

# Up the Hill and Down Again: Constraining Dual-Class Stock

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**Key Words:** Dual-Class Stock, Listing Rules, UK Listing Review, Sunset Clauses, Long-Termism, Big Tech

## *Abstract*

*The headline recommendation of Jonathan Hill's 2021 UK Listing Review was that dual-class stock should be permitted on the premium-tier of the London Stock Exchange. The aspiration was to encourage more high-quality UK equity listings, particularly of high-growth tech-companies, for which dual-class stock is especially beneficial. Dual-class stock allows founders to list their firms, and retain majority-control, while holding significantly less of the cash-flow rights in the company. However, in the UK, dual-class stock is usually discussed in qualified terms, in an attempt to placate sceptical institutional shareholders. Using the UK Listing Review as a platform, this article explores the constraints commonly proposed to be attached to dual-class stock, and argues that, although it is important to protect public shareholders, constraints must not be too severe. A balance must be respected otherwise UK initiatives to relax rules on dual-class stock could deter the very firms they are intended to attract.*

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## **1. Introduction**

In November 2020, in the shadow of Brexit, and the emerging potential for the UK to take control of its financial services laws and regulations, HM Treasury commenced a review into the competitiveness of the UK's listed company regime.<sup>1</sup> It would be undertaken in the context of traditional industries being displaced by high-growth technology, e-commerce and science companies,<sup>2</sup> with a view to

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<sup>1</sup> HM Treasury, 'Call for Evidence – UK Listing Review' (19 November 2020).

<sup>2</sup> *ibid.*

encouraging “more high-quality UK equity listings and public offers”.<sup>3</sup> Jonathan Hill, as Chair, solicited views and evidence on, *inter alia*, free-float requirements, prospectus regulations, and, crucially, dual-class stock. Dual-class stock is where a company issues two (or more) classes of shares, with at least one class having attached to it a disproportionately high level of voting rights – rights to vote at a general meeting of shareholders - as compared to cash-flow or equity rights – rights to dividends or distributions upon a winding-up. Dual-class stock therefore enables a founder of a company to list its company, sell a majority of the existing stock on the public markets, and raise finance for future growth, without losing control. Such a structure can be especially beneficial for high-growth companies from the tech-sphere, since founders may, even upon listing, desire to retain control of the company to pursue an idiosyncratic vision<sup>4</sup> which is not easily observable to the public markets. With control, a founder can cause the company to invest in research and development (R&D) and other long-term initiatives without fear of removal from the company by the public shareholders or by a predatory acquiror subsequent to short-lived periods of low share price. However, until recently, the most prestigious segment of the London Stock Exchange’s (LSE) Main Market, the premium-tier, was hostile to dual-class stock, implementing an effective prohibition when the segment was created.<sup>5</sup>

Dual-class stock pervades the current UK regulatory discourse.<sup>6</sup> The conclusions of the UK Listing Review (the Review),<sup>7</sup> published in 2021, appeared to finally climb the steep hill to relaxing the premium-tier prohibition of dual-class stock, bringing the UK into line with numerous other major stock exchanges around the world, such as the New York Stock Exchange (NYSE), the Nasdaq Stock Exchange (Nasdaq), Hong Kong, Singapore, Shanghai, India and Tokyo. Although, as the regulator of the Main Market, the Financial Conduct Authority (FCA) must conclude a consultation process on

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<sup>3</sup> HM Treasury, ‘Policy Paper: Terms of Reference: Lord Hill’s review on listings’ (19 November 2020)

<sup>4</sup> Z Goshen and A Hamdani, ‘Corporate Control and Idiosyncratic Vision’ (2016) 125 Yale LJ 560, 577.

<sup>5</sup> n 15 and accompanying text.

<sup>6</sup> BEIS Green Paper, ‘Building our Industrial Strategy’ (January 2017) 1, 67; FCA Discussion Paper DP17/2, ‘Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape’ (February 2017) 1, 8 and 22; HM Treasury, ‘Financing growth in innovative firms: Consultation’ (August 2017) 1, 33; R Kalifa, ‘Kalifa Review of UK Fintech’ (26 February 2021) 1, 65.

<sup>7</sup> HM Treasury, ‘UK Listing Review’ (3 March 2021)

associated changes to the Listing Rules<sup>8</sup> before the Review's proposals become effective, it does appear that the UK is inexorably on course to relax its rules on dual-class stock. In fact, reports suggest that the issuer of a recent initial public offering (IPO) on the LSE Main Market's standard-tier was informally notified prior to IPO that it was likely that dual-class stock will be permitted on the premium-tier in the foreseeable future.<sup>9</sup> Whether or not the rules are relaxed subsequent to the FCA's consultation, dual-class stock will remain front-and-centre of UK corporate governance debates for years to come. However, with the level of hostility to dual-class stock that exists amongst the UK institutional investor community, as evinced during the Call for Evidence phase,<sup>10</sup> any relaxation of the premium-tier prohibition on dual-class stock will be accompanied by conditions designed to protect public shareholders from potential abuses of the structure and to appease institutional investors. Accordingly, unlike the US, where dual-class stock is permitted on the NYSE and Nasdaq with very few restrictions, the Review has proposed numerous conditions that it is hoped will maintain the high corporate governance standards of the premium-tier.<sup>11</sup>

Subjecting dual-class stock to restrictions resonates with the approach of several Asian exchanges such as Hong Kong, Singapore, Tokyo, India and Shanghai. However, it is not axiomatic that subjecting dual-class stock to a package of public shareholder protection mechanisms will continue to support the growth and innovation that dual-class stock is intended to achieve. This article commences by discussing the premium-tier's approach to dual-class stock, following which the propensity for dual-class stock in general to satisfy the objectives of the Review will be presented. Using the conditions proposed by the Review as a launching point, this article will then critically assess the types of constraints commonly proposed to be placed upon the operation of dual-class stock. It will

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<sup>8</sup> The listing rules sourcebook as published by the FCA exercising its primary market functions, which applies to Main Market-listed companies.

<sup>9</sup> T Bradshaw, 'Deliveroo targets £10bn valuation in London IPO' *Financial Times* (4 March 2021)

<https://www.ft.com/content/f8108b89-419f-40e8-97c9-ce2c15b905e9>

<sup>10</sup> H Jones, 'British company bosses warn against 'race to the bottom' in listing review' *Reuters* (6 January 2021)

<https://www.reuters.com/article/us-britain-ipo-idUSKBN29B1QY>

<sup>11</sup> Review (n 7) 19.

be discussed that it is imperative that the design of constraints, that protect public shareholders from potential abuses by controllers, must also appreciate the freedom that founders seek through the adoption of dual-class stock to pursue their visions for their businesses. The article will conclude with a discourse on the challenges facing UK regulators in developing rules that balance the interests of public shareholders and founders, especially when confronted with a traditionally powerful body of UK institutional investors. However, unless that balance is maintained, climbing up the hill to relax the premium-tier prohibition of dual-class stock to attract further listings will be nothing but a futile endeavour.

## 2. Dual-Class Stock and the Premium-Tier

Although dual-class stock had been previously permitted on the LSE's Main Market,<sup>12</sup> after an informal discouragement of new listings of dual-class stock in the 1960s,<sup>13</sup> in 2010, upon the delineation of the Main Market into premium- and standard-tiers, non-voting stock was formally prohibited from the premium-tier,<sup>14</sup> followed by, in 2014, a *de facto* premium-tier prohibition of classes of stock with voting rights disproportionate to their equity rights.<sup>15</sup> The premium-tier was pitched as the most prestigious tier of the LSE, to which are attached the highest standards of corporate governance, and existing dual-

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<sup>12</sup> Blue-chip companies such as Marks and Spencer, Ranks, and House of Fraser once adopted dual-class stock (B Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford University Press 2008) 317).

<sup>13</sup> Cheffins (ibid) 317; 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; B Cheffins, *Company Law: Theory, Structure and Operation*, (Oxford University Press 1997) 472 and 475.

<sup>14</sup> Financial Services Authority, 'Listing Regime Review: Feedback on CP09/24 and CP09/28 with final rules' (February 2010).

<sup>15</sup> See Listing Rules, Premium Listing Principles 3 and 4. Although, technically, a dual-class structure with unlisted enhanced-voting shares would not be contrary to the Premium Listing Principles, in practice, it would be inadmissible as infringing the spirit of the Premium Listing Principles (FCA Policy Statement PS14/8, 'Response to CP13/15 – Enhancing the effectiveness of the Listing Regime' (May 2014) 31).

class companies were required to shift their inferior-voting stock from the premium-tier.<sup>16</sup> Dual-class stock can, though, be listed in the UK on the standard-tier and high-growth segment of the Main Market, and, outside of the Main Market, on the Alternative Investment Market (AIM),<sup>17</sup> and the Acquis Stock Exchange (Acquis).<sup>18</sup> Therefore, a brief exposition as to why the UK public markets do not already present a welcoming environment for dual-class stock founders is felicitous.

AIM, Acquis and the Main Market's high-growth segment each cater for specific, albeit overlapping, audiences, with investor bases that reflect the types of issuers that float on those exchanges. AIM was established for small, growing companies, with less onerous listing requirements,<sup>19</sup> and Acquis, with its main and growth markets, sits even below AIM with respect to the size of the companies it is attempting to attract.<sup>20</sup> Although the Main Market's high-growth segment was established to attract companies too large for AIM,<sup>21</sup> and, in particular, high-growth tech-companies, it is considered as only a market for mid-sized companies,<sup>22</sup> not able to satisfy the free-float requirements of the premium- and standard-tiers,<sup>23</sup> and, as of the date of writing, only two companies have ever listed on the segment.<sup>24</sup> When a company outgrows AIM, Acquis or the high-growth segment, it is likely to desire a graduation to the standard- or premium-tiers to access the broader base of investors therein, together with the resultant enhanced share price and liquidity. Therefore, even if the openness to dual-class stock of those

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<sup>16</sup> eg Schroders, Hansa Investment Company, and Daily Mail and General Trust.

<sup>17</sup> However, dual-class stock is currently discouraged from AIM (T Egan and others, 'The revival of dual class shares', IFLR (Spring 2020) <https://www.iflr.com/article/b1lmx6clj4l38j/the-revival-of-dual-class-shares>)

<sup>18</sup> An alternative trading platform formerly known as the NEX Exchange.

<sup>19</sup> White Page Ltd in association with the London Stock Exchange, 'A Guide to AIM' (2010) 1, 4.

<sup>20</sup> AQSX, 'Market Consultation Paper' (1 May 2020) 1, 1 and 4.

<sup>21</sup> LSE, 'High Growth Segment' <https://docs.londonstockexchange.com/sites/default/files/documents/hgsflyer.pdf>

<sup>22</sup> Practical Law Company, 'Introduction to the High Growth Segment' [https://uk.practicallaw.thomsonreuters.com/7-525-8411?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/7-525-8411?transitionType=Default&contextData=(sc.Default)&firstPage=true)

<sup>23</sup> Unless waived, at least 25 per cent of listed shares must in public hands (Listing Rules, rules (LRs) 6.14R, 9.2.15R and 14.2.2R).

<sup>24</sup> See Practical Law Company, 'What's Market, IPOs: Main Market' [https://uk.practicallaw.thomsonreuters.com/Browse/Home/Resources/IPOsMainMarket?transitionType=Default&contextData=\(sc.Default\)&navId=A90F79070BFD8D395C00ACF51F6729B4&comp=pluk](https://uk.practicallaw.thomsonreuters.com/Browse/Home/Resources/IPOsMainMarket?transitionType=Default&contextData=(sc.Default)&navId=A90F79070BFD8D395C00ACF51F6729B4&comp=pluk)

lesser boards was successful in attracting the high-growth companies pursued by the UK,<sup>25</sup> the growth of such companies would be stunted unless they can ‘upgrade’, and, accordingly, the rules of the standard- and premium-tier become germane.

As above, dual-class stock is, though, permitted on the standard-tier, which does envisage larger company listings. However, as of the time of writing, only two companies have undertaken IPOs on the standard-tier with structures resembling anything like dual-class stock – in 2020, The Hut Group floated with the founder holding a single ‘special share’ which, in effect, ascribes the right to block takeovers for a period of three years post-IPO,<sup>26</sup> and, in 2021, Deliveroo listed with a more traditional dual-class stock structure ingraining voting control in the hands of a founder holding only a minority of the equity for a period of three years post-IPO.<sup>27</sup> Even though the US has seen a surge in founders adopting dual-class stock on the listed markets,<sup>28</sup> to the extent dual-class stock can attract founders to list,<sup>29</sup> they have not been attracted in droves by the standard-tier’s openness to the structure. There are two main reasons. Firstly, the ‘standard-tier’ suffers from an identity-crisis, with poorly defined objectives as to the issuers it is seeking to attract and with little to distinguish itself from the premium-tier over-and-above permitting laxer listing standards.<sup>30</sup> Issuers and investors alike view the segment as being inferior to the premium-tier.<sup>31</sup> The Hut Group and Deliveroo are unusual in representing large,

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<sup>25</sup> eg see Review (n 7) 1 and 7.

<sup>26</sup> Upon a change of control, the special shareholder can veto any shareholders’ resolution (THG Holdings plc, ‘Prospectus’ (10 September 2020) 186; THG Holdings plc, ‘Articles of Association adopted by special resolution passed on 9 September 2020’ articles 69.1 and 69.6).

<sup>27</sup> Deliveroo Holdings plc, ‘Prospectus’ (March 2021) 3 and 21.

<sup>28</sup> In 2020, 15 per cent of US IPOs adopted dual-class stock – strikingly, they accounted for 60 per cent of the IPO market capitalisation for the year (Council of Institutional Investors (CII), ‘Dual-Class IPO Snapshot 2017-2020 Statistics’ (2021) <https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf>).

<sup>29</sup> See ‘Dual-Class Stock to the Rescue’ below.

<sup>30</sup> Review (n 7) 22.

<sup>31</sup> FCA (n 6) 19.

high-profile, UK standard-tier listings,<sup>32</sup> but the restriction to the standard-tier (as a result of their capital structures) will have entailed compromises for the companies. For instance, The Hut Group delayed listing until it was sufficiently mature to attract an adequate level of investors and liquidity despite the diminished status of the standard-tier,<sup>33</sup> and, in fact, after taking into account IPO pre-allocations (including to existing investors)<sup>34</sup> and private placements,<sup>35</sup> only around 25 per cent of the issued shares in the company became widely available to public shareholders; the existing pre-IPO shareholders retained a majority (and a significant majority of the fully diluted) share capital of the company. Although Deliveroo listed as a younger company,<sup>36</sup> its business model had been significantly accelerated by the 2020 pandemic,<sup>37</sup> and, again, only a minority of shares were offered to the public, with seventy per cent retained by pre-IPO shareholders,<sup>38</sup> and thirty per cent of IPO shares allocated to three ‘anchor investors’.<sup>39</sup> Notably, speculation was rife that Deliveroo was using the standard-tier as merely a staging-post until graduation to the premium-tier would become possible after the relaxation of its prohibition of dual-class stock.<sup>40</sup> Second, non-premium-listed firms are ostracised from the FTSE UK Index Series (including, for example, the FTSE-100 and FTSE-350).<sup>41</sup> Ostracism from the indices

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<sup>32</sup> The IPO valuations of The Hut Group and Deliveroo were £5.4bn and £7.6bn, respectively (A Ramnarayan and S Cruise, ‘The Hut Group shares soar 30% after bumper \$7 billion IPO’ *Reuters* (16 September 2020) <https://uk.reuters.com/article/uk-the-hut-group-trading/the-hut-group-shares-soar-30-after-bumper-7-billion-london-ipo-idUKKBN2670QJ>; T Bradshaw and A Mooney, ‘Disaster strikes as Deliveroo becomes “worst IPO in London’s history”’ *Financial Times* (31 March 2021) <https://www.ft.com/content/bdf6ac6b-46b5-4f7a-90db-291d7fd2898d>).

<sup>33</sup> The Hut Group was sixteen years old at IPO.

<sup>34</sup> THG Prospectus (n 26) 172.

<sup>35</sup> *ibid* i.

<sup>36</sup> Deliveroo was eight years old at IPO.

<sup>37</sup> S Butler and K Makortoff, ‘Deliveroo sets aside £112m to cover legal costs of delivery rider cases’ *The Guardian* (8 March 2021) <https://www.theguardian.com/business/2021/mar/08/deliveroo-losses-flotation-covid-ipo-london-stock-exchange>

<sup>38</sup> Derived from data set-out in Deliveroo Prospectus (n 27) 181-182.

<sup>39</sup> M. Taylor, ‘Deliveroo’s shares are a mess’ *Wired* (31 March 2021).

<sup>40</sup> *ibid*; Bradshaw (n 9).

<sup>41</sup> The FTSE-indices comprise sub-categories of firms ranked by market capitalisation.

is a key reason why the standard-tier is considered unattractive,<sup>42</sup> since it excludes issuers from investment by passive investors with investment strategies that simply track specific indices,<sup>43</sup> and the corresponding increase in liquidity and share price.<sup>44</sup> Of further importance, given the UK Government's aspirations to 'empower' retail investors and increase the opportunities for investors to share in the growth of companies,<sup>45</sup> is that many pension plans and other investment products pursue passive investment strategies, meaning that the capacity for the general public to participate in a diversified manner in the performance of dual-class companies is curtailed if they are restricted to the standard-tier and omitted from the indices.<sup>46</sup> As an example, perversely, passive investors tracking the FTSE-100 are currently not able to invest, or share, in the burgeoning post-IPO share price of, The Hut Group, even though it would otherwise sit comfortably within the FTSE-100 based upon market capitalisation.<sup>47</sup>

Although the prospects of the standard-tier may be improved if it were to be 're-branded' and if standard-tier constituents were to become eligible for index-inclusion,<sup>48</sup> in relation to the former, it

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<sup>42</sup> Review (n 7) 23.

<sup>43</sup> L Bebchuk and S Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (2019) 119 Colum L Rev 2029, 2044; B Cheffins, 'The Undermining of UK Corporate Governance (?)' (2013) 33 OJLS 503, 508.

<sup>44</sup> B Sharfman, 'A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs' (2018) 63 *Villanova L Rev* 1, 4; R. Anderson et al, 'The Dual Class Premium: A Family Affair' (2017) 1, 7 <https://ssrn.com/abstract=3006669>; D Lund, 'Nonvoting Shares and Efficient Corporate Governance' (2019) 71 *Stanf L Rev* 687, 711; S Hirst and K Kastiel, 'Corporate Governance by Index Exclusion' (2019) 99 *BU L Rev* 1229, 1253-4.

<sup>45</sup> Review (n 7) 43 and 1.

<sup>46</sup> MSCI, 'Should Equity Indexes Include Stocks of Companies with Share Classes having Unequal Voting Rights?' (January 2018) 1, 14; A Grinapell, 'Dual-Class Stock Structure and Firm Innovation' (2020) 25 *SJLBF* 40, 74. In the US, where the S&P has excluded dual-class stock (n 49), S&P 500 index-tracker returns would have been higher if dual-class stock had not been excluded (B Sharfman and V Deluard, 'How Discretionary Decision-Making Has Created Performance and Legal Disclosure Issues for the S&P 500 Index' (2021) 1, 33 [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3794306](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3794306)).

<sup>47</sup> As of 23 March 2021, with a market capitalisation of £6.615bn, The Hut Group would have been the seventy-eighth largest company within the FTSE-100 (data derived from LSE, 'FTSE 100' <https://www.londonstockexchange.com/indices/ftse-100/constituents/table?lang=en>).

<sup>48</sup> eg see the recommendations of the Review (n 7) 23-24.

would take time to change perceptions, and, in relation to the latter, the decision would be in the hands of private index providers in consultation with their institutional investor clients.<sup>49</sup> Additionally, even if issuers were to become more open to the standard-tier, firms may seek to upgrade to the premium-tier in the future. The strength of the UK public markets and its ability to attract high-growth companies are currently intrinsically linked to the admissions requirements of the premium-tier. In the next part of this article, the manner in which dual-class stock in general can succeed in attracting those companies will be discussed.

### 3. Dual-Class Stock to the Rescue

In acknowledging the important role that the public markets play in funding company growth and investment, and enabling investors to share in that growth, the Review noted the need to encourage the growth companies of the future to list in the UK.<sup>50</sup> However, recent experience suggests that the LSE's Main Market may not be cultivating an environment conducive to attracting those firms. The absolute number of companies on the Main Market fell by 57 per cent between 1999 and 2016.<sup>51</sup> Further data suggests a drastic fall of 40 per cent just between 2008 and 2020.<sup>52</sup> The decline does not simply stem from companies leaving the listed sector after public-to-private takeovers, but also ensues from a dearth of new listings. As shown in Figure 1, Main Market IPO have been moribund in recent years, with annual numbers not recovering to those seen before the 2008 financial crisis. The decay in IPOs is in stark contrast to the rise in private, unlisted, businesses, which have increased in the UK by 69 per cent between 2000 and 2019.<sup>53</sup> Furthermore, the types of companies that do list on the Main Market are not

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<sup>49</sup> In contrast, in the US, S&P, in 2017, excluded dual-class firms from its S&P Composite 1500 indices (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](https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf?force_download=true))

<sup>50</sup> Review (n 7) 1 and 7.

<sup>51</sup> FCA (n 6) 42.

<sup>52</sup> Review (n 7) 1.

<sup>53</sup> House of Commons Library Briefing Paper No. 06152, 'Business statistics' (16 December 2019) 1, 3.

evocative of the ‘new economy’ that the UK is seeking to attract,<sup>54</sup> with companies from such industries only comprising 14 per cent of the market capitalisation of LSE IPOs between 2007 and 2017 – as compared to 60 per cent and 47 per cent on NASDAQ and the NYSE, respectively.<sup>55</sup>

*[Insert Figure 1, appended]*

Dual-class stock could encourage listings of innovative high-growth companies, especially in the new economy sectors of tech and life sciences.<sup>56</sup> A one share, one vote prescription on the premium-tier is not appealing to such companies, due to the loss of control an IPO could entail for a founder of a large, innovative, high-growth company. A one share, one vote premium-tier listing could, if the founder does not retain a majority of the votes in the company, result in the founder becoming exposed to the whims of the public markets, since, for a company incorporated in England and Wales, those with majority-voting control can remove directors from the board,<sup>57</sup> have a decisive influence on appointments to the board,<sup>58</sup> and determine the outcome of takeover offers.<sup>59</sup> Since the board

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<sup>54</sup> See Review (n 7) 1-2. The ‘new economy’ describes the economic structure resulting from the intersection of globalisation and information technology (M. Pohjola, ‘The New Economy: facts, impacts and policies’ (2002) 14 *Information Econ & Policy* 133, 134.

<sup>55</sup> HKEX Concept Paper, ‘New Board’ (June 2017) 11.

<sup>56</sup> *ibid* 6.

<sup>57</sup> Companies Act 2006 (CA 2006), s.168.

<sup>58</sup> Commonly, the articles of association (articles) adopted by public companies are modified versions of the Companies (Model Articles) Regulations 2008, SI 2008/3229 (the Model PLC Articles). Under Model PLC Articles, article 20, an ordinary resolution, which requires a majority of votes exercised in favour (CA 2006, s.282), is required to appoint directors to the board or to re-elect at the annual general meeting (AGM) directors previously appointed by the board itself. Furthermore, premium-listed companies are required to apply the UK Corporate Governance Code (UK CGC). Although such companies can explain non-compliance with the UK CGC’s provisions (applying on a ‘comply-or-explain’ basis), it is expected that all directors will submit themselves to an annual shareholders’ vote for re-election (provision 18, UK CGC).

<sup>59</sup> If proceeding as a takeover offer, the minimum acceptance condition must result in the bidder acquiring at least a majority of the target’s voting rights (The Takeover Code as published by the UK’s Panel on Takeovers and Mergers (Takeover Code),

determines the strategy of the company, and, almost ubiquitously, has the power to hire and fire the management team,<sup>60</sup> a founder may fear that early- or growth-phase investments in R&D and product-cycles, resulting in short-term share price declines,<sup>61</sup> could lead to the founder being removed from the board by the public shareholders, or removed as an executive indirectly through the public shareholders' influence over board decision-making owing to their control over board composition. Similarly, a decline in share price could expose the company to a predatory takeover bid, subsequent to which the management team is changed by the acquiror.<sup>62</sup> Such fears are especially pertinent in the realm of high-growth tech-companies where forthcoming innovative products may need to be kept confidential,<sup>63</sup> and where the correlation between medium-to-long-term investment and future benefit may not be easily observable to public shareholders,<sup>64</sup> who accordingly undervalue the company. After all, a corollary of the assumption that innovative companies have visionary founders<sup>65</sup> is that those who are not so perspicacious can not fully appreciate the founder's idiosyncratic vision.

A founder could preserve control by listing and retaining a majority of the stock in the company. However, in so doing, the founder will crystallise less of its investment in the company, and, since further shares issuances will dilute the founder's interest, will be constrained in the level of equity finance that can be raised at IPO and on an ongoing basis.<sup>66</sup> Dual-class stock, could, though, ride to the

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Rule 10). If proceeding as a scheme of arrangement, subject to Court sanction, the takeover will be approved by a majority in number holding seventy-five per cent of the votes of members exercising votes at a Court Meeting (CA, s.899).

<sup>60</sup> The board, *prima facie*, has managerial power (Model PLC Articles, article 3), but will generally delegate to executives under its powers of delegation (article 5).

<sup>61</sup> 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>

<sup>62</sup> In relation to the 'market for corporate control', see n 77.

<sup>63</sup> Grinapell (n 46) 62.

<sup>64</sup> J Chemmanur, 'Dual Class IPOs: A theoretical analysis' (2012) 38 *J Bank Fin* 305, 306.

<sup>65</sup> Goshen and Hamdani (n 4) 577; Grinapell (n 46) 61-62.

<sup>66</sup> B Reddy, 'Finding the British Google: Relaxing the Prohibition of Dual-Class Stock from the Premium-Tier of the London Stock Exchange' 79 *CLJ* 315, 324.

rescue. By creating classes of shares to which are attached differing levels of voting rights, but equal cash-flow rights, the founder can, by holding enhanced-voting shares and issuing inferior-voting shares to the public, engineer a scenario where it maintains majority-voting control while only retaining a minority of the cash-flow rights. Accordingly, the founder is able to sell a large portion of its investment in the company without losing control, and, by issuing inferior-voting shares, can also raise finance at IPO and post-IPO while continuing to retain control.<sup>67</sup> With an unconstrained dual-class structure, with no restrictions as to when enhanced-voting rights can be exercised, the founder can guarantee his/her continued control and tenure as an executive, and takeovers of the company will not proceed without the founder's acquiescence. By assuaging the loss-of-control concerns of founders, dual-class stock can create a more welcoming premium-tier ecosystem for tech-companies.

#### **4. The Need for Constraints**

The preceding section of this article paints a pretty picture of dual-class stock. Read in isolation, one may therefore question why dual-class stock was ever prohibited from the premium-tier in the first place. The reason can be summed-up in four words – ‘private benefits of control’. The concept pertains to the founder exercising its voting control to cause the company to take actions that are personally beneficial to the founder, but potentially detrimental to shareholder-value. A controller of a one share, one vote firm, where the controller holds a majority of the shares, could also exercise its voting control in such a manner,<sup>68</sup> but, with dual-class stock, such behaviour is theoretically incentivised further, since the controller receives the full value of the extraction of the relevant private benefits, but only suffers from any commensurate fall in share price in proportion to a potentially disproportionately small equity

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<sup>67</sup> *ibid* 324.

<sup>68</sup> D Ratner, ‘The Government of Business Corporations: Critical Reflections on the Rule of One Share, One Vote’ (1970–1971) 56 *Cornell L Rev* 1, 20; B. Reddy, ‘The Fat Controller: Slimming Down the Excesses of Controlling Shareholders in UK Listed Companies’ (2018) 38 *OJLS* 733, 736; C Holderness and D Sheehan, ‘The Role of Controlling Shareholders in Publicly Held Corporations: An Exploratory Analysis’ (1988) 20 *J Financ Econ* 317, 318.

ownership.<sup>69</sup> The extraction of private benefits can manifest itself in a variety of ways, from blatant extraction of the company's assets,<sup>70</sup> to more subtle extraction through the pursuit of projects which create financial,<sup>71</sup> or non-pecuniary,<sup>72</sup> benefits for the founder, but which are not optimal for shareholder wealth-maximisation. A detailed consideration of those actions, and, in contrast, the benefits that dual-class stock can bring to the UK public markets, is outside the scope of this article (and has been discussed in depth by others elsewhere),<sup>73</sup> since this article is primarily concerned with the conditions that may be attached to the acceptance of dual-class stock. However, by constraining the ability or scope of a founder to extract private benefits, the consequences of dual-class stock can be better shifted to positive, rather than negative, outcomes for public shareholders. Those constraints could encompass both measures that require enhanced-voting shares to be converted into inferior-voting shares upon events occurring which notionally increase the risks that pernicious private benefits will be extracted (so-called 'sunset clauses'), and measures that reduce the incentives or scope for the extraction of private benefits *ab initio*. In the next section, the conditions that are commonly proposed to be attached to dual-class stock will be assessed, and it will be discussed that a balance must be preserved, protecting public shareholders on the one hand, and maintaining founder freedom on the other. Much

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<sup>69</sup> F Easterbrook and D Fischel, 'Voting in Corporate Law' (1983) 26 J Law Econ 395, 409.

<sup>70</sup> S Johnson and others, 'Tunneling' (2000) NBER Working Paper 7523 1, 2; D Ashton, 'Revisiting Dual-Class Stock' (1994) 68 St. John's L Rev 863, 916.

<sup>71</sup> Easterbrook and Fischel (n 69) 409; 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 R Morck (ed), *Concentrated Corporate Ownership* (University of Chicago Press 2000) 303.

<sup>72</sup> R Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 HLR 1642, 1664; A Dyck and L Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 J Fin 537, 540.

<sup>73</sup> eg 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; M Moore, 'Designing Dual Class Sunsets: The Case for a Transfer-Centered Approach' (2019) 1, 28 <https://ssrn.com/abstract=3478572>; Ashton (n 70); Reddy (n 66) 328-346.

like Goldilocks' infamous, and perilous, sampling of porridge,<sup>74</sup> some conditions blow too hot, some too cold, and some are just right.

## 5. Restrictions on the Exercise of Enhanced-Votes

The one hand giveth, the other taketh away. Having empowered founders with disproportional voting rights, an obvious constraint would be to qualify the instances in which those enhanced-voting rights may be exercised. The most restrictive approach would be to limit the exercise of enhanced-voting rights to blocking takeovers. This is essentially the approach recommended by the Review,<sup>75</sup> which has suggested that a takeover bid is possibly the biggest threat to a founder's ability to bring its vision to fruition after IPO.<sup>76</sup> If takeovers can be blocked, though, an absence of the 'market for corporate control' eliminates an important disciplining mechanism on management, since the management team will no longer be incentivised to perform diligently to protect their jobs from a decline in share price that opens-up the company to a takeover bid.<sup>77</sup> The underpinning of the restrictive approach is that by treating the enhanced-voting shares as one share, one vote on all other resolutions of the company, the public shareholders, assuming that they hold a majority of the equity, can still indirectly control the composition of the management team through their influence over the composition of the board,<sup>78</sup> thereby preserving an alternative disciplining mechanism. Ideologically, the restrictive approach may seem to be a happy medium that enables dual-class stock listings without prejudicing the rights of public shareholders if incumbent management is not performing adequately. However, such as approach can

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<sup>74</sup> R. Southey, 'The Story of the Three Bears' in *The Doctor* (Longman, Hurst, Rees, Orme, Brown & Green 1837).

<sup>75</sup> The Review also permits an enhanced-voting shareholder to exercise its enhanced-voting rights on resolutions to approve the holder's personal board incumbency (Review (n 7) 21).

<sup>76</sup> *ibid* 20.

<sup>77</sup> The 'market for corporate control' can engender managerial discipline (H Manne, 'Mergers and the Market for Corporate Control' (1965) 73 J Political Econ 110), but, it could also result in managerial behaviour being overly influenced by short-term share price (eg N Mizik, 'The Theory and Practice of Myopic Management' (2010) 47 J Mark Res 594, 594; M Moore and E Walker-Arnott, 'A Fresh Look at Stock Market Short-termism' (2014) 41 J Law Soc 416, 430 and 438).

<sup>78</sup> nn 57-60 and accompanying text.

create difficulties for founders who seek to retain post-IPO control from three perspectives – board composition, public shareholder blocking rights, and proactive public shareholder involvement.

Firstly, founders are likely to covet control over the composition of the board as a whole, and in other jurisdictions, the decision to adopt dual-class stock will have been partly driven by a desire to retain that control. As discussed, the board will have control over the company’s strategy, and will have the power to hire and fire managers.<sup>79</sup> Without control over the composition of the board, a founder can not guarantee its continued tenure as, for example, chief executive officer (CEO) of the company.<sup>80</sup> The founder, realising its worst fears post-IPO, has no assurances that public shareholders, using share price as a proxy for CEO performance,<sup>81</sup> will not cram the board with directors hostile to the founder’s continuing role as CEO. Even the Review, which advocates the restrictive approach, acknowledges, “When founders bring their companies to market, they often seem to be concerned mostly about their vision not being derailed by being removed as a director/CEO.”<sup>82</sup> The divergence between the Review’s acknowledgement and its approach will have been influenced by evidence that it is unusual for shareholders to remove directors from the boards of Main Market-listed companies.<sup>83</sup> However, shareholders do not have to assert their control directly, and the mere shadow of their powers can influence the behaviour of boards (and, therefore, management).<sup>84</sup> A CEO who ignores the

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<sup>79</sup> *ibid.*

<sup>80</sup> Although the Review’s proposals do also permit a founder to exercise its enhanced-voting rights to insulate itself from removal from the *board*, they do not guarantee the founder’s continued tenure as a *manager* of the company. The perverse situation could develop where an aggrieved founder, ousted as CEO, remains on the board as a disruptive influence.

<sup>81</sup> nn 60-65 and accompanying text.

<sup>82</sup> Review (n 7) 20.

<sup>83</sup> In 2018, 2019 and 2020, only 0, 4 and 7, respectively, FTSE-350 director re-election resolutions were rejected by shareholders (with all 7 in 2020 occurring at a single company’s boardroom coup (Petropavlovsk plc)) (data derived from Practical Law Company, ‘Annual Reporting and AGMS: What’s Market practice’ for 2018, 2019 and 2020).

<sup>84</sup> Several studies have remarked upon the propensity for management and boards of listed companies to take short-term-orientated decisions in response to short-term orientated shareholders – eg Moore and Walker-Arnott (n 77) 430 and 438); J Ang and W Megginson, ‘Restricted Voting Shares, Ownership Structure, and the Market Value of Dual-Class Firms’ (1989) 12 *J Financ Res.* 301, 305).

demands of the public shareholders will be playing loose-and-fast with his/her continued employment, since boards can exert significant pressure on CEOs to resign, and being a listed company CEO is certainly not a ‘job-for-life’.<sup>85</sup> Even outside the domain of dismissal, the founder may encounter board opposition (influenced by the powers of public shareholders to remove board members) to its proposed actions or strategies, encumbering the ability of the founder to freely pursue its vision. Famously, the board of the US dual-class firm, Facebook, was opposed to the founder’s decision to acquire Instagram, an acquisition that the founder, overriding the board through his voting control over board composition, continued to pursue and which has created significant value for Facebook over the years.<sup>86</sup> It is exactly the pressure to genuflect to the short-term caprice of public shareholders that founders are seeking to avoid through the implementation of dual-class stock.<sup>87</sup>

Second, the inability to exercise enhanced-voting rights on all shareholder resolutions will prospectively result in the public shareholders maintaining veto rights over *all* actions of the company which require shareholder approval. Several corporate actions require an ordinary resolution (majority

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<sup>85</sup> A recent report suggested a rising FTSE-350 CEO churn rate amounting to 16.5 per cent in 2016 (Heidrick & Struggles, ‘Heidrick & Struggles FTSE 350 and global surveys reveal rising CEO churn rate’ (5 June 2018) <https://heidrick.mediaroom.com/2018-06-05-Heidrick-Struggles-FTSE-350-and-global-surveys-reveal-rising-CEO-churn-rate>

<sup>86</sup> CFA Institute, ‘Dual-Class Shares: The Good, The Bad and The Ugly’ (August 2018) 1, 8.

<sup>87</sup> eg the founders of the US dual-class firm, Alphabet (then Google), stated, upon IPO: “we have set up a corporate structure that will make it harder for outside parties to take over or *influence* [*emphasis added*] Google. This structure will also make it easier for our management team to follow the long term, innovative approach emphasized earlier” (Form S-1/A Amendment No. 8 to Registration Statement of Google Inc. (filed on 16 August 2004) at 29)). Even the Review states, “Arguably, that [IPO] is the point at which the company is most at risk of falling sway to the dangers of short-termism by both investors and directors as the public share price provides a daily report card on their decisions.” ((n 7) 20). Also see 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, 35; Goshen and Hamdani (n 4); Reddy (n 66) 328.

vote),<sup>88</sup> or special resolution (voting approval of seventy-five per cent or more)<sup>89</sup> to be undertaken. Additionally, under the Listing Rules, certain actions require the pre-approval of shareholders holding premium-listed shares.<sup>90</sup> The freedom that may be sought by founders, in adopting dual-class stock could be appreciably curbed. For example, under Chapter 10 of the Listing Rules, shareholder pre-approval is required for large ‘Class 1’ transactions.<sup>91</sup> Relevantly, an early-stage company, which has yet to generate substantive profits, may find that many potential acquisitions will result in it crossing the thresholds for shareholder pre-approval under Chapter 10.<sup>92</sup> Even though a visionary founder of an innovative, high-growth, founder-led tech-firm may see significant long-term value and synergies in making large acquisitions, it will be time-consuming to obtain shareholder pre-approval, preventing the company from acting nimbly and alerting competitors to the possibility of an acquisition, and there is no guarantee that the public shareholders will share the founder’s confidence that the relevant acquisition will eventually be successful. By way of analogy, if Deliveroo were to seek to graduate to

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<sup>88</sup> CA 2006, s.282. eg an ordinary resolution is required under CA 2006 to approve substantial property transactions (s.190), approve loans to directors (s.197), ratify the acts of directors (s.239), authorise political donations (s.366), approve executive remuneration (ss.439 and 439A), appoint and dismiss the auditor (ss.489(4) and 510(2)), allot shares (s.551), and approve share buy-backs (ss.694 and 701).

<sup>89</sup> CA 2006, s.283. eg a special resolution is required under CA 2006 to amend the articles (s.21), change the name of the company (s.77), re-register the company as a private company (s.97), reduce general meeting notice periods (s.307), disapply pre-emption rights (s.571), and reduce share capital (s.641), and, under the Insolvency Act 1986, voluntarily wind-up the company (s.84).

<sup>90</sup> LR 9.2.21R. eg shareholder approval is required for: establishment of employee share schemes, long-term incentive plans and discounted share options, certain transfers between listing categories, cancellation of listings, 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, and certain repurchases of securities.

<sup>91</sup> LR 10.5.1R. A transaction is Class 1 if the ‘percentage ratio’ for any class test is 25 per cent or more (LR 10.2.2R). Class tests broadly follow a classification of the size of a transaction compared to the size of the company pursuant to a gross assets test, a profits test, a consideration test and a gross capital test (LR 10 Annex 1).

<sup>92</sup> eg if the profits of the target are more than 25 per cent of the profits of the acquiring company, it could constitute a Class 1 transaction (ibid). In the US, in 2016, seventy-five per cent of technology listings involved pre-profit companies (HKEX (n 55) 15).

the premium-tier as reports have suggested,<sup>93</sup> and as a condition of such admission it was required to restrict the founder's exercise of enhanced-voting rights to takeover decisions, as a pre-profit company,<sup>94</sup> its ability to engage in acquisitions quickly and efficiently in what is a saturated industry<sup>95</sup> would be impeded by having to regularly seek shareholder pre-approval. Outside of substantial transactions, public shareholders could also create complications for a founder by not approving director remuneration policies pursuant to their binding voting powers,<sup>96</sup> or by eliciting bad publicity for the company, and the founder, by not approving remuneration actually paid to the founder under the relevant policy, pursuant to their advisory voting powers.<sup>97</sup> Public shareholders could use such votes to register discontent with the manner in which the firm is being managed, or to impose pressure on the founder to take certain actions.<sup>98</sup> These are the types of public market pressures that deter founders from listing in the first place.

Third, public shareholders could proactively create disruption. Shareholders with sufficient votes can cause the company to call a shareholders' general meeting to hear shareholder-proposed

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<sup>93</sup> Bradshaw (n 9).

<sup>94</sup> Butler and Makortoff (n 37).

<sup>95</sup> S Singh, 'The Soon To Be £200B Online Food Delivery Is Rapidly Changing The Global Food Industry' *Forbes* (9 September 2019) <https://www.forbes.com/sites/sarwantsingh/2019/09/09/the-soon-to-be-200b-online-food-delivery-is-rapidly-changing-the-global-food-industry/>; T Bradshaw, 'Deliveroo's challenge to serve up growth after IPO' *Financial Times* (11 March 2021) <https://www.ft.com/content/5ce64d6e-8ee5-46f6-9580-f59d0708b547>. In relation to consolidation elsewhere in the industry, see T Bradshaw and R Milne, 'Amazon's Deliveroo investment approved by UK regulator' *Financial Times* (4 August 2020) <https://www.ft.com/content/edf8a144-a101-4ef8-80e3-7d2f1565d35c>

<sup>96</sup> CA 2006, s.439A.

<sup>97</sup> CA 2006, s.439.

<sup>98</sup> Activist investors may use governance-related issues as a means of exerting 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>; 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>).

resolutions,<sup>99</sup> or can await the AGM and propose resolutions for the agenda.<sup>100</sup> In theory, those shareholders could instigate corporate actions, such as amendment to the articles of the company,<sup>101</sup> or even instruct the board to take certain actions.<sup>102</sup> In practice, it is unlikely that public shareholders will be able to corral sufficient votes to take those actions,<sup>103</sup> but one could see potential for public shareholders to undermine the founder's control. As with vetoes, activist shareholders could cause significant disruption by regularly requiring the calling of general meetings to exert pressure on the founder. Such agitations will be off-putting to a founder. A scenario could even be foreseen where, in the midst of a takeover offer that could otherwise be blocked by the founder, activists use shareholder-proposed resolutions to coerce the founder into accepting the offer, or even outside of a takeover offer, activists could use such tactics to compel the founder to voluntarily dismantle the dual-class structure in the hopes of putting the company 'into play' and opportunistically soliciting a takeover.

The value of dual-class stock to founders above-and-beyond the ability to block takeovers can be elucidated from the US experience. Founders have other options to block takeovers in the US, including 'blank-check preferred stock plans', 'poison pills' and charter supermajority requirements to approve mergers.<sup>104</sup> Founders, however, still appear to be adopting dual-class stock *en masse*.<sup>105</sup> This

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<sup>99</sup> For companies incorporated in England and Wales, members holding at least 5 per cent of the paid-up capital (that carries the right to vote), or 5 per cent of the total voting rights may require the directors to call a general meeting (CA 2006, s.303).

<sup>100</sup> For companies incorporated in England and Wales, members holding at least 5 per cent of the voting rights, or at least 100 members with a right to vote and average sum paid-up per member of at least £100, can propose resolutions for the AGM (CA 2006, s.338).

<sup>101</sup> A special resolution would be required (n 89).

<sup>102</sup> Since management control is in the hands of the board (n 60), shareholders can only cause the company to take, or omit to take, actions if the articles so permit (*Automatic Self-Cleansing Filter Syndicate v Cuninghame* [1906] 2 Ch. 34). A special resolution is required under Model PLC Articles, article 4.

<sup>103</sup> A special resolution requires a seventy-five per cent vote (n 89).

<sup>104</sup> For a description of antitakeover devices, see T Chemmanur and others, 'Management Quality and Antitakeover Provisions' (2011) 54 J Law Econ 651, 686-689. The Delaware Courts have endorsed antitakeover devices as a legitimate exercise of a board's business judgement (eg *Moran v Household Intl, Inc.*, 500 A.2d 1346 (Del. 1985); *Air Products & Chemicals, Inc. v Airgas, Inc.*, C.A. No. 5249—CC (Del. Ch. Feb. 15, 2011)).

<sup>105</sup> n 28.

is the case even though the empirical evidence on dual-class stock is heavily skewed in the direction of discounted share prices after IPO as compared to similar one share, one vote firms.<sup>106</sup> Since such discounts do not correlate with decreased operating performance or stockholder returns, they represent public shareholders pricing-in the risk that their interests may be expropriated through the extraction of private benefits.<sup>107</sup> In contrast, the empirical evidence on the effect on share price of antitakeover devices, generally, is more mixed.<sup>108</sup> It would appear that founders are willing to accept higher costs of capital to reap the benefits of being able to insulate all of the directors from public shareholder removal and control the shareholder voting process; dual-class stock is more valuable to founders than simple antitakeover devices, and it appears that founders appreciate that nuance in practice as well as in theory.<sup>109</sup>

If the principal reason to relax the premium-tier's dual-class stock prohibition is to attract high-growth, new economy companies to the market, that aspiration will not be satisfied by taking an overly restrictive approach to the exercise of enhanced-voting rights. One may therefore suggest that the more permissive US approach,<sup>110</sup> where there are no mandated restrictions on how enhanced-voting rights may be exercised, should be adopted. However, giving a founder *carte blanche* to exercise enhanced-voting rights on all matters brings with it other pitfalls from a UK-perspective. As discussed in more

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<sup>106</sup> B Reddy, 'More than Meets the Eye: Reassessing the Empirical Evidence on US Dual-Class Stock' (2021) 23 U Pa J Bus L.

<sup>107</sup> *ibid.*

<sup>108</sup> See the literature review in I Wanasika and Y Limbu, 'Effects of Antitakeover Defenses on Value in the Pharmaceutical Industry' (2015) 15 AJM 59, 63.

<sup>109</sup> Ashton (n 70) 927.

<sup>110</sup> For an account of the permissive approach to regulation, see Cheffins (1997) (n 13) 250. Purveyors of 'private ordering theory' (for example, D Fischel, 'Organized Exchanges and the Regulation of Dual Class Common Stock' (1987) *U Chi L Rev* 119, 140; Sharfman (n 44)) advocate that the market can simply decide whether to support dual-class stock and issuers will organically implement relevant public shareholder protections voluntarily to attract investors. However, the theory relies upon the efficiency of stock market pricing mechanisms to effectively discern the relative value of governance measures (Moore (n 73) 15), and such efficiency has been doubted (L Bebchuk, 'Asymmetric Information and the Choice of Corporate Governance Arrangements' (2002) *Harvard Law School Discussion Paper* No. 398 1, 4).

detail later in this article,<sup>111</sup> freshly introducing dual-class stock to the premium-tier at this stage of the Main Market’s evolution without at least a nod toward UK institutional investor concerns<sup>112</sup> will be politically and diplomatically difficult. Also, even though investors seemingly price-in their risk at IPO,<sup>113</sup> the FCA will also be concerned about the ongoing consequences of dual-class stock rather than simply pricing, since, it has at its heart a mission to protect consumers, protect and enhance the integrity of the UK financial system, and promote competition.<sup>114</sup> Additionally, public shareholders in the UK do not benefit from a plethora of litigious tools available in the US<sup>115</sup> – the US enjoys simpler *ex-post* tools to litigate against controlling shareholders after expropriation has taken place (which, in turn, can deter expropriation in the first place),<sup>116</sup> a more open litigious culture,<sup>117</sup> and more plaintiff-favourable civil procedure rules.<sup>118</sup> Furthermore, a competitive advantage could be gained if at least some *ex-ante* protective measures were adopted that place a ceiling on the types of expropriation that could occur – by assuaging public shareholder concerns to a degree, the cost of capital for UK dual-class firms could

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<sup>111</sup> See ‘The “Policy Minefield”’ below.

<sup>112</sup> n 10.

<sup>113</sup> nn 106-107.

<sup>114</sup> FCA, ‘Our Mission 2017: How we regulate financial services’ (2017) 1, 5

<sup>115</sup> Similar points have been made in the context of dual-class stock in Hong Kong litigation (eg H. Huang et al, ‘The (re)introduction of dual-class share structures in Hong Kong: a historical and comparative analysis’ (2019) JCLS 1, 17 and 23).

<sup>116</sup> In Delaware, controlling shareholders owe a limited form of fiduciary duty to the company and the minority shareholders (*Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987)), which, unless corporate governance protocols are followed, manifests itself in the potential for an *ex-post* entire fairness review of ‘conflicted’ transactions (*Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983)).

<sup>117</sup> A litigious culture is fueled by the custom 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), and by the easy access to ‘opt-out’ class action suits federally (US Federal Rules of Civil Procedure (2019 edition), Rule 23(a)) and in many States.

<sup>118</sup> Unlike the UK (Rule 44.2(2)(a), Civil Procedure Rules), the US does not impose default ‘loser-pay’ rules, where the loser is required to pay the costs of the successful party.

be reduced, as compared to the US where they are habitually discounted.<sup>119</sup> Therefore, a more granular approach with general scope for founders to exercise enhanced-voting rights, but with restrictions on specifically defined corporate actions, as adopted in a number of other jurisdictions, such as Hong Kong,<sup>120</sup> Singapore,<sup>121</sup> India<sup>122</sup> and Shanghai,<sup>123</sup> could better balance the control sought by founders and protection of public shareholders. The restricted corporate actions must be chosen carefully, though, since the founder must be able to operate the company on a day-to-day basis unhindered by public market pressure, but should not be able to egregiously and opportunistically take actions that expropriate value from public shareholders. Whereas limiting the capacity to cause a company to engage in large transactions can severely encumber the business strategy of a high-growth company,<sup>124</sup> placing restrictions on the founder's ability to, for example, amend the articles of the company, voluntarily wind-up the company, reduce capital, disapply pre-emption rights, appoint auditors, or engage in related-party transactions,<sup>125</sup> limit the opportunities for abusive behaviour without undermining the founder's pursuit of its vision.

A wholesale adoption of the approach of those Asian exchanges,<sup>126</sup> though, will not be appropriate in a UK-context. All four of those exchanges require all shares to be treated on a one share, one vote basis on resolutions to appoint and remove independent directors.<sup>127</sup> Although independent

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<sup>119</sup> n 106 and accompanying text.

<sup>120</sup> Hong Kong Listing Rules, Rule 8A.24.

<sup>121</sup> SGX Mainboard Rules, Rule 730B.

<sup>122</sup> SEBI (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Rule 3(VII).

<sup>123</sup> CSRC, 'Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange (Revised in 2019)' (April 2019), article 4.5.10.

<sup>124</sup> nn 90-95 and accompanying text.

<sup>125</sup> Independent shareholder pre-approval is already required prior to the entering into of large related-party transactions outside the ordinary course of business (Listing Rules, Chapter 11), and those requirements could be strengthened for dual-class companies.

<sup>126</sup> nn 120-123.

<sup>127</sup> *ibid.*

directors could play an important role in monitoring the actions of controlling shareholders<sup>128</sup> and relating public shareholder concerns to the board, if public shareholders could nominate and appoint their chosen representatives, it could have the inadvertent incentive on a founder to not comply with the UK Corporate Governance Code recommendations that at least half the board, not including the chair, be independent non-executive directors<sup>129</sup> and that the Chair be independent upon appointment<sup>130</sup> – in a contentious scenario, a board in compliance could quickly become majority comprised of directors appointed by, and loyal to, the public shareholders, jeopardising the ability of the founder to manage the company insulated from public shareholder pressure. As discussed, a founder adopting dual-class stock will desire to control the composition of a majority of the board. Public shareholders could, though, be given the right to nominate and appoint a minimum number of, although not all, independent directors, or have veto rights over independent directors nominated by the founder.<sup>131</sup> Another feature of the Asian exchanges is the manner in which the restriction is implemented – on specific corporate actions, all shares are treated as one share, one vote. However, in the UK, such a mechanism could allow the public shareholders, if they hold sufficient equity, to unilaterally cause the company to take those actions.<sup>132</sup> Instead, a better mechanic would be a dual-vote system, pursuant to which two voting approvals are required to effect the relevant corporate action; a vote where enhanced-

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<sup>128</sup> eg 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 LJ* 11, 59; J Dahya et al, ‘Does Board Independence Matter in Companies with a Controlling Shareholder?’ (2009) 21 *J. App. Corp. Finance* 67, 76.

<sup>129</sup> Provision 11, UK CGC.

<sup>130</sup> *ibid*, provision 9.

<sup>131</sup> L Bebchuk and A Hamdani, ‘Independent Directors and Controlling Shareholders’ (2017) 165 *U PA LR* 1271; A Paccos, ‘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; Reddy (n 68) 755. Although for a premium-listed company with a controlling shareholder (broadly deemed to be a shareholder holding at least 30 per cent of the votes – LR App 1.1), public shareholders already have, in the first instance, a veto over the appointment of independent directors, the controlling shareholder can still unilaterally appoint that director pursuant to a second vote (LRs 9.2.2ER, 9.2.2FR and 9.2.2DG).

<sup>132</sup> nn 99-103 and accompanying text.

voting rights are respected, and a second vote where all shares are treated on a one share, one vote basis. In that way, the holders of a majority of the equity will possess a veto right over specified corporate actions (which could potentially be used to harm their interests), but can not unilaterally cause the company to take those actions. Although a dual-class stock founder holding a majority of the equity would be able to effect the relevant actions on his/her own, the company would be in no worse a position than if it had a one share, one vote controlling shareholder.

The Asian approach to corporate actions, as modified above, strikes an equilibrium between founder latitude and public shareholder protection. Regulators who fear the motives of a founder in taking *management* decisions should, as discussed later in this article, look to other tools to align founder actions with shareholder-value.<sup>133</sup>

## 6. Time-Dependent Sunset Clauses

Another condition that could be attached to dual-class stock is a ‘time-dependent sunset clause’, a concept that has been floated for many years.<sup>134</sup> Regulation could require that the articles of any dual-class issuer include provisions that automatically convert enhanced-voting shares into one share, one vote shares after a specific time period post-IPO. The rationale is that the company only requires dual-class stock in the early post-IPO years (when asymmetric information issues may subsist between public shareholders and the founder<sup>135</sup>) to allow the founder to pursue its long-term vision without fear of removal or a takeover if short-term profits are non-existent or minimal. However, as the business matures, with product-cycles becoming more obvious, and business strategy becoming clearly evident, the need for dual-class stock erodes, and the risk increases that dual-class structure is being maintained merely to extract pernicious private benefits.<sup>136</sup>

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<sup>133</sup> See ‘Maximum Voting Ratios’ below.

<sup>134</sup> eg Daniels and Halpern (n 128) 58.

<sup>135</sup> Ang and Megginson (n 84) 317; Chemmanur (n 64) 306.

<sup>136</sup> L Bebchuk and K Kastiel, ‘The Untenable Case for Perpetual Dual-Class Stock’ (2017) 103 Virginia L Rev 585, 605.

The challenge with mandated time-dependent sunset clauses is in ascertaining the optimum time period on a one-size-fits-all basis. Although some empirical evidence suggests that the benefits of dual-class stock fade as firms become older,<sup>137</sup> there is no clear brightline period after which the structure becomes costly to public shareholders. In the US, where time-dependent sunset clauses are not mandated, a handful of dual-class issuers have voluntarily adopted such provisions.<sup>138</sup> Predictably, though, as shown in Figure 2, the time periods adopted for such provisions vary considerably.<sup>139</sup> Even other stakeholders are uncertain of the optimal period, with regulators in India mandating,<sup>140</sup> and the Review proposing,<sup>141</sup> a five-year period, yet the Council of Institutional Investors, a representative body for US institutional investors publicly antagonistic to dual-class stock,<sup>142</sup> recommends a longer period of seven years.<sup>143</sup> Such divergences are unsurprising, since the optimal period will vary on a firm-by-firm basis, based upon a variety of factors, including the maturity of the company at IPO, the length of

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<sup>137</sup> 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> - finding that young dual-class firms (less than 12 years-old) were valued higher and were more efficient than young one share, one vote firms, but older dual-class firms had lower valuations, operating margins, pace of innovation, and labour productivity than similarly-aged one share, one vote firms. M Cremers et al, 'The Life-Cycle of Dual Class Firms: From IPO to Sunset' (2018) ECGI Working Paper No. 550/2018 1, 30 - finding that although dual-class firms were valued higher than similar one share, one vote firms at IPO, the premium declined over time, with them becoming discounted as compared to one share, one vote firms 6 to 9 years post-IPO. However, it is challenging to analyse the empirical evidence on dual-class stock, and studies that evaluate firm valuation may in fact be reflecting the market's perception of, rather than the true operating performance or returns of, such firms (Reddy (n 106) 28-29).

<sup>138</sup> Time-dependent sunset clauses are, though, rare in the US (A Winden, 'Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures' (2018) 3 CBLR 852, 870; D Aggarwal and others, 'The Rise of Dual-Class Stock IPOs' (2020) 1, 20 <https://ssrn.com/abstract=3690670>).

<sup>139</sup> In Figure 2, there is no emerging definitive standard as to an optimal time-dependent sunset period, but the trend is to adopt periods longer than the five years proposed by the Review.

<sup>140</sup> SEBI (Fourth Amendment) (n 122), Rule 3(VII).

<sup>141</sup> Review (n 7) 21.

<sup>142</sup> eg CII, 'Dual-Class Stock' [https://www.cii.org/dualclass\\_stock](https://www.cii.org/dualclass_stock).

<sup>143</sup> 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](https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024_NYSE_Petition_on_Multiclass_Sunsets_FINAL.pdf)

product-cycles, and the nature of the business.<sup>144</sup> An even more esoteric consideration will be the bearing that the time horizon and age of the founder has on the length of the innovative growth-phase of the company. It is unfeasible to predict at the time of an IPO the exact point in time when the motivations of a controller will diverge from the interests of the public shareholders,<sup>145</sup> and any mandated sunset clause, such as the Review's proposed five-year period, will be completely arbitrary in nature.<sup>146</sup> An obvious consequence is that dual-class structure could be defenestrated too soon, before the founder has had the opportunity to implement its vision or resolve the asymmetric information issues between it and the market as a result of challenges in project observability.<sup>147</sup> Even if public shareholders were given the opportunity to extend the sunset period prior to its expiry,<sup>148</sup> institutional investors, who are traditionally sceptical of dual-class stock,<sup>149</sup> are likely to be opposed to any extension – the very short-term pressures and project unobservability consequences from which founders are insulating themselves through dual-class stock will influence the voting of shareholders on the extension.<sup>150</sup> Even if public shareholders were inclined to consider an extension of the structure, to increase the chances of the extension, the founder may find it necessary to cause the company to take actions that are more easily observable to the public shareholders,<sup>151</sup> and, therefore, foregoing the more uncertain, innovative projects that dual-class stock is intended to encourage.<sup>152</sup> The success of US dual-class firms such as Facebook, Alphabet and Regeneron which have continued to innovate and create value for public shareholders many years after IPO,<sup>153</sup> could have been curtailed if they had

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<sup>144</sup> J Fisch and S Solomon, 'The Problems of Sunsets' (2019) U of Penn, Law School Research Paper No. 19-04 1, 17.

<sup>145</sup> *ibid* 18.

<sup>146</sup> *ibid* 16; Winden (n 138) 917; Lund (n 44) 739; Moore (n 73) 28.

<sup>147</sup> Winden (*ibid*) 917.

<sup>148</sup> In India, public shareholders may extend the initial period for one further five-year period (n 140).

<sup>149</sup> n 142; n 10.

<sup>150</sup> 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; Moore (n 73) 32; Fisch and Solomon (n 144) 20; Cremers (n 137) 41.

<sup>151</sup> Sharfman (*ibid*) 9.

<sup>152</sup> In relation to the capacity for dual-class stock to encourage innovation, see Reddy (n 66) 332.

<sup>153</sup> Facebook, Alphabet and Regeneron listed in 2012, 2004 and 1991, respectively.

implemented short time-dependent sunset clauses, with or without the option for public shareholders to extend, since it would have required them to shape their business strategies and product-cycles to short-term fluctuations in share price.

*[Insert Figure 2]*

Even if the optimal time period could be discerned, although quixotically persuasive, mandatory time-dependent sunset clauses could have a chilling effect on an exchange seeking to attract swathes of innovative companies. Founders of truly innovative companies may be reluctant to list in the knowledge that an IPO only grants them a finite period of control within which to pursue their idiosyncratic visions.<sup>154</sup> Furthermore, an exchange mandating time-dependent sunset clauses will suffer from a competitive disadvantage against the NYSE, Nasdaq, Hong Kong, Singapore, Tokyo<sup>155</sup> and Shanghai, with India being the only dual-class stock jurisdiction that also mandates such a sunset.<sup>156</sup> Moreover, notable in the context of the UK's aim to attract innovative firms to the LSE at earlier stages of their life-cycles,<sup>157</sup> even if a dual-class issuer were inclined accept a time-dependent sunset, it is likely that IPO would be delayed until the founder could be certain that the relevant time period would be a sufficient period of control. Although The Hut Group and Deliveroo both employed time-dependent sunsets of three-years,<sup>158</sup> it is questionable that these firms are truly the innovative tech-start-ups desired. The Hut Group had been promoted as a tech-listing, but some commentators described the

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<sup>154</sup> In 2011, the founders of US dual-class firm Alphabet stated, "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... We have protected Google from outside pressures and the temptation to sacrifice future opportunities to meet short-term demands." (Alphabet's 2011 Founders' Letter (31 December 2011) <https://abc.xyz/investor/founders-letters/2011/>).

<sup>155</sup> Although the Tokyo Stock Exchange, 'New Listing Guidebook: 1<sup>st</sup> and 2<sup>nd</sup> sections' (2018) (at 143) expresses a vague expectation that dual-class structure should dissolve once its purpose no longer exists, a time-dependent sunset clause is only one method of satisfying that expectation, with other forms of sunset also potentially acceptable.

<sup>156</sup> n 140.

<sup>157</sup> Review (n 7) 19.

<sup>158</sup> nn 26 and 27.

company as a retail enterprise, with ‘tech’ only forming a minority of the company’s business.<sup>159</sup> It would also be a stretch to describe Deliveroo as operating in an innovative industry, with the online food delivery segment becoming extremely saturated,<sup>160</sup> and industry innovation largely driven outside of the delivery service field.<sup>161</sup> The founders and CEOs of The Hut Group and Deliveroo are businessmen rather than the visionary tech-founders of Facebook, Alphabet, Snap, Zoom and many other US dual-class tech-firms. The Hut Group is also a mature firm, listing 16 years after being founded, with venture capital investors, rather than public shareholders, being the beneficiaries of the huge returns during the high-growth phase of the company.<sup>162</sup> Although Deliveroo listed eight years after foundation, the founder acknowledged that the 2020 global pandemic had accelerated customer take-up of food delivery services by at least three years,<sup>163</sup> and, after much anti-trust regulatory scrutiny regarding a 2020 investment by Amazon,<sup>164</sup> it may be that an IPO in a market where the brand is known (and where the company operates in a consumer-facing sector currently divided along continental lines<sup>165</sup>) was the only realistic option for the company and investors. Concerningly, with the imposition of time-dependent sunset clauses potentially deterring numerous early-stage, high-growth innovative firms, a market could develop where it is mainly mature firms, and firms that are less redolent of the ‘new economy’ aspirations of the Review, adopting dual-class stock, for which dual-class stock in fact

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<sup>159</sup> S Fieldhouse, ‘The Hut Group IPO: a retailer posing as a tech company?’ *The Armchair Trader* (28 August 2020)

<https://www.thearmchairtrader.com/the-hut-group-ipo-a-retailer-posing-as-a-tech-company/>

<sup>160</sup> n 95.

<sup>161</sup> Singh (n 95).

<sup>162</sup> P Evans and S Chambers, ‘Matt Moulding, the shy tycoon who built a €5bn Hut’ *The Sunday Times* (30 August 2020)

<https://www.thetimes.co.uk/article/matt-moulding-the-shy-tycoon-who-built-a-5bn-hut-0z23n192t>

<sup>163</sup> Butler and Makortoff (n 37).

<sup>164</sup> Bradshaw and Milne (n 95).

<sup>165</sup> Singh (n 95).

provides little in the way of benefits, and where pernicious private benefit extraction is more likely to overshadow the upsides.<sup>166</sup>

A one-size-fits-all time-dependent sunset clause is a blunt tool. In fact, it is not time *per se* that causes a change in the dynamics of the firm – time is merely a proxy for events that could occur over time that result in greater likelihood of private benefit extraction and/or lesser necessity for dual-class stock.<sup>167</sup> For example, transfers of enhanced-voting shares to a new controller, a new board changing the strategic direction of the company, or simply the skills or interest of the founder waning could all undermine the need for, and benefits of, dual-class stock or result in greater levels of private benefit extraction.<sup>168</sup> Rather than imposing an arbitrary time period which could deter founders, a more targeted approach would be more effective, whereunder dual-class stock is converted into one share, one vote upon specific events taking place. It is simple to tailor provisions to certain events – as below, sunset clauses could be triggered by transfers of enhanced-voting shares or cessation of a founder’s influence on the company’s strategy.<sup>169</sup> The occurrence of other events, such as when the founder’s skills begin to wane, are more ethereal and may be impossible to define accurately. In those cases, though, the approach should be to ensure that the incentives on the founder to take actions that are costly to public shareholders or to voluntarily continue with a costly dual-class structure are moderated. A solution would be to ensure that the founder has sufficient ‘skin-in-the-game’, to which this article turns next.

## 7. Maximum Voting Ratios

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<sup>166</sup> Concern has already been levied at The Hut Group’s sale-and-leaseback arrangements with the founder (S Goodley, ‘Questions raised over The Hut Group boss’s landlord role’ *The Guardian* (11 January 2021) <https://www.theguardian.com/business/2021/jan/11/questions-raised-over-the-hut-group-bosss-landlord-role>

<sup>167</sup> In relation to takeover defences, generally, W Johnson et al, ‘The Lifecycle Effects of Firm Takeover Defenses’ (2018) 1, 31 <http://dx.doi.org/10.2139/ssrn.2808208>; Reddy (n 66) 342.

<sup>168</sup> Reddy (ibid) 342.

<sup>169</sup> See ‘Transfer-Linked and Director-Linked Sunset Clauses’ below.

Maximum voting ratios operate by placing a cap on the ratio of voting rights attached to an enhanced-voting share to voting rights attached to an inferior-voting share. For example, Hong Kong,<sup>170</sup> Singapore,<sup>171</sup> Shanghai,<sup>172</sup> India<sup>173</sup> mandate maximum voting ratios of 10:1, and the Review proposes a 20:1 ratio for the premium-tier.<sup>174</sup> Classically, voting ratios have two roles. Firstly, a maximum voting ratio ensures that the public shareholders have at least a *de minimis* level of votes. A maximum voting ratio could ensure that public shareholders hold sufficient votes to propose shareholders' resolutions.<sup>175</sup> Of course, if the exercise of enhanced-voting rights is already restricted to, for example, the blocking of takeovers,<sup>176</sup> all shareholders would be treated on a *pari passu* basis on all other votes no matter the voting ratio, in which case, the second role is more apropos – a maximum voting ratio essentially requires a controller to maintain a minimum level of skin-in-the-game, capping its incentives to extract private benefits, which rise at an increasing rate as the controller's equity interest declines.<sup>177</sup> For instance, with a voting ratio of 20:1, a dual-class founder seeking to establish majority-voting control would need to hold at least approximately 4.8 per cent of the company's equity. Figure 3 sets-out the minimum level of equity that a controller must hold to maintain majority-voting control at different maximum voting ratios.

*[Insert Figure 3]*

Determining the appropriate one-size-fits-all voting ratio, though, is as challenging as determining the optimal time-dependent sunset period. The market capitalisation of the company will

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<sup>170</sup> Hong Kong Listing Rules, Rule 8A.10.

<sup>171</sup> SGX Mainboard Rules, Rule 210(10)(d).

<sup>172</sup> CSRC Rules (n 123) article 4.5.4.

<sup>173</sup> SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2019, Rule 3(II).

<sup>174</sup> Review (n 7) 21.

<sup>175</sup> nn 99-100.

<sup>176</sup> See 'Restrictions on the Exercise of Enhanced-Voting Rights' above.

<sup>177</sup> Bebchuk et al (n 71) 301; L Bebchuk and K Kastiel, 'The Perils of Small-Minority Controllers' (2019) 107 Geo LJ 1453, 1473.

be relevant – 4.8 per cent of the equity is obviously much more skin-in-the-game where market capitalisation is £5 billion compared to just £50 million.<sup>178</sup> Market capitalisation could also vary over time, through share price fluctuations and further finance-raising equity issuances. Additionally, a further consideration is personal net-wealth, with a given voting ratio having different bearings on the behaviour of a founder depending upon the gains he/she has made at or pre-IPO. Other business interests of the founder may also be pertinent.

Therefore, a progressive avenue would be to instil flexibility. The FCA could mirror its approach to the free-float rules, by imposing a default requirement that could be waived or revised on a case-by-case basis.<sup>179</sup> Furthermore, rather than implementation by way of voting ratio, consideration should be given to, instead, requiring a founder to retain a specific number of equity shares based upon a percentage of the issued shares as of the date of IPO (as adjusted on a continuing basis for future non-cash stock splits, bonus shares and reorganisations). If the founder disposes of sufficient shares to drop below the relevant threshold, its enhanced-voting shares would convert into one share, one vote. Such a ‘divestment sunset’ presents advantages over maximum voting ratios, since a voting ratio could create the perverse post-IPO disincentive on the founder to issue further equity for finance since, if the founder already owns the minimum level of equity to retain majority-voting control, it would have to subscribe to further equity shares in the issuance to maintain that majority-voting control. Since the relevant threshold could be lowered by the FCA in its discretion, and, with a divestment sunset, it will not organically increase the amount of equity required to be held with escalating market capitalisation over time, the default can be set relatively high. The default should represent a legitimate level of skin-in-the-game, but not be so high that it prevents a founder from crystallising significant wealth on IPO and leading to issuers dismissing a premium-listing out-of-hand. It is difficult to contend, though, that 4.8 per cent,<sup>180</sup> for example, is generally a sufficient level of skin-in-the-game to substantively

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<sup>178</sup> Accordingly, in Hong Kong, enhanced-voting shareholder mandatory equity ownership requirements may be lowered if the market capitalisation of the company is HK\$80 billion or more (HK Listing Rules, Rule 8A.12).

<sup>179</sup> n 23. The FCA has exercised its discretion to lower the free-float threshold for several companies in the past, including Eurasian Natural Resources Corporation, Ferrexpo and Fresnillo.

<sup>180</sup> As per the Review’s proposals (n174).

disincentivise a controller from extracting substantial private benefits, other than possibly with the largest of listings. It is likely that such a founder will have garnered sizable riches by substantially exiting its investment in the company at IPO, and, consequently, 4.8 per cent will not represent a meaningful constraint on the controller. The situation is exacerbated if, owing to the dispersed nature of the remainder of the shares held by public shareholders,<sup>181</sup> the founder can maintain ‘effective control’ with less than, and in some cases, substantially less than, a majority of the votes in the company.<sup>182</sup>

The default level for the premium-tier should be carefully considered, but it could be set higher than that of the Asian exchanges<sup>183</sup> and still remain competitive. Unlike with the divestment sunset described, a founder listing on the Asian exchanges must continue to participate in fresh share issuances in order to retain majority-voting control while holding the minimum level of equity. Such considerations can be important for high-growth tech-firms where stock consideration acquisitions can be essential to growth. Although a founder wishing to create an extreme divergence between voting and cash-flow rights may be attracted to the US, where no minimum equity retention requirements are regulatorily imposed, in practice, it seems that founders do not regularly seek to extravagantly depress their equity interests. Figure 4 summarises hand-collected founder equity ownership information for the 10 largest (by market capitalisation) founder-led dual-class firms that listed in the US after 2000, as at IPO and as of 2020. Most of those firms listed with the founders holding at least 15 per cent of the equity, and, in many cases, far more. Although, post-IPO, many of those founders have reduced their

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<sup>181</sup> In a dispersed ownership system, due to a tendency for shareholders to free-ride on the research and monitoring efforts of other shareholders and challenges in acting collectively, a blockholder with a marginally large interest can exert significant and disproportionate influence (Fischel (n 110) 141; Ratner (n 68) 19). For an overview of free-rider issues, see eg J Gordon, ‘Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice’ (1988) 76 Cal L Rev 1, 44.

<sup>182</sup> By analogy, under the mandatory offer rules of the Takeover Code, 30 per cent of the voting rights is deemed to engender effective control (Rule 9.1).

<sup>183</sup> Hong Kong (Hong Kong Listing Rules, Rule 8A.12) and Shanghai (CSRC Rules (n 123), article 4.5.3.) require, on top of 10:1 maximum voting ratios, that the holders of enhanced-voting shares hold at least (or more than, in the case of Shanghai) 10 per cent of the cash-flow rights in the company on an on-going basis. Singapore and India apply solely 10:1 voting ratios (nn 171 and 173).

equity ownership percentages, those figures include dilution from post-IPO equity issuances, which would not be taken into account when applying a divestment sunset (as opposed to a maximum voting ratio). Further research in this area would be welcome, but, based upon more recent large US dual-class IPOs, a default level of around 15 per cent, which under the proposals in this article could, in any case, be relaxed in the discretion of the FCA, would appear to satisfy the balance between attracting issuers and protecting public shareholders. Taking the two most enduring firms in Figure 4 – Facebook and Alphabet - as of 2020, those firms had been listed for 8 and 16 years, respectively, and the founders owned approximately 13 and 11.5 per cent of the equity, respectively. Both firms, though, have issued substantial levels of stock post-IPO for financing and acquisition purposes, and, therefore, for the purposes of a divestment sunset (a limited form of which has been implemented by Alphabet<sup>184</sup>), the founders would still hold well above 15 per cent of the IPO-date outstanding stock.<sup>185</sup>

*[Insert Figure 4]*

A handful of dual-class founders shown in Figure 4 have clearly substantially reduced their equity holdings in a much shorter period than Facebook and Alphabet through divesting of shares rather than dilution – however, they are in the minority, and the premium-tier should not be so welcoming to firms that intend to implement such excessive divergences between voting and cash-flow rights. An appropriate level of skin-in-the-game is potentially the most crucial form of public shareholder protection for dual-class firms. For example, a founder who’s interest has waned will be more open to stepping-down from management and handing the reins to a fresh management team that will increase shareholder-value if that founder has more than a negligible level of wealth still tied-up in the

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<sup>184</sup> Each Alphabet founder has contractually agreed not to dispose of non-voting stock to the extent that it will result in him holding a greater number of ten-votes-per-share stock than non-voting stock (see Form 8-K of Alphabet Inc. dated 2 October 2015).

<sup>185</sup> Using data gathered from the most recent (as of 17 September 2020) Form-4 and Form-5 insider trading filings, the equity ownership of Facebook’s founder and Alphabet’s founders (adjusting for Alphabet stock-splits post-IPO), in 2020, represented approximately 17 per cent, and 25 per cent of the IPO-date equity, respectively.

company.<sup>186</sup> Equally, the founder may even be willing to collapse the dual-class structure voluntarily if it will create an uplift in share-value at a time when the need for dual-class stock has eroded.<sup>187</sup> A divestment sunset will mitigate insidious behaviour *ab initio*, and, since the divestment of equity post-IPO is in the hands of the founder, will be more attractive to founders than the cliff-edge of an arbitrary time-dependent sunset.

## 8. Transfer-Linked and Director-Linked Sunset Clauses

Two common conditions attached to dual-class stock, and also proposed by the Review for the premium-tier,<sup>188</sup> are restrictions on the capacity to hold and transfer enhanced-voting stock. Essentially, these are event-driven – more specifically, ‘transfer-driven’ and ‘director-linked’ – sunset clauses, since enhanced-voting shares automatically convert into one share, one vote upon a restricted transfer, or upon the holder ceasing to be a director. Hong Kong,<sup>189</sup> Singapore,<sup>190</sup> Tokyo,<sup>191</sup> India<sup>192</sup> and Shanghai<sup>193</sup> have all mandated transfer-driven sunset clauses, and, even in the US, it is not uncommon for transfer-driven sunsets to be voluntarily adopted.<sup>194</sup> Director-linked sunset clauses are also

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<sup>186</sup> eg n 211 and accompanying text.

<sup>187</sup> Dual-class stock is often discounted by investors (n 106-107 and accompanying text).

<sup>188</sup> Review (n 7) 21.

<sup>189</sup> Hong Kong Listing Rules, Rule 8A.18.

<sup>190</sup> SGX Mainboard Rules, Rule 210(10).

<sup>191</sup> Tokyo Guidebook (n 155) 145.

<sup>192</sup> SEBI (Fourth Amendment) (n 122), Rule 3(VII).

<sup>193</sup> CSRC Rules (n 123), article 4.5.10.

<sup>194</sup> Winden (n 138) 881. eg Alphabet, Facebook, Snap and Lyft have all implemented transfer-driven sunset clauses (see Amended and Restated Certificate of Incorporation of Alphabet Inc. (filed 2 October 2015), Article IV, Section 2; Amended and Restated Certificate of Incorporation of Facebook, Inc. (adopted 20 June 2016), Article IV, Section 3; Amended and Restated Certificate of Incorporation of Snap Inc. (filed 2 February 2017), Article V, section 6; Form S-1 Registration Statement of Lyft, Inc. (filed 1 March 2019) at 196).

mandated in Hong Kong,<sup>195</sup> Singapore<sup>196</sup> and Shanghai,<sup>197</sup> and, in the US, the voluntary uptake of related death or incapacity sunsets has become more common in recent years.<sup>198</sup>

A transfer-driven sunset can be easily espoused. Institutional investors readily, albeit perhaps reluctantly, invest in dual-class stock.<sup>199</sup> However, heavily factored into any investment decision is their faith in the enhanced-voting shareholder. This is particularly pertinent where the exercise of enhanced-voting rights is unrestricted and the founder is entrenched as CEO. Institutional investors will be overtly backing the founder's talent and vision for the company,<sup>200</sup> and pricing the securities accordingly. As the Review states, "Their vision and their ability to execute that vision is often part of the company's selling point."<sup>201</sup> If a fundamental motive for dual-class stock is to give founders a transition period during which they can pursue their visions insulated from the public shareholders, its justification falls away upon a transfers of voting-control to other persons. Exceptions to the transfer-driven sunset could be permitted, so long as they do not run a cart-and-horses through the protective measure. Exceptions for transfers for estate planning or charitable purposes, provided that the transferor continues to have control over voting decisions of the transferee, would be acceptable.<sup>202</sup> In contrast,

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<sup>195</sup> Hong Kong Listing Rules, Rule 8A.11.

<sup>196</sup> SGX Mainboard Rules, Rule 210(10).

<sup>197</sup> CSRC Rules (n 123), article 4.5.3.

<sup>198</sup> Winden (n 138) 875. eg Alphabet Charter (n 194), Article IV, section 2; Facebook Charter (n 194), Article IV, section 3; Snap Charter (n 194), Article V, sections 5 and 6; Lyft Registration Statement (n 194) at 196.

<sup>199</sup> The empirical evidence as to whether institutional investors shun dual-class firms in the US is inconclusive. Finding institutional investor ownership in dual-class firms was the same or greater than such ownership in one share, one vote firms - Anderson (n 44) 28; S 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; and S Smart and C Zutter, 'Control as a Motivation for Underpricing: A Comparison of Dual and Single-Class IPOs' (2003) 69 *J. Fin. Econ.* 85, 98. Finding slightly less institutional ownership of dual-class firms - K Li et al, 'Do Voting Rights Affect Institutional Investment Decisions? Evidence from Dual-Class Firms' (2008) 37 *Financ. Manag.* 713, 720.

<sup>200</sup> Moore (n 73) 25; Reddy (n 66) 342.

<sup>201</sup> Review (n 7) 20.

<sup>202</sup> eg the Review alludes to similar exceptions ((n 7) 21). Hong Kong permits transfers of enhanced-voting shares to entities that will hold the shares on behalf of the transferor (Hong Kong Listing Rules, Rule 8A.18(2)).

wide exceptions to allow unencumbered transfers to family members, as preserved by Deliveroo for example,<sup>203</sup> are less easily justifiable.<sup>204</sup> Although a founder may believe that a family member can continue his/her legacy, research has shown that firm performance deteriorates when family members assume management from founders.<sup>205</sup>

A director-linked sunset ensures that the enhanced-voting shareholder is engaged in the running of the company,<sup>206</sup> and further reflects the contention above that investors are buying stock based upon their faith in the founder's vision. If the founder is no longer driving the strategy of the company, the validation for retaining disproportionate control crumbles. From a UK-perspective, a director-linked sunset also has another positive consequential effect by subjecting any founder holding enhanced-voting shares to the directors' duties regime.<sup>207</sup> Although practical and legal impediments can moderate the capacity of those duties to deter misconduct or mismanagement,<sup>208</sup> at least a baseline level of accountability will exist against which the founder's actions can be gauged.

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<sup>203</sup> Deliveroo prospectus (n 27) 170.

<sup>204</sup> eg Huang et al (n 115) 16.

<sup>205</sup> A breadth of empirical literature has noted the propensity for performance of firms to decline upon control transferring to heirs. A subset includes: R 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 (The University of Chicago Press, 2000) 338; 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.

<sup>206</sup> Review (n 7) 21.

<sup>207</sup> Directors of companies incorporated in England and Wales owe duties to the company under CA 2006 (ss.171-177). Even for foreign incorporated companies, directors owe duties in most jurisdictions (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](https://uk.practicallaw.thomsonreuters.com/Browse/Home/International/CorporateGovernanceandDirectorsDutiesGlobalGuide?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk)).

<sup>208</sup> In relation to mismanagement, the Courts have generally taken a deferential approach to managerial decisions of directors (*Smith v Fawcett* [1942] Ch. 304, 306; *Burland v Earle* [1902] AC 83, 93). Even in relation to misconduct, public company boards rarely commence claims against directors, and although shareholders can commence derivative claims on behalf of companies (CA 2006, ss.260-264), under the procedure, a number of hurdles, the application of which is not always certain,

Of course, the founder being a director is not a surety that the founder will play an integral role in guiding the company's strategy. If the founder is not also intrinsically involved in day-to-day management, his/her non-executive directorship could represent no more than a bauble on a Christmas tree, as was once infamously remarked.<sup>209</sup> Tokyo and India have tacitly accepted this subtlety by taking a stricter approach which requires, in most circumstances, that the enhanced-voting shareholder remains as an executive manager.<sup>210</sup> However, from a practical perspective, it is challenging in the least to draft regulatory rules which adequately define an executive employment role of sufficient seniority and genuine in substance as well as form. A founder with control over the composition of the board could easily 'game' the system. Such a 'manager-linked' (as opposed to director-linked) sunset could create unintended consequences, and result in a founder CEO 'hanging-on' too long past his/her expiry date. If a management-linked sunset clause were in operation at Alphabet, where the founders remain on the board but have stepped-away from their CEO and President roles,<sup>211</sup> they may not have been so enthusiastic to usher-in a fresh CEO as they would have also lost control of their company. Although in an ideal world manager-linked sunsets are commended, from a practical perspective, mandated director-linked sunsets would be more effective on the premium-tier.

The adoption of transfer-driven and director-linked sunset clauses would be a cogent approach for the premium-tier to take. They respect the balance between ensuring that investors get what they have bargained for and ensuring that a founder can pursue his/her personal vision for the business. They

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must be cleared before leave will be granted to hear the case (J Armour, 'Derivative actions: a framework for decisions' (2019) 135 LQR 421). Additionally, if the shareholders are dispersed, each only holding a small portion of the equity, the costs and effort in commencing a claim may outweigh the benefits which accrue solely to the company, and even free-riding non-intervening shareholders can share in those benefits.

<sup>209</sup> The quote is attributed to the late Tiny Rowland, former CEO of Lonrho plc.

<sup>210</sup> In Tokyo, the enhanced-voting shareholder must remain as a director and manager if the dual-class structure has been implemented to ensure the continued involvement of a person in management (Tokyo Guidebook (n 155) 144), and, in India, such a shareholder must remain as an 'executive' in the company (SEBI (Third Amendment) (n 173), Rule 3(II); SEBI (Fourth Amendment) (n 122), Rule 3(VII)).

<sup>211</sup> Alphabet, 'A letter from Larry and Sergey' (December 3, 2019) <https://blog.google/inside-google/alphabet/letter-from-larry-and-sergey>

strike at the heart of events that could occur which undermine the legitimacy of dual-class stock,<sup>212</sup> and collapse the structure into one share, one vote with surgical precision, making the blunt trauma of a time-dependent sunset clause all the more jarring.

## 9. The ‘Policy Minefield’

In this article, in the context of the UK’s premium-tier finally entertaining the possibility of dual-class stock, the most common varieties of investor protections have been canvassed. A common thread is the importance of providing credible comfort for public shareholders that their interests will not be egregiously expropriated, without undermining the very reasons that a founder may seek the succour of dual-class stock in the first place. The dual-class stock path that the UK takes over the coming years will characterise the trajectory of the LSE for decades to come, and it is vital that the regulators appropriately weigh the competing tensions. However, that regulatory path is mired in peril. UK regulators must contend with highly influential UK institutional investors who are traditionally opposed to any initiatives that dilute shareholder rights,<sup>213</sup> and have, in the past, denounced dual-class stock.<sup>214</sup> UK institutional investors focus on the costs of dual-class stock created by an attenuation of their powers to influence the management of companies and discipline self-serving managers.<sup>215</sup> Although the ability of such managers to exploit their control by siphoning assets from the firm<sup>216</sup> or engaging in

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<sup>212</sup> Also see text accompanying nn 167-168.

<sup>213</sup> eg see the response to the Call for Evidence on the Review (n 1) by The Investor Forum, a UK representative body for asset managers and asset owners (5 January 2021) <https://www.investorforum.org.uk/wp-content/uploads/securepdfs/2021/01/UK-Listings-Review-January-2021-002.pdf> Also see P Stafford and A. Mooney, ‘Investors push back against UK listings overhaul’ *Financial Times* (3 March 2021) <https://www.ft.com/content/8ed0d759-c34f-4f3f-a076-6461093da6a2>

<sup>214</sup> eg see the response to the dual-class stock listing of Lyft in the US: 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](http://ctwinvestmentgroup.com/wp-content/uploads/2019/03/Lyft-IPO-dual-class-sign-on_Final.pdf) The signatories included the UK-led institutions Legal and General Investment Management, Hermes Equity Ownership Services, and the Local Authority Pension Fund Forum. Also see Stafford and Mooney (ibid).

<sup>215</sup> See text accompanying nn 57-62.

<sup>216</sup> n 70, and accompanying text.

conflicted transactions<sup>217</sup> should be substantively restrained by strong UK anti-fraud rules, audit requirements, financial press, and, on the premium-tier, related-party transaction regulations,<sup>218</sup> institutional investors will still be concerned that founder control could manifest itself in the company taking actions primarily in the interests of the founder rather than shareholder wealth-maximisation,<sup>219</sup> or the entrenchment of a management team unsuited to leading the company.<sup>220</sup> Those concerns will reverberate with the UK regulators, since, historically, the UK regulators have been heavily influenced by the views of UK (particularly ‘long-only’) institutional investors, who have often engaged in extensive collaborative lobbying and have often played a significant role in the development of market regulations.<sup>221</sup> That direct influence harks back to an era when UK pension funds and insurance companies were the dominant players on the UK equity markets.<sup>222</sup> The views of UK institutional investors on dual-class stock and the influence they can exert will have led to the Review taking a half-hearted premium-tier approach to dual-class stock and adopting a suite of constraints which, as discussed in this article, are likely to deter the very founders the Review is seeking to attract.

One may query, though, why institutional investors should take such a conservative position on shareholder rights in the context of dual-class stock when the empirical evidence does not show that dual-class firms perform worse, from the perspective of operating performance and buy-and-hold

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<sup>217</sup> Johnson et al (n 70) 7; M Bertrand et al, ‘Ferretting Out Tunneling: An Application to Indian Business Groups’ (2002) 117 Q.J. Econ. 121, 139.

<sup>218</sup> See Chapter 11 of the Listing Rules.

<sup>219</sup> n 71, and accompanying text.

<sup>220</sup> Reddy (n 66) 341.

<sup>221</sup> L Enriques et al, ‘The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies’ in R Kraakman et al (eds), *The Anatomy of Corporate Law* (Oxford University Press, 2017) 104. 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, 1771 noted that UK institutional investors have had significant influence over a variety of corporate governance measures, such as shareholder consent for major corporate transactions under the Listing Rules, pre-emption rights, and the UK CGC, as well as being “involved at every stage of the drafting of the [Takeover] Code”.

<sup>222</sup> For example, in the early 1990s, such investors owned over half of the shares in UK-listed companies (B Cheffins, ‘The Stewardship Code’s Achilles’ Heel’ (2010) 73 *MLR* 985, 1020.

returns, than one share, one vote firms,<sup>223</sup> and where concerns that they could be lumbered with a self-serving dual-class stock controller or an underperforming management team can be mitigated through the judicious use of transfer-driven sunset clauses and ensuring that the controller has sufficient skin-in-the-game. Their position, though, betrays underlying tenets, with UK institutional investor views on dual-class stock being a microcosm of their resistance to reform of the equity markets generally. The importance UK institutional investors attach to maintaining shareholder rights will partly stem from them coveting their perceived dominion over company boards that coerces those boards into continuously heeding share price, and, relatedly, a desire to preserve their position as the dominant influence on UK corporate governance policy. They will fear that the influence over the regulators that they have enjoyed for decades<sup>224</sup> will diminish if their power to exert influence over corporate actions in the listed markets is also moderated. By way of comparison, institutional investors have not enjoyed quite such a historic dominance over corporate managers in the US, and when the NYSE was considering the relaxation of its erstwhile prohibition of dual-class stock in the late 1980s and early 1990s, institutional investors did not dominate the market to the same extent as the UK during that period,<sup>225</sup> leading to the broadly permissive dual-class stock rules now apparent on the NYSE. Additionally, UK institutional investors are becoming more global themselves,<sup>226</sup> and reforms designed to attract contemporary, high-growth, new economy IPOs on the LSE will not be a priority for those investors when they can maintain exposure to such companies through investments on foreign exchanges and even, in some cases, in private equity firms.

Similarly, one may also query why the UK regulators kowtow to the views of UK institutional investors when the traditionally influential cabal of UK pension funds and insurance companies that

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<sup>223</sup> See text accompanying n 107.

<sup>224</sup> n 221.

<sup>225</sup> 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; W Forbes and L Hodgkinson, *Corporate Governance in the United Kingdom: Past, Present and Future* (Palgrave Macmillan, 2015) 16.

<sup>226</sup> Investor Forum (n 213).

once dominated the market now only form a very small part of the equity markets in the UK.<sup>227</sup> The market is currently dominated by foreign institutions which, despite their public opposition,<sup>228</sup> have, in practice, been open to investing in dual-class stock.<sup>229</sup> There are three main reasons for the outsized influence of UK institutional investors on UK capital markets policy. Firstly, since the Cadbury Report of 1992,<sup>230</sup> shareholders have been given a central role in policing the corporate governance of listed companies. The UK CGC operates by prompting corporate disclosure so that informed shareholders can instigate changes in those companies if necessary, and recent regulatory measures have emphasised a desire for greater stewardship engagement by (especially UK) institutional investors with the management of companies in which they invest.<sup>231</sup> Giving founders greater scope to insulate themselves from public shareholders through the adoption of dual-class stock will hamper those regulatory efforts, and, equally, institutional investors will be concerned as to how they will be able to satisfy regulatory fiat for them to engage with investee companies more effectively if they do not possess the tools to ensure that their voices are heard.<sup>232</sup> Second, preserving regulatory and governance exceptionalism has contributed to the LSE achieving disproportionately lofty prominence and scale.<sup>233</sup> Developing a reputation for the highest standards of corporate governance and preservation of investor rights created a burgeoning market to which investors were attracted. The natural tendency is to continue with such an approach on the assumption that it will continue to reap similar rewards. Third, the very nature of the LSE's regulator, the FCA (which has, in one guise or another, had responsibility for the Listing Rules since 2000), can foster a conservative approach to reform. As an independent public body with a statutory foundation and a mission to protect consumers, prevent anti-competitive

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<sup>227</sup> As of the end of 2018, UK pension funds and insurance companies only held 6.1 per cent of UK listed equities (Office for National Statistics, 'Ownership of UK quoted shares: 2018' (14 January 2020) 5).

<sup>228</sup> n 142.

<sup>229</sup> n 199. As also evidenced by numerous successful US dual-class stock IPOs.

<sup>230</sup> Report of the Committee on the Financial Aspects of Corporate Governance (Gee Publishing, 1992).

<sup>231</sup> eg see FRC, 'The UK Stewardship Code 2020'.

<sup>232</sup> Investor Forum (n 213).

<sup>233</sup> *ibid.*

behaviour and protect the integrity of the UK's financial system,<sup>234</sup> the FCA is more likely to prioritise protecting against downside risk to public shareholders,<sup>235</sup> which will exacerbate its inclination to support the views of UK institutional investors, rather than support companies seeking to innovate, risk-take and disrupt.

However, it is surely time for a change in approach. It is natural for a national regulator to seriously consider the stances of domestic financial institutions, but when investors are becoming increasingly more global, regulators should also consider whether prioritising the views of investors forming a minority of the market is in the best long-term interests of the exchange or the wider economy. Taking stewardship first - although with dual-class stock the effectiveness of stewardship engagement by institutional investors with firm management will be tempered, even with one share, one vote firms, commentators have noted that several structural, legal and commercial pressures exist that discourage institutional investors (especially passive investors that are progressively forming a larger part of the market<sup>236</sup>) from engaging with corporate management on a firm-by-firm basis.<sup>237</sup> There has been significant scepticism that UK institutional investors do in fact engage effectively with one share, one vote firms,<sup>238</sup> and the regulators have begun to embrace a wider notion of stewardship moving beyond individual firm engagement to stewarding systemic market-wide risks.<sup>239</sup> Given that there is sparse evidence that effective and widespread issuer-specific engagement is taking place even in one share, one vote firms, the ideal of stewardship should not be a decisive reason to overly constrain the utilisation of dual-class stock. In relation to the desire to preserve the exceptionalism of the premium-tier, it should be acknowledged that the shareholder rights governance mechanics that have been ingrained into the

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<sup>234</sup> n 114.

<sup>235</sup> Cheffins (1997) (n 13) 379.

<sup>236</sup> The Investment Association, 'Investment Management in the UK 2019-2020: The Investment Association Annual Survey' (September 2020) 49.

<sup>237</sup> R Gilson and J Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 CLR 863, 891; in relation to the UK: B Reddy, 'The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code' (2021) 84 MLR 842, 854-861.

<sup>238</sup> eg J Kingman, 'Independent Review of the Financial Reporting Council' (2018) DBEIS 1, 8 and 46.

<sup>239</sup> See eg Stewardship Code (n 231) Principles 4 and 7; Reddy (n 237) 865-871.

premium-tier are reminiscent of an exchange built upon retail, manufacturing, financial and natural resource issuers. In an era where new economy companies, the businesses of which are not as simple to assess or observe as the previous ‘old economy’ firms, are becoming more pervasive, an ideological focus on public shareholder rights could hinder rather than support the continued success of the LSE. Furthermore, the LSE is arguably facing greater competition from foreign exchanges than at any other time in its history. Whereas prior to leaving the EU, the UK could exert influence over EU regulations to drag the regulatory approaches of the exchanges of other Member States closer and closer to those of the premium-tier, now the LSE is in more open competition with those exchanges. Although a ‘race-to-the-bottom’ in terms of corporate governance would not be in the long-term interests of any economy, there needs to be a greater acknowledgement that the LSE is falling behind other exchanges when it comes to attracting new economy companies to IPO. Therefore, although investors should be protected from egregious exploitation, it may be time to appreciate that a compromise is necessary that sacrifices ideologically optimal shareholder rights in favour of a pragmatic regime that balances investor protection against encouraging innovation and entrepreneurship. Deliveroo is a case in point. The company listed on the standard-tier after the Review’s publication, and implemented a ‘genuine’ dual-class stock structure<sup>240</sup> that gave it more flexibility than the Review’s proposals for the premium-tier, notwithstanding the company’s possible intention to upgrade to the premium-tier in the future.<sup>241</sup> It would appear, at least in the case of Deliveroo, that concerns in this article that the Review’s proposals on dual-class stock do not cater for the needs of founders have a real-world basis. Exceptionalism may preserve the prestige of the premium-tier, but “at what cost”? As the Review itself points-out, “it makes no sense to have a theoretically perfect listing regime if in practice users increasingly choose other venues”.<sup>242</sup>

Ultimately, though, the underlying purpose of the FCA, as the LSE’s regulator, may need to be reviewed. As discussed above, in its current form, it is always more likely to prioritise protection

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<sup>240</sup> n 27 and accompanying text.

<sup>241</sup> n 40 and accompanying text.

<sup>242</sup> Review (n 7) 2.

against downside risk over promoting upside potential.<sup>243</sup> By way of contrast, the NYSE has a self-regulatory footing, which gives it greater scope to consider its commercial interests in attracting further issuers.<sup>244</sup> This author certainly does not advocate for the UK to take a completely ruthless approach to attracting issuers to the equity markets while throwing public shareholder rights under the bus. However, as iterated throughout, it is all about balance. Interestingly, Hong Kong, as described in this article, has developed what could be considered to be a fairly pragmatic position on dual-class stock that venerates public shareholder rights, while recognising the twenty-first Century aspirations of tech-company founders. It is no surprise that the Hong Kong regulator wears two hats, as a listed company in its own right – requiring it to consider its own competitive interests – and as a regulator of the market under statute.<sup>245</sup> The Main Market reverting to a self-regulatory approach as it had pre-2000 may be a too drastic and regressive step for the UK to take (and itself creates potential conflicts of interest), but a more forward-looking system could be developed if the mission of the FCA were re-evaluated to ensure that as well as protecting consumers and the UK financial system, it has more of a stake in the upside of UK companies, by also embracing responsibility for the growth, competitiveness and success of the UK markets and economy.<sup>246</sup>

## 10. Conclusion

Although a few steps behind other major exchanges, the UK's premium-tier has finally commenced climbing the hill toward an acceptance of dual-class stock, with a view to attracting innovative, high-growth companies to the market. Unlike the US though, where dual-class stock is subject to very few regulatory constraints, the regulatory environment of the UK and the prominence of UK institutional

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<sup>243</sup> See text accompanying n 235.

<sup>244</sup> Infamously, when the SEC attempted to regulate dual-class stock in 1988 (pursuant to Code of Federal Regulations, Title 17, Chapter 2, Part 240 § 240.19c-4), it was struck down by the Court of Appeals for the District of Columbia as an example of the SEC exceeding its powers (*Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990)).

<sup>245</sup> Huang et al (n 115) 34.

<sup>246</sup> Ironically, given the Review's conservative approach to dual-class stock, it also made a similar plea ((n 7) 18).

investors, who are generally hostile to dual-class stock, will inevitably result in the use of dual-class stock on the premium-tier being conditional upon the adoption of measures that protect public shareholders. Such protective measures are not necessarily undesirable, and, indeed, many exchanges, such as Hong Kong, Singapore, Tokyo, Shanghai and India also mandate investor protections in this regard. However, a balance must be maintained that reduces the risks that the interests of public shareholders will be excessively expropriated, while not blunting the very benefits of dual-class stock that attract founders to adopt the structure and list on the public markets. A premium-tier package has been suggested in this article that combines (i) focused event-driven sunset clauses that convert enhanced-voting into one share, one vote shares upon the occurrence of events that could increase the risks that the interests of the public shareholders will be impaired – specifically, upon the holder ceasing to be a director, transferring the enhanced-voting shares, or ceasing to own sufficient ‘skin-in-the-game’, with (ii) provisions that protect against abuse of dual-class stock *ab initio* – specifically, ensuring that a separate public shareholder vote is required to effect certain corporate actions that could potentially be used to harm public shareholder interests. The possibility of granting public shareholders more robust independent director appointment rights has also been proposed.

The package that has been proposed in this article deviates though from the Review’s curious curate’s egg of a package for premium-tier dual-class stock. The Review’s proposals, when factoring-in the conditions attached, do not represent ‘genuine’ dual-class stock and amount to little more than, effectively, a five-year, takeover-blocking golden share and a five-year guaranteed founder board seat. Although the premium-tier rules on dual-class stock are likely to evolve and shift over many years, the FCA must fundamentally accept the reasons for founders adopting dual-class stock, otherwise any initiatives to introduce ‘dual-class stock-lite’ will not spawn the flood of high-growth, innovative, early-stage IPOs envisaged. Such companies have numerous other options, ranging from dual-class stock listings on foreign exchanges and lucrative buy-outs by larger firms, to exploitation of the rich availability of private capital.

Why though may the UK risk the worst of both worlds – relaxation of the high corporate governance standards of the premium-tier without any meaningful upside in attracting listings? The answer lies in the nature of the FCA as regulator of the LSE. With its mission to protect consumers and

the financial markets, the FCA will be primarily focused on ensuring that listed company controversies do not occur – protecting against the downside rather than promoting the upside. Such an approach also bolsters the outsized influence that UK institutional shareholders, who have been antagonistic to dual-class stock, have enjoyed for decades. It is not a surprise, therefore, that shareholder rights take priority to attracting high-growth, founder-led companies to the premium-tier. However, if the UK continues to disproportionately favour the views of UK institutional investors, it will potentially move in a different direction to the other major global exchanges where dual-class stock is being welcomed more openly. A balance needs to be struck, which may require a review of the FCA’s raison d’être, with perhaps a shift to the regulator bearing some accountability for the health, competitiveness and success of the UK economy alongside its watchdog role in protecting consumers and the integrity of the financial markets. With respect to dual-class stock, without that right balance, even as the UK climbs the steep hill toward dual-class stock acceptance, it could fall right back down again.

## Appendix

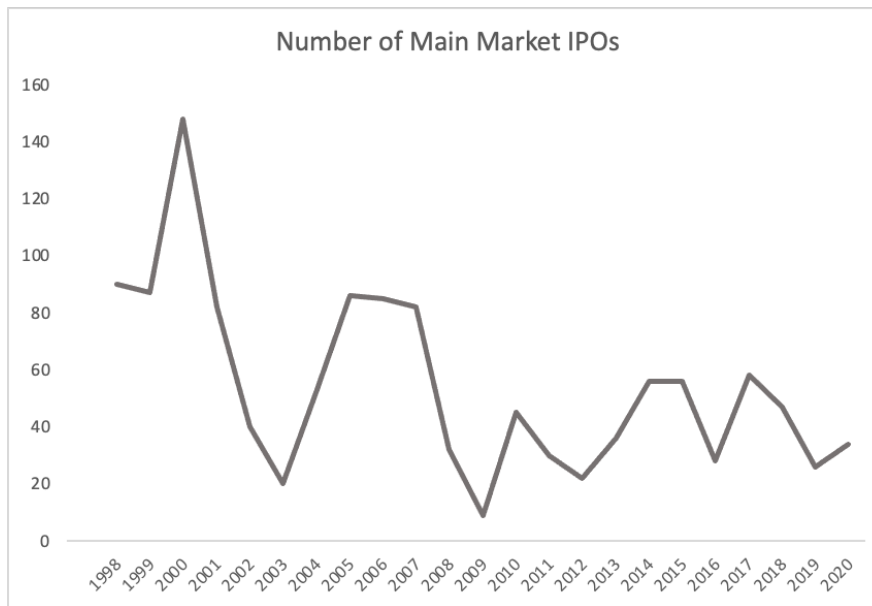


Figure 1: UK IPOs on the LSE's Main Market 1998-2020 (data derived from: London Stock Exchange, 'Reports: Primary markets, New issues and IPOs' <https://www.londonstockexchange.com/reports?tab=new-issues-and-ipos&accordionId=0-838a7e19-cb32-49ba-a1b5-3e4eaca7021b>)

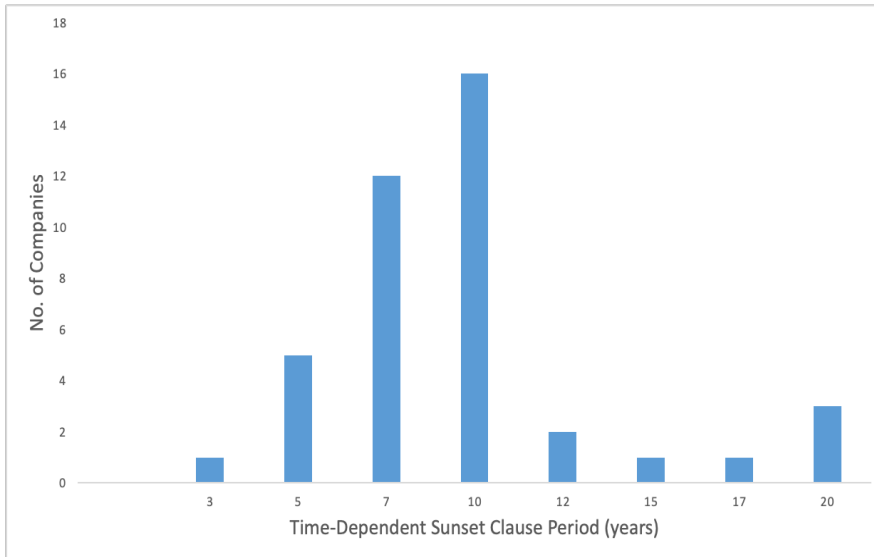


Figure 2: US Dual-class stock IPOs that have adopted time-dependent sunset clauses as of 31 December 2020 (data derived from: CII, ‘Companies with Time-Based Sunset Approaches to Dual-Class Stock’ (February 2019) [https://www.cii.org/files/2-13-19\\_Time-based\\_Sunsets.pdf](https://www.cii.org/files/2-13-19_Time-based_Sunsets.pdf); CII, ‘Dual-Class IPO Snapshot 2017-2020 Statistics’ (2021) <https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf>).

<b>Voting Ratio</b>	<b>Minimum Equity Requirement for Majority Voting Control</b>
20:1	4.8%
10:1	9.1%
5:1	16.7%
4:1	20.0%
3:1	25.0%
2:1	33.3%
One share, one vote (1:1)	50.0%

Figure 3: Minimum equity requirement to maintain majority voting control as a factor of enhanced-voting share:inferior-voting share voting ratio (*Author created*).

<b>Firm</b>	<b>IPO Date</b>	<b>Founder(s) Equity as of IPO</b>	<b>Founder(s) Equity 2020</b>
Facebook	2012	23.55%	12.90%
Alphabet	2004	28.07%	11.40%
Workday	2012	63.25%	25.91%
Square	2015	30.29%	17.09%
Veeva	2013	14.89%	11.47%
Twilio	2016	10.40%	5.20%
Okta	2017	14.60%	8.90%
Zoom	2019	19.08%	16.18%
RingCentral	2013	25.74%	10.83%
Snap	2017	36.10%	28.62%

Figure 4: Founder(s) equity ownership for the top 10 (by way of market capitalisation) US dual-class firms with post-2000 IPO dates (data hand-collected from the SEC's 'Edgar website' – 2020 equity ownership was derived from the most recent public filings as of 17 September 2020; market capitalisation rankings determined as of 17 September 2020 from the constituents of the MSCI USA Index <https://www.msci.com/constituents>).