even deterring their listings. By combining the acceptance of WVR-firms to the premium-tier with the introduction of shrewdly formulated restrictions, investors can be given comfort that they will be protected from the most egregious aspects of expropriation and, accordingly, the cost of capital for WVR-firms will be reduced.

Any restrictions that are proposed need to tread a fine line between protecting public shareholders and giving controllers sufficient flexibility to enable them to extract benign controller benefits, such as the pecuniary and non-pecuniary controller benefits related to pursuing a long-term vision. If that line is not carefully observed, any relaxation of the rules may be rendered moot by those restrictions being too onerous to attract issuers. A balanced package of protections has been proposed. The package acknowledges that certain events that occur over time could increase the risks that the WVR-tradeoff will shift into a net-detrimental position; when such events occur, superior-shares will automatically convert, in whole or in part, into inferior-shares. In that way, voting power can revert to the public shareholders when the risks of pernicious controller benefit extraction increase. The approach resonates with contemporary theoretical and empirical studies that suggest that WVR-structure is beneficial for young, growth-phase firms, with those

benefits eroding with maturity. The package also encompasses limited corporate governance measures that temper the extraction of pernicious controller benefits while the WVR-structure subsists. Finally, the package gives the FCA leeway in relation to whether to admit WVR-firms on a firm-by-firm basis, and recognises that controllers should justify the need for WVR-structure, and should show that those holding superior-shares have been, and are, integral to the success of the business. The ability to manage a business in accordance with a long-term vision is fundamental to many of the theoretical benefits of WVR-firms, and without that facet, greater perils subsist that the structure is being implemented to extract pernicious controller benefits. The protection package proposed would place the UK somewhere between the US and the Far East in terms of permissiveness, and uses a regulatory methodology that retains scope for ongoing review and reform. Hong Kong, in particular, has attracted high-profile WVR-firms to its exchange notwithstanding taking a more restrictive approach, and, therefore, the protection package proposed for the UK should not have the contrary effect of debilitating the very benefits in attracting listings that opening-up the premium-tier to WVR-firms is intended to achieve.

The evidence suggests that the UK's fear of 'founders without limits' is inflated, and by relaxing the premium-tier prohibition of WVR-firms in conjunction with judicious restrictions, an environment can be created that supports the listing of UK-businesses, while limiting the downsides. The package is by no means foolproof, and controllers with insidious intentions may well still list their firms and expropriate public shareholders. However, the risks will be mitigated. Risks of public investors being harmed also apply to OSOV-firms, and, therefore, the approach should mirror that taken toward dispersed-ownership OSOV-firms, where regulations and corporate governance mechanisms have been formulated to reduce, although not eliminate, agency costs. Even in the US, which adopts a more permissive WVR-environment, the empirical evidence suggests that, from an operating performance perspective, there are more WVR-firm 'winners' than 'losers'.

WVR-structure is not a panacea to unearthing the elusive British Google. Founders may still see other benefits in selling their tech-companies to foreign acquirors, such as high offer prices propelled by a weak pound, and the ability to create inter-company synergies and gain access to wider data. Additionally, relaxing the rules on WVR-firms will need to be integrated into a market that promotes innovation, entrepreneurship and long-termism. However, permitting WVR-firms on the premium-tier does form one step in supporting the development of large, successful, growing British businesses, in which the public can participate. The introduction of WVR-structure in a sensible manner could engineer a burgeoning market for such firms, thereby bolstering and enriching the British economy in uncertain times. Founders without limits will no longer be associated with limitless abuse, but, instead, with limitless possibilities.

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