COMMITTEE ON CAPITAL MARKETS REGULATION

THE RISE OF DUAL CLASS SHARES: REGULATION AND IMPLICATIONS

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The Rise of Dual Class Shares: Regulation and Implications

Executive Summary

Shares of common stock in corporations represent a bundle of rights: economic rights, such as the rights to receive dividends declared by the corporation, and governance rights, including the right to vote on certain corporate decisions. These rights are typically allocated proportionally, with each share of common stock entitled to the same economic and voting rights as every other share. However, many jurisdictions allow corporations to offer classes of common stock with unequal voting rights (a "**dual class**" share structure).[1]

In recent years, several prominent companies, such as Google, Facebook, and Alibaba, have gone public with dual class structures in which a minority of the shares, held by the company´s founders and executives, have special voting rights that provide their holders with effective control, while a majority of the company's stock, which has regular voting rights, is held by outside investors. The increase in companies going public with dual class share structures, and the corresponding desire by stock exchanges to attract public offerings, have drawn renewed attention to these structures. However, public debate regarding the use of dual class shares has existed for almost a century—at least since 1925, when Dodge Brothers listed on the New York Stock Exchange with a structure that gave the automaker's founders total voting control with only 1.7 percent of equity.[2]

This report surveys the prevalence of dual class shares in several jurisdictions and the laws in those jurisdictions governing their use. It also considers the approach taken by private actors, including stock exchanges, providers of stock indexes, and institutional investors, with respect to dual class shares. That discussion is followed by consideration of the empirical evidence in favor of and against restricting the use of dual class shares. The report then evaluates specific proposals to regulate dual class shares by requiring that they "sunset" after a predetermined period of time, as well as additional disclosure requirements for dual class shares.

The Committee recommends that the Securities and Exchange Commission (SEC) encourage dual class issuers to provide more robust disclosures regarding material risks associated with the dual class structure, through the SEC's review of and comment on public filings by these issuers. For example, where appropriate, the SEC should direct a dual class issuer to disclose the risk that shares will be excluded from major indexes. The Committee also recommends that the SEC encourage dual class issuers to disclose data showing the divergence between economic ownership and control, such as the numerical gap between a shareholder's ownership interest and voting rights.

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[1] Although corporations can offer more than two classes of stock with unequal voting rights, for simplicity we refer to this kind of structure as a "dual class" share structure. The scope of this report is limited to dual class structures; it does not address other means of separating corporate ownership and control.

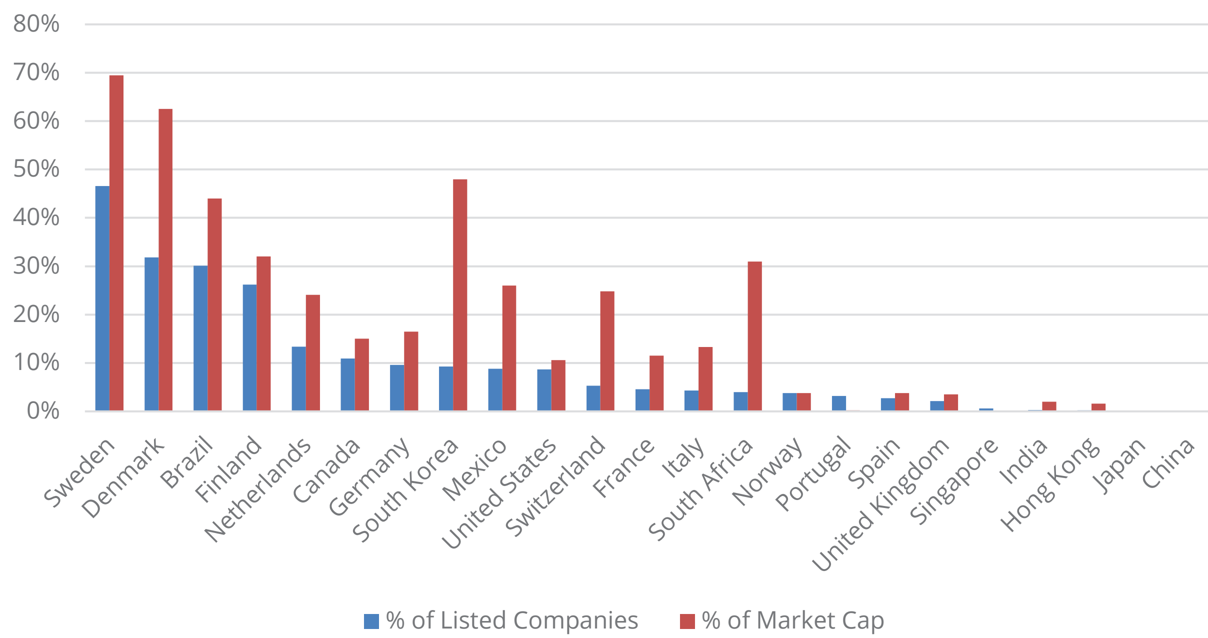
[2] See Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 Geo. Wash. L. Rev. 687, 694-97 (1986).

Contents

1. Prevalence and regulation of dual class shares

The prevalence of dual class share structures varies widely across jurisdictions (see **Figure 1**). Differences between jurisdictions are in part explained by regulation. Many countries allow the use of dual class shares with few or no restrictions, while others either prohibit outright or strongly restrict the ability of corporations to offer shares to the public that have unequal voting rights. But regulation is not the only explanation for differences between countries: even among countries that allow departures from a "one share, one vote" structure, there are significant disparities with respect to the prevalence of dual class equity structures. This section surveys the prevalence of dual class structures in several major jurisdictions as well as applicable regulations in those jurisdictions.

Figure 1. Prevalence of listed companies with multi-class structures (2016).[3]



a. United States

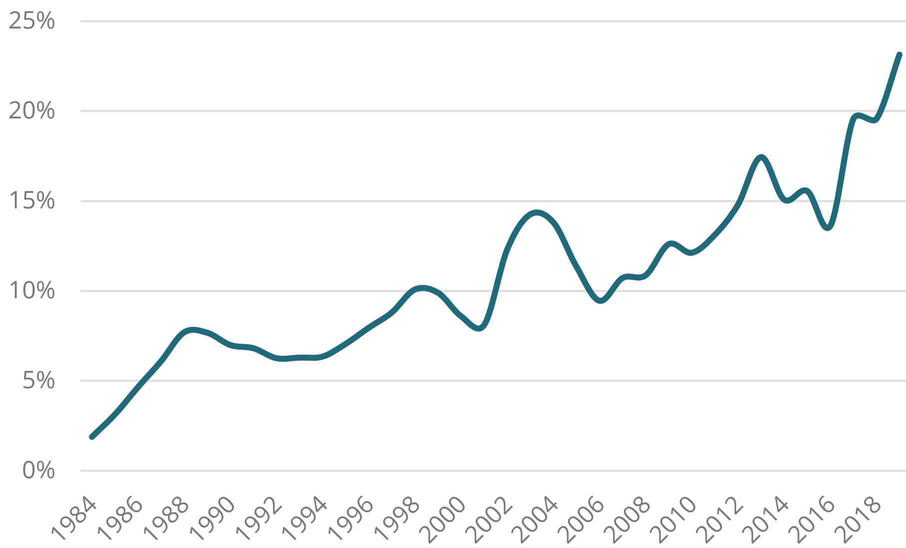
Between 2005 and 2015, the number of U.S. companies with dual class share structures increased by 44 percent.[4] By July 2016, 6.4 percent of the companies included in the S&P 500 and 8.2 percent

[3] See Jinhee Kim, Pedro Matos and Ting Xu, *Multi-Class Shares Around the World: The Role of Institutional Investors* 39 (Nov. 2018).

[4] See *Recommendation of the Investor as Owner Subcommittee: Dual Class and Other Entrenching Governance Structures in Public Companies,* Investor Advisory Committee, Securities and Exchange Commission 1 (Feb. 27, 2018), available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac030818-investor-as-owner-subcommittee-recommendation.pdf. The index provider MSCI reports that as of September 1, 2017, 10.9% (by market cap) of the U.S. issuers included in the MSCI ACWI Index, its global flagship index, had multi-class share structures. See *Should Equity Indexes Include Stocks of Companies with Share Classes Having Unequal Voting Rights?*,

of those included in the Russell 3000 had dual class share structures.[5] The prevalence of dual class share structures has further increased since then: according to one measure, more than 20 percent of the companies listing shares on U.S. exchanges between 2017 and 2019 had a dual class structure (see **Figure 2**).[6]

Figure 2. Dual class IPOs as a share of all U.S. IPOs, 1984-2019 (three-year moving average).[7]



Institutional Shareholders Services (ISS), the proxy advisory firm, reports different numbers, because they only include dual class share companies that are in the Russell 3000 and dual class share structures in which the class of shares with superior voting rights represents more than 5 percent of voting rights.[8] Still, their numbers are consistent with an increase in the prevalence of dual class share structures in the United States. According to data from ISS, as of early 2019, 7 percent of companies in the Russell 3000 had a dual class share structure, an increase of one percentage point over the previous decade.[9]

Dual class equity structures in the U.S. are more prevalent among small capitalization companies than larger companies. ISS reports 9 percent of non-S&P 1500 companies in the Russell 3000 have

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MSCI 22 (January 2018), available at https://www.msci.com/documents/1296102/8328554/Discussion+Paper_Voting+rights.pdf.

[5] See Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Virginia L. Rev. 585, 594 (2017).

[6] See Jay R. Ritter, *Initial Public Offerings: Dual Class IPOs* (Jan. 14, 2020), available at https://site.warrington.ufl.edu/ritter/files/2020/02/IPOs2019DualClass.pdf.

[7] See id.

[8] See *Dual Class Shares: Governance Risks and Company Performance*, ISS Analytics: Governance Insights (June 14, 2019).

[9] See id.

multi-class share structures, compared to less than 5 percent for S&P 1500 companies.[10] Dual class equity structures are also more prevalent in certain industries than others. These industries include the tech industry, where notable companies like Google and Facebook maintain such structures.[11] It also includes the media industry, where dual class share structures—such as the structure adopted by The New York Times Company—are widely considered necessary to insulate the editorial independence of media companies from shareholder pressure.[12]

Public companies in the United States are subject to a two-tier system of federal and state regulation. Very generally, federal law governs the production and distribution of information about issuers and their securities, the flow of funds in securities markets, and the basic structure of securities markets, while state law addresses corporate governance directly, including the regulation of conflict of interest transactions.

Currently, U.S. federal law does not restrict the ability of companies to publicly offer stock that is part of a dual class equity structure.[13] However, under federal securities law as interpreted and enforced by the SEC, the disclosure requirements imposed in connection with public offerings require companies to disclose risk factors associated with nontraditional governance structures such as dual class shares.[14]

A review of recent SEC filings by companies planning a public offering illustrates that companies with dual class share structures disclose risks associated with investors' lack of control. The We Company (WeWork), for example, disclosed that its dual class structure would "limit the ability of other stockholders to influence corporate activities" and, as a result, it could take actions that "stockholders other than [its founder] do not view as beneficial." The company also emphasized that "[a]s a stockholder, even a controlling stockholder, [its founder] is entitled to vote his shares,

[10] See id. It is not clear whether ISS accounts for the fact that new companies with multi-class share structures have been excluded from the S&P 1500 since 2017. See text accompanying note 64.

[11] See *Dual Class Shares: Governance Risks and Company Performance* (cited in note 8); Amir Efrati, *Google Preserves Cash and Control*, Wall Street Journal (April 12, 2012); Emily Chasan, *Facebook to Join Ranks of Dual-Class Listings*, Wall Street Journal (Feb. 8, 2012); Enda Curran, *How Hong Kong Lost the Alibaba IPO*, Wall Street Journal (March 15, 2014).

[12] See *Dual Class Shares: Governance Risks and Company Performance* (cited in note 8). See also Joe Nocera, *How Punch Protected The Times*, N.Y. Times (Oct 1. 2012), available at https://www.nytimes.com/2012/10/02/opinion/nocera-how-punch-protected-the-times.html.

[13] See *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (striking down SEC Rule 19c-4, which prohibited (1) covered exchanges from listing or continuing to list the equity securities of an issuer with a dual class share structure and (2) covered securities associations from authorizing the equity securities of such an issuer for quotation and/or transaction reporting on an automated quotation system). See also Stephen M. Bainbridge, *The Scope of the SEC's Authority Over Shareholder Voting Rights*, UCLA School of Law Research Paper No. 07-16 (May 2007), available at https://ssrn.com/abstract=985707.

[14] See *Recommendation of the Investor as Owner Subcommittee* at 3-4 (cited in note 4).

and shares over which he has voting control as a result of voting arrangements, in his own interests, which may not be the same as, or may conflict with, the interests of our other stockholders." In addition, the We Company disclosed that its dual class structure could diminish the value, liquidity and trading price of its low-vote common stock.[15]

Virtually all state corporate codes adopt one vote per common share as the default rule but allow corporations to depart from the norm by adopting appropriate provisions in their constitutive documents.[16] Dual class capital structures are routinely upheld by state courts.[17] However, courts in certain states review proposed transactions involving dual class (and other controlled) corporations more carefully than transactions involving noncontrolled corporations.

For example, Delaware, the favored state of incorporation for U.S. businesses, allows a corporation's certificate of incorporation to provide that one or more classes or series of stock will have limited or no voting rights.[18] But when a controlling shareholder (including a shareholder that controls a corporation using dual class shares) has an interest in a transaction that differs from that of other shareholders, Delaware law treats the board as incapable of exercising truly independent judgment as to whether the transaction is in the best interests of the company and the other shareholders, due to the ability of the controlling shareholder to remove directors and elect new ones. Accordingly, Delaware courts reviewing transactions involving controlling shareholders apply the onerous "entire fairness" standard of judicial review—requiring the board to show that both the price and process are fair—instead of the more deferential "business judgment" standard.[19]

For example, in *In re Ezcorp Inc. Consulting Agreement Derivative Litigation*,[20] corporate management, which controlled 100 percent of voting power while owning just 5.5 percent of the outstanding stock, entered into a series of allegedly "rubber-stamped" related-party transactions that

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[15] See The We Company, S-1A (Sep. 13, 2019), available at https://www.sec.gov/Archives/edgar/data/1533523/000119312519244329/d804478ds1a.htm. WeWork's public offering ultimately failed. See Maureen Farrell, *WeWork Parent Postpones IPO*, Wall Street Journal (Sep. 17, 2019), available at https://www.wsj.com/articles/wework-parent-expected-to-postpone-ipo-11568671322; Maureen Farrell and Corrie Driebusch, *WeWork to List Shares on Nasdaq, Make Governance Changes*, Wall Street Journal (Sep. 13, 2019), available at https://www.wsj.com/articles/wework-to-list-shares-on-nasdaq-make-governance-changes-11568348421.

[16] See Bainbridge, *The Scope of the SEC's Authority Over Shareholder Voting Rights* at 7 (cited in note 13).

[17] See id.

[18] See 8 Del. C. § 151(a) ("Every corporation may issue 1 or more classes of stock or 1 or more series of stock within any class thereof, … which classes or series may have such voting powers, full or limited, or no voting powers, … as shall be stated and expressed in the certificate of incorporation….").

[19] See Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face*, 30 Del. J. Corp. L. 673, 678 (2005) ("Delaware is more suspicious when the fiduciary who is interested is a controlling stockholder … there is an obvious fear that even putatively independent directors may owe or feel a more-than-wholesome allegiance to the interests of the controller, rather than to the corporation and its public stockholders.").

[20] C.A. No.9962-VCL (Del. Ch. Jan. 25, 2016).

purportedly undermined the company's financial health. Public shareholders sued in the Delaware Court of Chancery, alleging breach of fiduciary duty and waste of corporate assets, and successfully defended the suit against a motion to dismiss (the suit was ultimately settled).[21] In the process, the Chancery Court applied the "entire fairness" standard of judicial review because the transaction expressly provided a benefit to an affiliate of the controlling shareholder.[22]

That said, Delaware courts have identified certain circumstances in which transactions involving controlling shareholders will not be subject to "entire fairness" review. In *IRA Trust FBO Bobbie Ahmed v. Crane*,[23] the Delaware Court of Chancery held that the "entire fairness" standard would otherwise apply to the recapitalization undertaken by a dual class share corporation to stop the erosion of the controlling stockholder's voting power and extend the time the controller held majority voting control of the corporation. However, the court held that since the corporation's board of directors conditioned the recapitalization on approval by (i) a fully empowered independent committee of the board of directors and (ii) a fully informed, uncoerced majority of the minority vote, the more deferential "business judgment" standard was appropriate. In doing so, the court applied the rule of *Kahn v. M & F Worldwide Corp.*,[24] which held that if a conflicted controller transaction is subject from the outset to the conditions of approval by both a special committee of independent directors and a majority of the unaffiliated stockholders, then the business judgment standard would apply instead of the entire fairness standard.[25] The *IRA Trust* holding suggests that the Delaware courts will emphasize procedural safeguards in protecting the interests of noncontrolling shareholders of corporations with dual class equity structures.[26]

b. Europe

The prevalence of dual class equity structures varies considerably between European jurisdictions. In a 2006 study of more than 4,000 publicly traded European corporations, Bennedsen and Nielsen found that—for countries that permitted dual class share structure at the time of the survey—the use of dual class shares ranged from highs in Sweden (62 percent of sample corporations) and

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[21] See id.
[22] See id.
[23] C.A. No. 12742-CB (Del. Ch. Dec. 11, 2017).
[24] Del. Supr., No. 334, 2013 (March 14, 2014).
[25] For more on the emphasis on procedural safeguards for control shareholder transactions, see Itai Fiegenbaum, *The Controlling Shareholder Enforcement Gap* (April 4, 2019), available at https://ssrn.com/abstract=3227828.
[26] For another case in which a Delaware court emphasized the requirement for controlling shareholders of dual class companies to abide by corporate formalities, see *Espinoza v. Zuckerberg*, 124 A.3d 47 (Del. Ch. 2015) (holding that informal approval by controlling shareholder of dual class company was insufficient to authorize an increase in non-management director compensation and formal consent was required).

Switzerland (52 percent) to lows in France (3 percent), Portugal and Spain (both 0 percent).[27] A 2007 survey, commissioned by the European Commission and conducted by ISS, reported similar results based on a sample of 464 companies in 16 European countries, though it differed noticeably in some cases. For example, ISS reported that 3 percent of U.K. companies in their sample used dual class shares (compared to 25 percent reported by Bennedsen and Nielsen). These differences could be explained by Bennedsen and Nielsen's much larger sample, which included numerous small companies.[28]

A more recent academic survey found that, as of 2016, dual class shares continued to be prevalent in Sweden (46.6 percent of companies analyzed; 69.5 percent when weighted by market capitalization) and were less common in France (4.6 percent; 11.5 percent by market cap) and the U.K. (2.1 percent; 3.5 percent by market cap) (see **Figure 1**).[29] The index provider MSCI reported that as of September 2017, the number of issuers included in the MSCI ACWI Index, its global flagship index, that had dual class share structures ranged from a high of 68.3 percent by market cap in Sweden to a low of 0.4 percent by market cap (representing just two issuers) in the United Kingdom.[30]

The disparities in prevalence of dual class voting structures in Europe are partly attributable to the different regulatory approaches to dual class equity structures that have been adopted by European jurisdictions. For example, some jurisdictions discourage them or prohibit them outright, while others allow shares with unequal voting rights (in some cases, subject to certain limits on the disproportionality of voting rights).

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[27] See Morten Bennedsen and Kasper Meisner Nielsen, *The Principle of Proportional Ownership, Investor Protection and Firm Value in Western Europe*, ECGI Working Paper Series in Finance, Working Paper No. 134/2006 (May 2008), available at https://ecgi.global/sites/default/files/The%20Principle%20of%20Proportional%20Ownership%2C%20Investor%20Protection%20and%20Firm%20Value%20in%20Western%20Europe.pdf.

[28] See Institutional Shareholder Services, *Report on the Proportionality Principle in the European Union*, 38-39 (May 18, 2007), available at https://ecgi.global/sites/default/files/final_report_en.pdf. See also Anete Pajuste, *Determinants and Consequences of the Unification of Dual Class Shares*, European Central Bank Working Paper No. 465 (March 2005), available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp465.pdf?2a436e67ce16b853494adab3efb255d7 (documenting a decline in the number of companies using dual class shares in several European countries, including Germany, Sweden and Switzerland, between 1995 and 2001).

[29] See Kim, Matos and Xu, *Multi-Class Shares Around the World* at 39 (cited in note 3). See also Kristof Ho Tiu, *Analysis: Differentiated Voting Rights in Europe* (Feb. 17, 2015), available at https://www.issgovernance.com/analysis-differentiated-voting-rights-in-europe/ (noting that in the Nordic region, differentiated voting rights implemented though dual class share structures are common). Differentiated voting rights can also be implemented without dual class structures, as in France. See text accompanying note 32.

[30] See *Should Equity Indexes Include Stocks of Companies with Share Classes Having Unequal Voting Rights?* at 22 (cited in note 4) (reporting that the number of issuers with unequal voting structures represented 53% of the market cap in Denmark and 38% in Finland, followed by Italy with 30%, Switzerland with 25%, Netherlands with 23%, and Germany—close to the global average—with 12%).

Some European jurisdictions have adopted a permissive approach to dual class voting structures: France, Italy, Ireland and Finland generally allow unequal voting structures.[31] France, in fact, has adopted a favorable approach to unequal voting rights more broadly: in 2014 France changed the default voting structure from one in which each share is entitled to an equal vote to a tenure voting structure, which entitles shareholders to a double vote after holding their shares for a loyalty period (typically, two years). French law allows companies to opt out of the tenure voting default structure through a shareholder resolution and a two-thirds majority binding vote.[32]

Other European jurisdictions—such as Germany, Belgium, and Spain—differentiate between common and preferred shares, allowing companies to issue non-voting preferred shares, but not common shares with unequal (or no) voting rights.[33] Still others differentiate between shares with unequal voting rights and shares with no voting rights at all: the Netherlands and Sweden, for example, allow companies to issue shares with unequal voting rights but do not permit the issuance of nonvoting shares (whether common or preferred).[34]

In the United Kingdom, company law grants companies considerable discretion in adopting the internal rules, including voting rights, under which the company is governed.[35] However, a company with a dual class share structure is only permitted to publicly offer shares within the "standard listing" regime (which covers financial instruments ranging from equity shares to Global Depositary Receipts, debt and securitized derivatives), but not the "premium listing" regime (which is limited to equity shares of companies and closed- and open-ended investment entities).[36] Premium

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[31] See *Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion*, OECD Steering Group on Corporate Governance 16 (Dec. 2007), available at https://www.oecd.org/daf/ca/40038351.pdf. Italian law allows listed companies to issue loyalty shares that entitle shareholders to a double vote after a two-year holding period, and non-listed companies to issue multiple-vote shares with a maximum of three votes per share. See Marco Ventoruzzo, *The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat*, ECGI Working Paper Series in Law, Working Paper No. 288/2015 13-17 (March 2015), available at https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id2574236.pdf.

[32] See Marco Becht, Yuliya Kamisarenka and Anete Pajuste, *Loyalty Shares with Tenure Voting - A Coasian Bargain? Evidence from the Loi Florange Experiment*, ECGI Working Paper Series in Law, Working Paper No. 398/2018 9-11 (April 2018), available at https://ecgi.global/sites/default/files/working_papers/documents/finalbechtkamisarenkapajuste.pdf. French companies with tenure voting are not treated as having dual class equity structures in the studies of dual class prevalence cited earlier.

[33] See *Lack of Proportionality Between Ownership and Control* at 16 (cited in note 31).

[34] See id. Swedish law provides that no share may carry voting rights that are ten times greater than the voting rights of any other share. See *Proportionality Between Ownership and Control in EU Listed Companies: External Study Commissioned by the European Union*, Shearman & Sterling LLP, Exhibit C (Part II) 235-236 (November 1, 2016).

[35] See *Bushell v. Faith (*1970) 1 All ER 53 (enforcing unequal voting rights structure).

[36] Financial Conduct Authority, *Listing Rules* 7.2.1A (Sep. 2018). As of May 31, 2019, 505 of the stocks (excluding closed- and open-ended investment companies) listed on the London Stock Exchange's Main Market had a premium listing, compared to 241 that had a standard listing. See *Companies and Securities: Instrument List*, London

listings are generally considered more attractive to investors because premium listed companies must satisfy more restrictive corporate governance and transparency standards (including the one-share, one-vote principle).[37]

A review commissioned by the Chancellor of the Exchequer and published in 2017 noted that permitting dual class structures within the premium listing regime could help make public offerings more attractive in the United Kingdom, and it urged the Financial Conduct Authority to consider the move, but the FCA has taken no firm action on the proposal.[38] Nevertheless, in November 2019, reports emerged that the UK government is considering altering the listing rules to permit the broader use of dual class shares, particularly to attract more listings by technology companies among whom dual class share structures are popular.[39]

c. Asia

Asian jurisdictions also exhibit variation with respect to the regulation and prevalence of dual class equity structures, though as a general matter such structures are not prevalent in major Asian jurisdictions. Indeed, rates of dual class share structures are low even in Asian jurisdictions that effectively permit such structures; in other jurisdictions, the "one share, one vote" principle has been codified and companies that assign unequal voting rights to their common stock are non-existent.

Japan and Hong Kong are examples of Asian jurisdictions where dual class equity structures are permitted but uncommon. In Japan, such structures are rare: the MSCI report described above indicates that as of September 2017, only one of the Japanese issuers in its global flagship index had a dual class share structure.[40] That is the case even though Japan permits the issuance of non-voting preferred or common shares and Japan's Corporation Act allows companies to adopt a "unit" share system, pursuant to which a company may specify in its articles of incorporation the

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Stock Exchange, available at https://www.londonstockexchange.com/statistics/companies-and-issuers/companies-and-issuers.htm.

[37] See Andrew Bailey, *Premium listing will not water down corporate governance*, Financial Times (June 10, 2018), available at https://www.ft.com/content/5dbf33e0-6b24-11e8-aee1-39f3459514fd.

[38] See *Financing Growth in Innovative Firms: Consultation*, HM Treasury 4.13 (August 2017), available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf; *Feedback Statement to DP17/2 Review of the Effectiveness of Primary Markets: the UK Primary Markets Landscape*, Financial Conduct Authority 2.25 (Sep. 2017), available at https://www.fca.org.uk/publication/feedback/fs17-03.pdf.

[39] See Attracta Mooney, *Big investors fight back over dual class shares*, Financial Times (Nov. 24, 2019), https://www.ft.com/content/bc220535-5055-47ce-811d-fc4a56d32937; Daniel Thomas, Philip Stafford and Patrick Jenkins, *UK seeks change in listing rules to lure tech start-ups*, Financial Times (Nov. 4, 2019), https://www.ft.com/content/d4d2da5a-fee8-11e9-be59-e49b2a136b8d.

[40] See *Should Equity Indexes Include Stocks of Companies with Share Classes Having Unequal Voting Rights?* at 22 (cited in note 4).

number of shares that will constitute one voting unit, which effectively allows an unequal voting structure. A corporation can divide its stock into multiple classes and specify how many shares of each class are needed to count as one unit.[41]

Dual class equity structures are also not prevalent in Hong Kong, even though Hong Kong law allows companies to incorporate with different voting rights for different classes of stock.[42] MSCI reports that as of September 2017, only one of the Hong Kong issuers in its global flagship index had a dual class share structure. That may be because, until 2018, the Hong Kong stock exchange did not allow companies with multiple classes of equity with different voting rights to be listed, so local dual-class companies wishing to go public would either have to list in another country or eliminate their dual class share structures.[43] As of year-end 2019, three dual class companies had listed on the Hong Kong stock exchange under the exchange's new listing regime.[44]

Unlike Japan and Hong Kong, South Korea has adopted the "one share, one vote" principle, and does not allow corporations to issue common shares with unequal (or no) voting power—they can, however, issue nonvoting preferred shares.[45] Likewise, China has incorporated the "one share, one vote" principle into both the Chinese company law and the securities regulator's listing rules for its major mainland stock exchanges.[46] As a result, Chinese companies seeking to adopt a dual class equity structure with unequal voting rights have undertaken public offerings in the United States: as of June 2016, approximately 30 percent of the China-headquartered companies listed on U.S. stock exchanges (and more than half of those that had listed since 2011) employed dual class share structures.[47] These companies have a combined market capitalization of $561 billion, representing more than 80 percent of the market value of all mainland Chinese companies that are listed in the United States.

China has, however, experimented with allowing listed companies to issue non-voting preferred shares.[48] In addition, China's company law anticipates that China's cabinet may promulgate separate regulations for the issuance of shares with differentiated voting rights,[49] and recently, Chinese

[41] See *Proportionality Between Ownership and Control in EU Listed Companies* at 332-345 (cited in note 34).
[42] See Companies Ordinance (Hong Kong), Cap. 622, Article 588(4).
[43] See below, Section 2(a).
[44] See *Market Statistics 2019*, HKEx 2 (2020), available at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf;
[45] See Commercial Act (Republic of Korea), Articles 369, 370 (2012).
[46] See Companies Law of People's Republic of China, Art. 103 (2018); China Securities Regulation Commission, *Guidelines for the Articles of Association of Listed Companies (2019 Revision)*, Art. 78 (2019).
[47] See Fa Chen and Lijun Zhao, *To Be or Not to Be: An Empirical Study on Dual Class Share Structure of US Listed Chinese Companies*, 16 J. of Int. Bus. Law 215 (2017).
[48] See *Measures for the Administration of the Pilot Program of Preferred Shares*, China Securities Regulation Commission (March 21, 2014).
[49] See Companies Law of People's Republic of China, Art. 131 (2018).

authorities have taken several steps to loosen restrictions on dual class shares.[50] In 2018, China's cabinet approved a pilot program to allow large "red-chip" companies—companies whose main business is in mainland China but that are incorporated and listed abroad—to issue depository receipts that trade on China's main stock exchanges. These red-chip companies include companies that opted out of listing in China in order to skirt various Chinese listing rules, including restrictions on dual class equity structures.[51] More recently, in early 2019 China's securities regulator approved the launch of a new science and technology innovation board that would allow companies with dual class share structures to go public.[52]

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[50] See *Promising startups to get backing for listing*, State Council of the People's Republic of China (September 27, 2018) ("[L]egislation and regulations related to the capital market will be improved to allow technological companies to adopt a management structure in which differentiated rights are given to the same amount of shares."), available at http://english.www.gov.cn/policies/latest_releases/2018/09/27/content_281476320340892.htm.

[51] See Gabriel Wildau, *China clears path for foreign-listed tech unicorns to return home*, Financial Times (March 30, 2018), available at https://www.ft.com/content/60859464-342b-11e8-ae84-494103e73f7f. Depository receipts avoid these restrictions because technically they are certificates issued by a bank that holds shares registered in another country, rather than the underlying shares themselves.

[52] See *Administrative Measures for the Management of the Pilot Registration System of Initial Public Offering on the Science and Technology Innovation Board (Trial)*, China Securities Regulation Commission (Jan, 30, 2019).

2. Response of private actors to dual class shares

In addition to government regulation, the prevalence of dual class equity structures is affected by the policies and behavior of private actors. Stock exchanges have liberalized their listing rules to allow public offerings by companies with dual class shares. On the other hand, index providers have considered—and in some cases adopted—policies that exclude companies with dual class share structures from their major indexes. Institutional investors have also weighed in on the debate about unequal voting shares.

a. Exchanges

Though some stock exchanges have historically imposed a "one-share, one-vote" rule on listing issuers, the current trend—driven by competition among stock exchanges for listings—has been in the direction of allowing the listing of stock with unequal voting rights (see **Table 1**).

Table 1. Stock exchange listing rules.

	Dual class shares allowed?		Dual class shares allowed?
New York Stock Exchange	✓	**Bombay Stock Exchange**	×
Nasdaq	✓	**National Stock Exchange (India)**	×
Tokyo Stock Exchange	✓	**Australian Securities Exchange**	×
Shanghai Stock Exchange	×	**Deutsche Börse**	✓
Hong Kong Stock Exchange	✓	**SIX Swiss Exchange**	✓
Euronext	✓	**Stockholm Stock Exchange**	✓
London Stock Exchange	×	**Johannesburg Stock Exchange**	✓
Shenzhen Stock Exchange	×	**Singapore Stock Exchange**	✓
Toronto Stock Exchange	✓		

In the United States, the New York Stock Exchange (since the mid-1980s) and NASDAQ allow a company's stock to be listed even if it has unequal voting rights, but both exchanges restrict the ability of listed companies to disparately reduce the voting power of already-issued shares by, for example, issuing shares of a new class of stock with greater voting rights.[53]

Other exchanges allow companies to list with dual class equity structures as long as they include substantive protections for non-controlling shareholders. The Toronto Stock Exchange, for example, requires that listed dual class companies provide "coat-tail" protections, which provide that holders of ordinary shares must be allowed to participate in any change of control transaction on the same terms as the holders of high-vote stock.[54] This kind of provision prevents controlling shareholders from selling their control stake at a premium at the expense of the company's other shareholders.

Recently, after losing out on initial public offerings to exchanges in the United States, both the Hong Kong and Singapore stock exchanges have liberalized their listing rules to allow for dual class equity structures. Although the Hong Kong stock exchange continues to emphasize that the "one-share, one vote" principle is "the optimum method of empowering shareholders and aligning their interests in a company," it amended its listing rules in April 2018 to allow for the listing of shares with unequal voting rights.[55] The Singapore exchange subsequently adopted similar rules.[56]

Like the Toronto Stock Exchange, the Hong Kong and Singapore exchanges impose certain requirements on dual class issuers that are intended to protect investors in those companies. Both exchanges impose a cap on the voting power of controlling shareholders: high-vote shares of listed dual class companies cannot have more than ten times the voting power of ordinary shares.[57] The Hong Kong stock exchange also requires additional investor protection safeguards for listed dual class companies: high-vote holders must be directors of the company and must collectively own at least a ten percent economic interest in the company; shares must automatically convert to regular common stock upon transfer or upon the retirement or incapacity of their initial holder;

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[53] See *NYSE Listing Company Manual* Rule 313.00(A) & (B): Voting Rights (2018), available at http://wallstreet.cch.com/LCMTools/PlatformViewer.asp?selectednode=chp_1_4&manual=%2Flcm%2Fsections%2Flcm-sections%2F; *NASDAQ Stock Market Listing Rules* Rule 5640: Voting Rights (2018), available at http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp_1_1_4_3_8_31&manual=%2Fnasdaq%2Fmain%2Fnasdaq-equityrules%2F. Both of these rules are based on SEC Rule 19c-4, and were adopted in response to SEC pressure after Rule 19c-4 was struck down. See note xx.

[54] See Toronto Stock Exchange, *TSX Company Manual*, Sec. 624(l) (2019).

[55] See *Consultation Conclusions: A Listing Regime For Companies From Emerging And Innovative Sectors*, Hong Kong Exchanges and Clearing Limited 1-5 (April 2018), available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-(April-2018)/cp201802cc.pdf.

[56] See *Singapore Details Rules For Offering Dual Class Shares, Follows Hong Kong*, Reuters (June 28, 2018), available at https://www.reuters.com/article/sgx-regulation/singapore-details-rules-for-offering-dual-class-shares-follows-hong-kong-idUSL4N1TS3E3.

[57] See Singapore Exchange Limited, *Mainboard Rules*, Chapter 2, Rule 210(10)(d) (2019); Hong Kong Exchanges and Clearing Limited, *Consolidated Main Board Listing Rules*, Chapter 8A.10 (2019).

and certain corporate decisions, such as the appointment or removal of an independent director or auditor, must be undertaken on a one-share, one-vote basis.[58]

Notably, stock exchanges in mainland China also appear to be liberalizing their approach regarding dual class share structures. After initial indications to the contrary, China's mainland stock exchanges agreed to allow Chinese mainland investors to buy dual class companies listed on the Hong Kong stock exchange through the trading platform linking the Hong Kong stock exchange to stock exchanges in mainland China.[59] And in 2019, the Shanghai Stock Exchange—one of China's two primary mainland exchanges—launched a science and technology innovation board that allows companies with dual class share structures to list, provided they meet certain financial and regulatory conditions.[60] The first listing of a dual class company on the board was approved in September 2019.[61]

[58] See Hong Kong Exchanges and Clearing Limited, *Consolidated Main Board Listing Rules*, Chapter 8A (2019).
[59] See Emma Dunkley, *China bourses plan reprieve on dual class Hong Kong shares*, Financial Times (July 18, 2018), available at https://www.ft.com/content/db181df0-8a39-11e8-bf9e-8771d5404543.
[60] See *Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange (Revised in 2019)* Art. 2.1.4 (March 2019).
[61] See Hudson Lockett, *Shanghai's Star Market fades after initial success*, Financial Times (Sep. 29, 2019), available at https://www.ft.com/content/f5285292-e112-11e9-9743-db5a370481bc.

b. Index providers

Index providers have often pushed back on the use of dual class shares. Unlike active investors, passive investors aim to hold the "entire" market or an entire segment of the market—in other words, they have committed to not sell the stock of companies within that segment of the market. Because passive investors cannot "vote with their feet" by selling stock of individual companies, exercising their voting rights is the primary way in which they can affect corporate policy.[62] However, major index providers such as FTSE, S&P and MSCI have taken different approaches to multiple class equity structures (see **Table 2**).

Table 2. Major index treatment of dual class shares.[63]

Inclusion	Weighting	Hurdle	Exclusion
• CRSP US Total Market • Nasdaq 100 • MSCI EAFE • FTSE Emerging Markets All Cap China A Inclusion • MSCI Emerging Markets Investable Market • CRSP US Large Cap Value • CRSP US Large Cap Growth • NASDAQ US Dividend Achievers Select • MSCI USA Minimum Volatility • MSCI US Investable Market Real Estate 25/50	• None	• Russell 1000 • FTSE Developed All Cap ex US • Russell 1000 Growth • Russell 2000 • Russell 1000 Value	• S&P 500 • S&P MidCap 400 • S&P SmallCap 600

[62] See *Should Equity Indexes Include Stocks of Companies with Share Classes Having Unequal Voting Rights?* at 13 (cited in note 4).

[63] The indexes included here represent those tracked by the twenty largest equity ETFs, as measured by assets under management. The list of these ETFs can be found using ETF.com's ETF Screener & Database, available at https://www.etf.com/etfanalytics/etf-finder/. See *S&P U.S. Indices Methodology*, S&P Dow Jones Indices 7 (March 2020), available at https://us.spindices.com/documents/methodologies/methodology-sp-us-indices.pdf; *Russell U.S. Equity Indexes v4.3: Construction and Methodology*, FTSE Russell 16 (March 2020), available at https://research.ftserussell.com/products/downloads/Russell-US-indexes.pdf; *FTSE Global Equity Index Series v9.3: Ground Rules*, FTSE Russell 12 (March 2020), available at https://research.ftserussell.com/products/downloads/FTSE_Global_Equity_Index_Series.pdf; *CRSP Indexes Methodology Guide*, Center for Research in Security Prices 6 (Jan. 2020), available at http://www.crsp.org/files/Equity-Indexes-Methodology-Guide_0.pdf; *MSCI Will Retain the MSCI Global Investable Market Indexes Unchanged and Launch a New Index Series Reflecting the Preferences of Investors on Unequal Voting Structures*, MSCI (Oct. 30, 2018), available at https://www.msci.com/documents/10199/238444/PR_Voting_Results.pdf/0b548379-fbe7-71c7-b392-7140b2215cc9; *NASDAQ-100 Index Methodology*, Nasdaq (Dec. 2018), available at https://indexes.nasdaqomx.com/docs/Methodology_NDX.pdf; *NASDAQ US Dividend Achievers™ Select Index Methodology*, Nasdaq (Oct. 2019), available at https://indexes.nasdaqomx.com/docs/Methodology_DVG.pdf.

Exclusion approach

Some index providers have adopted an exclusion approach to multi-class equity structures for certain indexes—that is, companies with multi-class structures are left out of the index. In the United Kingdom, only "premium listed" companies are eligible for inclusion in the FTSE UK Index Series, so companies with multiple class share structures (as well as others that fail to qualify for a premium listing) are excluded. And S&P Dow Jones Indices announced in 2017 that companies with multiple share class structures would be excluded from its S&P Composite 1500 indexes, including the S&P 500, though existing members would be grandfathered in.[64]

Hurdle approach

FTSE Russell has eschewed the strict exclusion approach in favor of a voting rights hurdle in order to ensure that minority investors have some minimum degree of control over companies they hold. Beginning in 2017, to be eligible for inclusion in certain FTSE Russell equity indexes, including the popular Russell 1000, 2000, and 3000 indexes, companies from developed markets must have at least 5% of their voting rights across all securities held by public investors.[65] (Existing constituents are grandfathered for five years until 2022.[66]) Because FTSE Russell already imposed voting rights restrictions on UK incorporated companies for inclusion in its UK Index Series, the effects of the new policy will be felt primarily in FTSE's United States and global indexes.[67]

Weighting approach

One concern with index exclusion is that it reduces the opportunity for passive investors to get comprehensive exposure to the market. An alternative to exclusion is a weighting approach, which reduces the weight of unequal voting shares in an index to better align economic exposure with listed voting power.[68] Both exclusion and weighting penalize companies for adopting dual class equity structures by reducing the demand for their shares from passive investors. Unlike outright exclusion, however, the weighting approach operates on a sliding scale—as the voting power of outside shareholders increases, the company's weight in the index increases—giving companies an

[64] See *S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules*, S&P Dow Jones Indices (July 31, 2017); Andrew Winden and Andrew Baker, *Dual Class Index Exclusion*, Rock Center for Corporate Governance, Working Paper Series No. 233 24–26 (August 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3201578. The S&P Composite 1500 (comprising the S&P 500, S&P MidCap 400 and S&P SmallCap 600) is designed to reflect the U.S. equity market, but follows stricter and, in some cases, more subjective eligibility rules than other, broader equity indexes.

[65] See *FTSE Russell Voting Rights Consultation – Next Steps*, FTSE Russell 3 (July 2017), available at https://research.ftserussell.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf.

[66] See id.

[67] See Winden and Baker, *Dual Class Index Exclusion* at 27–28 (cited in note 64).

[68] See *Should Equity Indexes Include Stocks of Companies with Share Classes Having Unequal Voting Rights?* at 14–15 (cited in note 4) (describing how a company's weight in the index could be adjusted by multiplying the free float of its securities by the ratio of the voting power of listed shares to the total free float of the company).

incentive to reduce the gap between free float and voting power even if they do not eliminate it entirely.

No major index provider has adopted a weighting approach. MSCI considered a weighting approach[69] but ultimately rejected it on the grounds that indexes should represent the broadest investment opportunities available, regardless of investor preferences regarding corporate governance policy.[70] Instead, MSCI includes dual class companies in its indexes, but offers an alternative series of benchmarks that specifically include voting rights in their weighting criteria and construction methodology.[71]

c. Institutional investors

Institutional investors have generally opposed dual class equity structures. Like passive investors that seek comprehensive exposure to markets, institutional investors tend to have long-term investment horizons, so voting rather than sale is often their primary tool to align their interests with the interests of corporate management. Accordingly, institutional investors such as CalPERS have expressed support for the "one-share, one-vote" principle.[72] Likewise, the Council of Institutional Investors (CII) has taken the position that each share of a public company's common stock should have equal voting rights in order to minimize principal-agent costs. With the endorsement of prominent institutional investors such as BlackRock and T. Rowe Price,[73] CII has called for restrictions on the use of dual class equity structures by listed companies.[74]

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[69] See id; Winden and Baker, *Dual Class Index Exclusion* at 39-31 (cited in note 64).

[70] See Rachel Evans, *MSCI Rejects Calls to Ban Dual Class Stocks From its Indexes*, Bloomberg (Oct. 30, 2018), available at https://www.bloomberg.com/news/articles/2018-10-30/msci-rejects-calls-to-ban-dual-class-stocks-from-its-indexes.

[71] See *MSCI Voting Rights-Adjusted Indexes Methodology*, MSCI (May 2019), available at https://www.msci.com/eqb/methodology/meth_docs/MSCI_Voting_Rights_Adjusted_Indexes_Methodology_May2019.pdf.

[72] See *Dual Class/Non-Voting Shares Update*, CalPERS Investment Committee (April 2018), available at https://www.calpers.ca.gov/docs/board-agendas/201804/invest/item06a-01_a.pdf.

[73] See Benjamin Bain, *BlackRock Backs Limits on Listings With Separate Share Classes*, Bloomberg (Oct. 24, 2018), available at https://www.bloomberg.com/news/articles/2018-10-24/blackrock-backs-limits-on-listings-with-separate-share-classes; Lorraine Mirabella, *T. Rowe Price Takes Stand Against Stock Structures That Create Unequal Shareholder Rights*, Baltimore Sun (Mar. 19, 2016), http://www.baltimoresun.com/business/bs-bz-t-rowe-price-oppose-dual-class-stock-20160319-story.html.

[74] See Ash Williams, Ken Bertsch and Jeff Mahoney, *Letter to John Zecca, Senior Vice President, NASDAQ Stock market* (Oct. 24, 2018), available at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf; Ash Williams, Ken Bertsch and Jeff Mahoney, *Letter to Elizabeth King, Chief Regulatory Officer, Intercontinental Exchange Inc. (NYSE)* (Oct. 24, 2018), available at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NYSE%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf; Ken Bertsch and

While CII views "one-share, one-vote" as the optimal approach, it has supported the use of dual class shares with sunset provisions, whereby the unequal voting structure is automatically wound down by the seven-year anniversary of a company's IPO unless it is approved by a majority of each share class on a one-share, one-vote basis.[75] BlackRock has proposed that dual class companies obtain shareholder approval for their dual class structures on a periodic basis, giving shareholders the opportunity to keep the current share classes or convert to a one-share, one-vote structure.[76]

Other international investor groups, such as International Corporate Governance Network and the European Shareholders Group, as well as country-specific shareholders' associations, have also strongly supported the principle that each share of a company's common stock should have equal voting rights.[77]

Jeff Mahoney, *Letter to Delaware State Bar Association: Limiting Multi-Class Voting Structures* (September 13, 2019), available at https://www.cii.org/files/issues_and_advocacy/correspondence/2019/September%2013%202019%20Final%20DGCL%20letter.pdf.

[75] See Council of Institutional Investors, *Dual Class Stock* (2019), available at https://www.cii.org/dualclass_stock..

[76] See also *Key considerations in the debate on differentiated voting rights*, BlackRock, available at https://www.blackrock.com/corporate/literature/whitepaper/blackrock-the-debate-on-differentiated-voting-rights.pdf. However, BlackRock has opposed excluding companies from broad market indexes based on unequal voting structures. See *A Potential Solution for Voting Rights and Index Inclusion Issues*, BlackRock (October 2017), available at https://www.blackrock.com/corporate/literature/publication/blk-a-potential-solution-for-voting-rights-and-index-inclusion-issues-october2017.pdf.

[77] See *Differential rights*, International Corporate Governance Network: ICGN Viewpoint (April 2015), available at https://www.icgn.org/policy/viewpoints/differential-rights; *Lack of Proportionality Between Ownership and Control* at 26-27 (cited in note 31).

3. Evidence for and against dual class shares

"The advantage of a dual class share structure is that it protects entrepreneurial management from the demands of shareholders. The disadvantage of a dual class share structure is that it protects entrepreneurial management from the demands of shareholders."[78] That the very same feature of a corporate structure can, depending on the circumstances, be both beneficial and detrimental to companies and investors complicates the policy debate about dual class shares.

That policy debate would be improved by distinguishing between two questions: (1) whether it is better or worse for companies, their shareholders, and the economy as a whole for management to be protected from the demands of shareholders and (2) whether shareholders and entrepreneurial management should have the *option* to agree to an arrangement whereby management is protected from the demands of shareholders. This section of the report reviews arguments on both sides of these questions and considers the empirical evidence in support of those arguments.

We find that the empirical evidence regarding the effects of dual class equity structures on company value, capital costs and performance is ultimately inconclusive. The difficulty in establishing a definitive link between dual class shares and company performance may be attributable to confounding factors—such as the relative sophistication of investors and regulators, protections afforded minority investors and restrictions on private benefits—that vary widely across jurisdictions. However, there is suggestive evidence that the use of dual class shares facilitates access to public equity financing for some companies that otherwise would rely on private equity.

The absence of compelling evidence that dual class shares harm companies, their shareholders or the broader economy—especially in countries with sophisticated public markets and strong investor protections like the United States—should caution policymakers against limiting the ability of companies to adopt dual class equity structures.

a. Are dual class structures helpful or harmful?

Opponents of dual class equity structures argue that economic rights should be aligned with voting rights because shareholders, as the owners and residual claimants against company assets, have the incentive to maximize a company's value.[79] Accordingly, participation in corporate decisions should be proportionate to the amount of capital shareholders have committed to the company.

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[78] See Andrew Hill, *Enrolment open for an MBA in Murdoch*, Financial Times (July 18, 2011), available at http://www.ft.com/cms/s/0/2fda9e8e-b176-11e0-9444-00144feab49a.html. See also Paul A. Gompers, Joy Ishii and Andrew Metrick, *Extreme Governance: An Analysis of Dual Class Firms in the United States*, 23 Rev. of Fin. Stud. 1051 (March 2010) (reporting that about 85 percent of companies with dual class shares have at least one class of shares that are held by people who do not want to dispose of them and that company insiders own roughly 60 percent of the votes but only 40 percent of the cash flow rights of dual class companies).

[79] See Sanford J. Grossman and Oliver D. Hart, *One Share-One Vote and The Market for Corporate Control*, 20 J. of Fin. Econ. 175 (1988) (discussing the optimality of the one-share, one-vote rule).

By separating control from economic incentives, unequal voting structures create opportunities for controlling shareholders to make decisions that benefit themselves at the expense of the company's value (and the interests of other shareholders). Their control over the company also insulates them from pressure in the market for corporate control.[80]

Several empirical studies, based on analyses of companies in a variety of different jurisdictions, appear to demonstrate that unequal voting structures hurt firm value. Claessens et al. (2002), based on a study of firms in eight East Asian economies, find that separation of cash flow and control decreases firm value.[81] Likewise, Lins (2003) reports that firm value is lower whenever votes are more concentrated than cash flow in emerging markets;[82] Cronqvist and Nielsen (2003) show that the presence of controlling minority owners decreases firm value and performance, especially when the controlling shareholders are families (Sweden);[83] and Maury and Pajuste (2004) document that firm value is lower when large owners control firms through disproportionate ownership structures (Finland).[84]

Focusing on the United States, Smart, Thirumalai and Zutter (2008) report that companies with multiple classes of shares traded at lower prices than single-class firms, both at IPO and over the subsequent five years. They also find statistically and economically significant value gains when dual class companies unify their share classes.[85] Gompers, Ishii and Metrick (2010) find that company values decrease when insiders have disproportionate control.[86] And Masulis Wang and Xie (2009) report that company value decreases as insider control rights and cash flow rights diverge. In particular, as the gap between insider control rights and cash flow rights increases, CEOs receive higher levels of compensation, corporate cash holdings are worth less to outside shareholders, managers are more likely to make shareholder-value destroying acquisitions, and capital expenditures contribute less to shareholder value.[87] Based on these studies, Adams and Ferreira (2008)

[80] See Milton Harris and Artur Raviv, *Corporate Control Contests and Capital Structure*, 20 J. of Fin Econ. 55 (1988).
[81] See Stijn Claessens, Simeon Djankov, Joseph P. H. Fan and Larry H.P. Lang, *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. of Fin. 2741 (2002).
[82] See Karl V. Lins, *Equity ownership and firm value in emerging markets*, 38 J. of Fin. and Quant. Analysis 159 (2003).
[83] See Henrik Cronqvist and Mattias Nilsson, *Agency costs of controlling minority shareholders*, 38 J. of Fin. and Quant. Analysis 695 (2003).
[84] See Benjamin Maury and Anete Pajuste, *Multiple Controlling Shareholders and Firm Value*, 29 J. of Banking and Fin. 1813 (2004).
[85] See Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter, *What's in a vote? The short- and long-run impact of dual class equity on IPO firm values*, 45 J. of Acc. and Econ. 94 (2008).
[86] See Gompers et al., *Extreme Governance: An Analysis of Dual Class Firms in the United States* (cited in note 78).
[87] See Ronald W. Masulis, Cong Wang and Fei Xie, *Agency Problems at Dual Class Companies*, 64 J. of Fin. 1697 (2009).

conclude in a literature review that there is support for the argument that unequal voting shares negatively affect the value of outside equity.[88]

On the other hand, proponents of allowing dual class equity structures counter that protecting management from the immediate demands of shareholders can be in a company's long-term best interest. They argue that public shareholders tend to be focused on short-term increases in a company's value. This short-term focus induces management to pursue strategies that will increase the immediate value of the company, potentially at the expense of investments by the company that will be more profitable in the long term.[89] This rationale motivated the French adoption of tenure voting as a default rule.[90]

There is some recent empirical evidence to support this argument. Jordan, Kim and Liu (2016) find that dual class companies face less short-term market pressure based on a variety of measures: they have fewer short-term investors, lower analyst coverage, and are less likely to be the target of a takeover. They also find that these companies have higher sales growth and R&D intensity, consistent with a focus on increased growth. Most significantly, they find that dual class share structures tend to increase the market valuation of high growth companies.[91]

Several empirical studies of dual class companies report ambiguous results, suggesting that dual class share structures may not be uniformly harmful or beneficial. Based a sample of Canadian companies, Jog, Zhu and Dutta (2010) find no evidence that companies with unequal voting structures exhibit better or worse company value, stock performance, or operating performance than companies that follow the one-share, one-vote principle.[92] Similarly, Morey (2017) finds that

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[88] See Renee Adams and Daniel Ferreira, *One Share-One Vote: The Empirical Evidence*, 12 Rev. of Fin. 51 (2008).

[89] See Thomas J. Chemmanur and Yawen Jiao, *Dual class IPOs: A theoretical analysis*, 36 J. of Banking and Fin. 305 (2012) (predicting that that multi-class initial public offerings are more likely to be prevalent in: companies operating in industries where value can be created by ignoring short-term trends; family firms and firms run by founders (who tend to build reputations for good management); and firms where large private benefits of control exist). See also Harry DeAngelo and Linda DeAngelo, *Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock*, 14 J. of Fin. Econ. 33 (1985) (suggesting that dual class structures encourage managers to make company-specific investment in their human capital); Jeremy Stein, *Takeover Threats and Managerial Myopia*, 96 J. of Pol. Econ. 61 (1988) (developing a model in which managers undertake costly methods of signaling, including investing in short-term projects, in order to avoid being replaced).

[90] See Becht, Kamisarenka and Pajuste, *Loyalty Shares with Tenure Voting - A Coasian Bargain?* at 12 (cited in note 32). See also Elizabeth Warren, *Companies Shouldn't Be Accountable Only to Shareholders*, Wall Street Journal (Aug. 14, 2018), available at https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687 (arguing that the short-termism of public markets warrants a broader reconsideration of the principle of shareholder control of public companies).

[91] See Bradford D. Jordan, Soohyung Kim and Mark H. Liu, *Growth opportunities, short-term market pressure, and dual-class share structure*, 41 J. of Corp. Fin. 304 (2016).

[92] See Vijay Jog, PengCheng Zhu and Shantanu Dutta, *Impact of Restricted Voting Share Structure on Firm Value and Performance*, 18 Corp. Gov. 415 (2010).

unequal voting structures do not result in a meaningful increase or reduction in long-term value creation, measured by return on invested capital.[93]

Kamonjoh (2016) finds that controlled companies in the S&P 1500 underperformed non-controlled firms over all periods with respect to total shareholder returns, revenue growth, return on equity and dividend payout ratios. However, he also reports that controlled companies generally outperformed non-controlled firms with respect to return on assets, return on invested capital and EBITDA growth.[94] A study by Bennedsen and Nielsen (2006) reports a negative relationship between unequal voting rights and price-to-book ratios in European companies in their sample. But their evidence is not definitive: they find significant regional variation in the effect of dual class share structures on company value.[95] They also find no impact of unequal voting rights on operating performance, likelihood of bankruptcy, dividend policy, or growth.[96]

Another group of studies offers evidence that the effect of dual class share structures depends on a company's maturity. Cremers, Lauterbach and Pajuste (2018) examine an extensive sample of U.S. dual and single class firms from the time of their IPO, and document that the valuation difference between dual and single class firms varies over their life cycle. They find that, around the time of the IPO, dual class firms tend to have higher valuations than single class firms. Over time, however, this valuation premium tends to dissipate.[97] Similarly, Kim and Michaely (2019) find that while young dual class companies trade at a premium and perform at least as well as single-class companies, as dual class firms mature, their valuation declines, and they become less efficient in

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[93] See Gabriel Morey, *Multi-Class Stock and Firm Value: Does Multi-Class Stock Enhance Firm Performance? A Regression Analysis*, Council of Institutional Investors (May 2017), available at https://www.cii.org/files/publications/misc/05_10_17_dual-class_value_study.pdf.

[94] See Edward Kamonjoh, *Investor Responsibility Research Ctr. Inst., Controlled Companies in the Standard & Poor's 1500: A Follow-up Review of Performance & Risk* 84 (Mar. 2016), available at https://irrcinstitute.org/wp-content/uploads/2016/03/Controlled-CompaniesIRRCI-2015-FINAL-3-16-16.pdf.

[95] See Bennedsen and Nielsen, *The Principle of Proportional Ownership* at 18-19 (cited in note 27) (finding that the regional differences correlate with investor protection and anti-self-dealing measures and explaining that controlling shareholders with increased voting rights—when they are not also managers—can be effective substitutes for investor protections in jurisdictions with weak investor protection regimes). See also Armando Gomez, *Going Public without Finance: Managerial Reputation Effects*, 55 J. of Fin. 615 (2000) (proposing a reputation-based explanation for why the value discount on unequal voting structures may be affected by investor protection regimes, according to which controlling shareholders build reputation through abstaining from exploiting non-controlling shareholders and lack of investor protection increases the potential gain from reputation building).

[96] See Bennedsen and Nielsen, *The Principle of Proportional Ownership* at 18-19 (cited in note 27).

[97] See Martijn Cremers, Beni Lauterbach and Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, European Corporate Governance Institute (ECGI) - Finance Working Paper No. 550/2018 (Dec. 2018), available at https://ssrn.com/abstract=3062895.

their margins, innovation, and labor productivity compared to similarly situated single-class companies.[98]

b. Should dual class structures be prohibited?

A related question is whether shareholders and management should have the legal ability to contract into an arrangement that gives some shareholders disproportionate voting rights. The argument that such an arrangement should be permitted emphasizes that the decision to acquire non-voting or unequal voting stock represents the voluntary choice of an informed agent in a competitive market—even though, in some cases, the arrangement might harm shareholders. Assuming that shareholders are adequately informed about the potential risks associated with unequal voting stock, competition for funding will facilitate the efficient pricing of different voting structures in public markets. The risks of unequal voting stock will be incorporated into their price and shareholders can decide for themselves whether the stock is appropriately valued.

Opponents of dual class equity structures might counter that shareholders are not adequately informed about the risks associated with such structures (if disclosure is poor) or that they do not fully assimilate that information into their decision about whether to hold unequal voting stock. For example, a passive investor in an index fund is not likely to exit his or her position based on an underlying issuer's voting rights structure. The presence of underinformed investors, or investors who are insensitive to concerns about corporate governance, could result in a failure to price in the risks associated with unequal voting rights, potentially suggesting that dual class shares should be prohibited or restricted to protect these investors.

Empirical evidence, however, indicates that dual class companies have lower market values than their single-class counterparts.[99] That suggests, contrary to the critics of dual class shares, that shareholders *do* appreciate the risks associated with the divergence between control rights and economic rights. Further, there is evidence that investors are discerning when it comes to different kinds of dual class companies. Anderson, Ottolenghi and Reeb (2017) report that investors demand a premium for holding dual class companies that are family-controlled, but dual class companies that are not family-controlled possess high stock valuations. Overall, their findings suggest that investors exhibit substantial concerns over *family control* rather than dual class structures.[100] Likewise, former SEC Commissioner Robert Jackson has offered evidence that firms with perpetual

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[98] See Hyunseob Kim and Roni Michaely, *Sticking around Too Long? Dynamics of the Benefits of Dual Class Voting*, European Corporate Governance Institute (ECGI) - Finance Working Paper No. 590/2019; Swiss Finance Institute Research Paper No. 19-09 (January 2, 2019), available at https://ssrn.com/abstract=3145209.

[99] See text accompanying notes 81–88.

[100] See Ronald Craig Anderson, Ezgi Ottolenghi and David M. Reeb, *The Dual Class Premium: A Family Affair*, Fox School of Business Research Paper No. 17-021 (August 14, 2017), available at https://ssrn.com/abstract=3006669. See also Chun-Keung Hoi and Ashok Robin, *Agency Conflicts, Controlling Owner Proximity, and*

dual class stock trade at a discount to those with sunset provisions.[101] Both of these studies indicate not only that investors are informed as to the risks associated with dual class stock, but that they exhibit particular concern about certain kinds of dual class structures. Left largely to their own devices—in the absence of any restrictions on dual class structures—it appears that shareholders compensate for their reduced ability to control management by demanding a higher return.

There is another side to that coin. If dual class companies are penalized by shareholders, then they will have a higher cost of capital. That, in turn, increases the hurdle for the type of investments that those companies can pursue. In the case of any individual company, the fact that it foregoes an otherwise profitable project would not seem to warrant legal intervention to restrict dual class shares. But if many similarly-situated companies do the same, then the prevalence of dual class shares might have negative consequences for the economy as a whole by increasing the cost of capital and reducing investment.[102] The fact that individual companies—and their shareholders—might not take into account the broader economic consequences of a dual class structure is an alternative argument for restricting their ability to use them.

Recent experience in the United States, however, suggests that many dual-class companies have successfully raised capital in order to fund long-term investments. Indeed, as demonstrated by **Figure 2,** the prevalence of dual class share structures as a percentage of U.S. IPOs has substantially increased in recent years.[103]

Moreover, there is evidence that the use of dual class equity structures is associated with low-cost public equity financing by companies that, for one reason or another, would not otherwise raise capital in public markets. If that is the case, then restricting the use of dual class structures would make it more costly for them to undertake potentially profitable investments.

The empirical literature on which companies adopt dual class equity structures and when is not extensive, but it suggests that many of them might not go public, or remain public, if they did not have the option of using unequal voting structures to maintain control rights while transferring economic rights. Amoako-Adu and Smith (2001), for example, find that family control of a large

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Firm Value: An Analysis of Dual-Class Firms in the United States, 18 Corp. Gov. 124 (2010) (dual-class structure overall is unrelated to firm value; value is correlated with the proximity of the controlling shareholder to the locus of management—whether the controlling shareholder is a top executive, board member or an outside); Belén Villalonga and Raphael Amit, *How Are U.S. Family Firms Controlled?*, 22 Rev. of Fin. Stud. 3047 (2009) (investors penalize the use of dual class shares by family-controlled companies compared to other control mechanisms).

101 See Robert J. Jackson, Jr., *Perpetual Dual Class Stock: The Case Against Corporate Royalty* (Feb. 15, 2018), available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty.

102 Cf. William D. Nordhaus, *Schumpeterian Profits and the Alchemist Fallacy*, Yale Economic Applications and Policy Discussion Paper No. 6 (2005) (estimating that companies captured only a small fraction of the overall benefits from technological advances over the 1948-2001 period).

103 See Ritter, *Initial Public Offerings: Dual Class IPOs* (cited in note 6).

stake before an initial public offering increases the likelihood of going public with a dual class structure.[104] Families that cannot take their companies public without relinquishing control may decide to stay private. Notably, Amoako-Adu and Smith also find that, up to ten years after the IPO, control changes in dual class firms happened in roughly two-thirds of the cases, which is inconsistent with the idea that dual class structures serve to unduly entrench managers.[105]

Another group of studies indicates that dual class recapitalizations are an important tool for public companies seeking to pursue growth opportunities. Lehn, Netter and Poulsen (1990) compare public companies that go private with those that remain public but choose to adopt dual class share structures. They find that companies that choose dual class recapitalizations over going private have better growth prospects, as measured by growth in sales and the number of employees, the ratio of R&D to sales, advertisement expenditure-to-sales ratios, and market-to-book ratios.[106] Lehn et al. offer the following interpretation of their evidence: firms that wish to consolidate control but have strong growth prospects prefer dual class recapitalizations because they allow the companies to pursue long-term projects while at the same time maintaining a public and less costly source of financing.[107] Their findings suggest that if dual class recapitalizations were prohibited, companies that were looking to consolidate control would rely instead on more expensive private financing, which would increase their cost of capital and potentially cause them to forego growth opportunities.

The reliance of these companies on private markets would also make it more difficult for retail investors, who are generally restricted from investing in private companies, to participate in their growth. Dimitrov and Jain (2006) find that the growth associated with the adoption of unequal voting structures is beneficial for shareholders. They report that companies that undertake dual class recapitalizations experience positive abnormal returns in a period of four years following the announcement of the recapitalization. In other words, the change creates value for controlling and non-controlling shareholders alike. They also find that abnormal returns are larger for companies that raise capital by issuing equity after a dual class recapitalization—consistent with the argument that dual class recapitalizations allow controlling shareholders to finance new investment without losing control of their companies.[108]

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[104] See Ben Amoako-Adu and Brian F. Smith, *Dual class firms: Capitalization, ownership structure and recapitalization back into single class*, 25 J. of Banking and Fin. 1083 (2001).
[105] See id at 1098–99.
[106] See Kenneth Lehn, Jeffry Netter and Annette Poulsen, *Consolidating corporate control: Dual class recapitalizations versus leveraged buyouts*, 27 J. of Fin. Econ. 557 (1990).
[107] See id at 578.
[108] See Valentin Dimitrov and Prem C. Jain, *Recapitalization of One Class of Common Stock into Dual Class: Growth and Long-Run Stock Returns*, 12 J. of Corp. Fin. 342 (2006). See also Stephan Nüesch, *Dual Class Shares, External Financing Needs, and Firm Performance*. 20 J. of Man. and Gov. 525 (2016) (dual class shares increase firm

Bauguess, Slovin and Sushka (2007) add more detail to this picture by showing that dual class recapitalizations can benefit companies and shareholders even if they are accompanied by the liquidation of large holdings by the controlling shareholder (that is, even if they are used by the controlling shareholder to cash out of their investment). They find that companies that use dual class structures to facilitate the transfer of economic rights by controlling shareholders exhibit superior industry-adjusted operating performance. They argue that dual class shares solve the problem of risk aversion by dominant shareholders. If the fortunes of controlling shareholders are undiversified, they are unlikely to sign off on risky investment opportunities; once they cash out, they are more willing to pursue those opportunities.[109] The possibility that the use of dual class equity structures is beneficial for both companies and their shareholders suggests that policymakers should proceed with caution when it comes to limiting their use.

performance if the firm requires external finance and decrease firm performance if the firm does not require external finance).

[109] See Scott W. Bauguess, Myron B. Slovin and Marie E. Sushka, *Large shareholder diversification, corporate risk taking, and the benefits of changing to differential voting rights*, 36 J. of Banking and Fin. 1244 (2012).

4. Evaluating policy responses

The debate about dual class equity structures tends to focus on the consequences of unequal voting rights, and whether those effects justify restrictions on the ability of management and shareholders to allocate voting rights as they see fit. Policymakers wary of banning dual class equity structures outright have sought alternative policy responses. One such alternative is requiring that dual class equity structures include time-based sunset provisions, whereby the unequal voting structure is automatically wound down (or required to be put to a shareholder vote) after a certain amount of time. However, additional disclosure requirements may be sufficient to protect investors while also allowing public companies access to the potential benefits of unequal voting structures. We evaluate both proposals in this section.

a. Sunset provisions

Former SEC Commissioner Jackson has expressed support for mandatory sunset provisions, stating that, unless higher voting rights associated with dual class shares include a sunset provision, they are "antithetical to our values as Americans."[110] Influential market participants have also expressed support for sunset provisions. As noted earlier, CII has supported time-based sunset provisions, whereby the multi-class equity structure is automatically wound down over time unless approved by shareholders on a one-share, one-vote basis, as a reasonable approach to achieving alignment between investors and management.[111] Likewise, the proxy advisory firm ISS recommends voting against or withholding votes from incumbent directors at companies with unequal voting rights if there are no "reasonable" sunset provisions.[112]

In addition, the push for sunset provisions has received academic support: Bebchuk and Kastiel (2017) advocate for time-based sunset provisions as a response to the adverse effects of dual class share structures.[113] Proponents of mandatory sunset provisions point to the empirical studies discussed in the prior section that offer evidence that the advantages associated with dual class share structures, if any, tend to diminish over time as companies mature.

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[110] See Jackson, *Perpetual Dual Class Stock: The Case Against Corporate Royalty* (cited in note 101).
[111] See Council of Institutional Investors, *Dual Class Stock* (2018), available at https://www.cii.org/dualclass_stock.
[112] The reasonableness of a dual class structure, according to ISS, depends on balancing a number of factors; a sunset period of more than seven years, however, is considered per se unreasonable. See *United States Proxy Voting Guidelines: Benchmark Policy Recommendations*, Institutional Shareholder Services 14 (November 18, 2019), available at https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.
[113] See Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual Class Stock*, 103 Virginia L. Rev. 558 (2017).

However, mandatory sunset provisions have their critics. Govindirajan et al. (2018) argue that mandatory time-based sunset provisions are ill-advised, for two reasons.[114] First, it is not clear when the sunset clause should take effect, and whether one size could fit all public companies: the number of years that it takes after IPO for a growth company to mature has been steadily declining, and differs based on the firm's technology and business model.[115] Second, given the increasing pace of disruption and the need for companies to consistently revise their business models, the assumption that companies actually reach a mature stage where further reinvention (and thus an unequal voting structure to facilitate it) is unnecessary is mistaken.[116] Instead of mandatory sunset provisions, Govindirajan et al. argue that companies should be required, after a predetermined period, to gain majority approval from all shareholders to continue a multiple class share structure.[117]

Fisch and Solomon (2019) criticize proposals based on mandatory time-based sunset provisions or shareholder votes.[118] Like Govindirajan et al., and for similar reasons, they argue that a one-size-fits-all approach to unequal voting structures is wrongheaded. In addition, they note that any proposal to predictably and suddenly dilute holders of high-vote stock after a predetermined period creates perverse incentives for them to maximize their personal economic position at the expense of other shareholders in anticipation of dilution.[119]

Unlike Govindirajan et al., Fisch and Solomon argue that mandatory shareholder approval to extend dual class equity structures past a particular date does not solve the problems of time-based sunset provisions. They question whether the institutional investors who would control such a decision would have the appropriate incentives to vote to retain the dual class structure, even where it enhances the value of the company.[120] After all, if these investors are not well positioned to pursue the long-term interests of the company when it initially went public—the reason for the dual class structure in the first place—then why would they be at the end of the sunset term? Especially when they stand to obtain a private benefit from eliminating the unequal voting structure, which will transfer control from the previously controlling shareholders to them.[121]

Instead, Fisch and Solomon highlight the benefits of sunset provisions that are tied to particular events, such as the dilution or transfer of a founder's interest, though they ultimately stop short of

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[114] See Vijay Govindarajan, Shivaram Rajgopal, Anup Srivastava and Luminita Enache, *Should Dual Class Shares Be Banned?*, Harvard Business Review (Dec. 3, 2018), available at https://hbr.org/2018/12/should-dual-class-shares-be-banned.
[115] See id.
[116] See id.
[117] See id.
[118] See Jill E. Fisch and Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. Rev. 1057 (2019.
[119] See id at 1083–84.
[120] See id at 1084–86.
[121] See id.

recommending *any* mandatory sunset provisions.[122] Even mandatory sunset provisions that are tied to events such as the dilution of a founder's economic interest may have unintended negative consequences. As discussed earlier, dual class recapitalizations can solve problems associated with the risk aversion of dominant shareholders, by allowing them to diversify their wealth while still maintaining control. Mandatory sunset provisions tied to the dilution of a founder's interest would foreclose that possibility.

b. Enhanced disclosure

Proponents of the "one-share, one-vote" principle argue that unequal voting rights allow controlling shareholders to extract private benefits. It is not clear, however, that "one-share, one-vote" is the best mechanism for restricting conflicted transactions; the direct regulation of related-party transactions may be more efficient.[123] In jurisdictions where noncontrolling shareholders have fewer means of redress against controlling shareholders, and controlling shareholders can more easily extract private benefits,[124] it may be necessary to protect noncontrolling shareholders by prohibiting unequal voting structures outright or by introducing significant restrictions on their use. But where robust investor protection regimes exist—such as in the United States, where controlling shareholder transactions involving Delaware corporations (the vast majority of large U.S. corporations) are subject to an exacting fairness review unless they receive the majority approval of the minority shareholders—they can be a more efficient substitute for regulation of conflicts of interest through voting.[125]

Likewise, the concern that public shareholders are not adequately informed of the risks associated with dual class shares is a better argument for additional disclosure than against dual class share structures. Under existing SEC regulations, companies must disclose and describe—both in their

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[122] See id at 1086–91.
[123] Legal tools for direct regulation of related-party transactions include requiring approval by a majority of noncontrolling shareholders or by disinterested or independent directors, enhanced disclosure, third-party advice or fairness opinions, and ex post judicial review. See Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 Colum. Bus. L. Rev. 663 (2014) (describing how the SEC and state courts regulate related-party transactions through a combination of ex ante screening and ex post litigation); Luca Enriques, *Related Party Transactions: Policy Options and Real-world Challenges (with a Critique of the European Commission Proposal)*, 16 European. Bus. Org. L. Rev. 1 (2015) (surveying legal tools for direct regulation of related-party transactions).
[124] See Alexander Dyck and Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. of Fin. 537 (Apr. 2004) (premium paid for control is higher when the buyer comes from a country that protects investors less and thus is more willing or able to extract private benefits).
[125] See Aurelio Gurrea-Martínez, *Theory, Evidence, and Policy on Dual Class Shares: A Country-Specific Response to a Global Debate*, Ibero-American Institute for Law and Finance Working Paper Series 3/2019; Singapore Management University School of Law Research Paper No. 32 (June 2, 2019), available at https://ssrn.com/abstract=3397880 (arguing that whether dual class shares should be allowed depends on the particular features of a country).

registered offerings and periodic reporting—risk factors relevant to an investment in the company.[126] According to the SEC, these risk factors include "risks posed by non-traditional governance structures."[127] With respect to dual class shares, these increased risks arise from a divergence between economic ownership and control, and they may include: (i) additional barriers to holding management accountable; (ii) disagreements between shareholders and management yielding litigation because voting is no longer a fair dispute resolution mechanism; (iii) shareholders with disproportionate voting rights approving changes to the detriment of other shareholders; and (iv) exchange delisting or removal from major indexes, resulting in lost liquidity.[128]

However, there are gaps in risk factor disclosures as they relate to dual class shares.[129] As observed by the SEC's Investor as Owner Subcommittee, while existing rules may require the disclosure of some risks, U.S. companies generally do not disclose specific information that would empower investors to fully understand the consequences of the dual class voting structure in question.[130] Specifically, companies are not required to, and generally do not, disclose straightforward quantitative information on the "wedge" – or difference – between economic ownership and corporate control that dual class share structures create.[131] Likewise, companies typically do not disclose how the existing wedge may increase over time, because of provisions that entrench existing controlling interests or permit companies to issue additional equity that increases the wedge.[132] Finally, companies do not disclose the specific kinds of conflicts of interest related to dual class shares that have arisen in the past, nor do they explain in detail how dual class share structures raise the risk of de-listing or removal from major indexes.[133]

The SEC should act to remedy these deficiencies. To the extent the empirical evidence suggests that investors penalize companies for a significant divergence between ownership and control, then the risks of unequal voting structures may be sufficiently managed by well-informed investors. As a result, greater disclosure of this divergence and its associated risks will empower investors to police and discipline the use of dual class share structures. The SEC's Investor as Owner Subcommittee has released actionable recommendations to this effect, some of which would commendably enhance disclosure without dramatically burdening the public companies concerned.[134]

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[126] See 17 C.F.R. § 229.105.
[127] See *Recommendation of the Investor as Owner Subcommittee* at 3 (cited in note 4).
[128] See id at 5–6.
[129] See id at 4.
[130] See id.
[131] See *Recommendation of the Investor as Owner Subcommittee* at 4 (cited in note 4).
[132] See id at 5.
[133] See id.
[134] See id at 6–8.

Accordingly, the Committee supports additional disclosures by companies with dual class share structures. Specifically:

- Through its review of and comment on issuer disclosures, the SEC should encourage each company with a dual class structure to disclose data that illustrates the divergence between economic ownership and control at that company. Such data could include: (i) straightforward quantitative metrics illustrating the numerical gap between a person's beneficial ownership and voting rights arising from the dual class share structure and (ii) the minimum beneficial ownership that persons with special voting shares can hold while still retaining majority control without further approval by other shareholders. To the extent the SEC is unsuccessful in eliciting satisfactory disclosure by scrutinizing public offerings and issuing guidance, then the SEC could require disclosure of this information under Regulation S-K Item 403, which requires companies to disclose the beneficial ownership of management and control persons.[135]
- Through its review of and comment on issuer disclosures, the SEC should encourage companies with dual class share structures to enhance their risk factor disclosures under Regulation S-K Item 105.[136] In particular, firms should disclose material risks related to dual class shares with greater specificity. For example, where applicable, such disclosures could identify the risk that the structure may result in delisting from major exchanges and removal from key indexes, reducing liquidity and the value of an investment in the company.

[135] See 17 C.F.R. § 229.403.
[136] See 17 C.F.R. § 229.105.

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