

London's Premium Segment and High-growth Companies: Return of the Dual-class Structure?

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The Premium Segment of the London Stock Exchange (**LSE**) is London's highest standard listing regime: companies listed on the Premium Segment must comply with stringent eligibility criteria and continuing obligations.

However, in recent years there has been a material reduction in the number of companies seeking admission to the Premium Segment. In addition, a number of market participants believe that high-growth tech companies are materially under-represented on the Premium Segment.

In an article published in late 2019,¹ the Financial Times indicated that, against this backdrop, the UK Government had recently consulted with the investment industry over potential changes to the UK Listing Rules (**Listing Rules**) designed to encourage high-growth companies to list on the Premium Segment. Most notably, this article indicated that the UK Government was considering the introduction of a regime to cater for the listing on the Premium Segment of companies with dual-class structures.

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¹ "UK seeks change in listing rules to lure tech start-ups" published by the Financial Times on 5 November 2019 (<https://www.ft.com/content/d4d2da5a-fee8-11e9-be59-e49b2a136b8d>).



Background

There has been significant debate in recent years over the merits of dual-class structures.

On the one hand, a number of institutional investors and stock indices are increasingly vocal in their criticisms of dual-class structures (and the potential associated founder and management entrenchment issues). These protagonists advocate the benefits of the one-share, one-vote principle in promoting good corporate governance, transparency and accountability and warn about the risks of conflicts arising between entrenched founders and management and other shareholders.

On the other hand, others, including high-growth companies with significant long-term capital projects, particularly companies in the technology sector, have advocated the benefits of insulating founders and entrepreneurs from increasingly short-term public market forces and from shareholder activists.

Current position in the UK

Although dual-class structures were prevalent in the UK until around the mid-1960s, they have since largely disappeared from the Premium Segment.

It is possible, in principle, for companies with dual-class structures to list on the AIM market and on the Standard Segment of the LSE. However, the Listing Rules contain a number of restrictions on companies with dual-class structures listing on the Premium Segment.

In 2014, the Financial Conduct Authority (FCA), which administers the Listing Rules, clarified this stance by introducing two new Premium Listing Principles, which apply to companies listed on the Premium Segment:

- Premium Listing Principle 3: All equity shares in a class that has been admitted to premium listing

must carry an equal number of votes on any shareholder vote.

- Premium Listing Principle 4: *Where a listed company has more than one class of securities admitted to premium listing, the aggregate voting rights of the securities in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company.*

The FCA specified, in a policy statement², that the purpose of the latter principle was “to prevent artificial structures involving multiple classes with different voting powers, which are designed to allow control to rest with a small group of shareholders”.

Competitive pressures

In recent years, the FCA has indicated a willingness to consider further the introduction of dual-class structures. For example, in a 2017 discussion paper, the FCA consulted on the effectiveness of the UK’s primary equity markets in supporting the growth of science and technology companies.³ Dual-class structures were among the proposals considered.

The creation in 2018 of a new category in the Listing Rules for premium listings of sovereign-controlled companies, reportedly to attract Saudi Aramco to a London listing, also suggests that the FCA is ready to respond to competitive pressures, regardless of criticism it might receive from certain institutional investor bodies.

Dual-class Structures in the U.S.

Many major U.S. corporates have undertaken IPOs with dual-class capital structures over the past decade or so. These companies have included LinkedIn, Alibaba, Facebook, Zillow, Zynga, Square, Yelp and First Data.

Despite the prevalence of dual-class structures in the U.S., they remain controversial.

² See FCA Policy Statement PS14/8, published May 2014, p. 31 (<https://www.fca.org.uk/publication/policy/ps14-08.pdf>).

³ See FCA Discussion Paper DP17/2, published February 2017, p. 8

(<https://www.fca.org.uk/publication/discussion/dp17-02.pdf>).

For example, in its IPO in 2017 SNAP, Inc. offered a class of stock (class A) with no voting rights. Following SNAP, Inc.'s IPO, some stock indices took steps to ban certain companies with dual-class structures: in the same year, FTSE Russell changed its eligibility requirements so that any company with 5% or less of its voting rights in the hands of unrestricted (free-float) shareholders would no longer be included in certain of its indices (subject to grandfathering provisions for existing constituents)⁴, and S&P Dow Jones Indices announced⁵ that it would cease to add companies with dual-class structures to certain of its indices.

The implementation of dual-class structures in the U.S. has also been the subject of high-profile litigation proceedings. Some of these proceedings have involved derivative claims by shareholders alleging that directors have breached their duties in connection with the implementation of dual-class structures and related transactions. There have been allegations, for instance, that the board failed to implement appropriate safeguards for minority shareholders.

Legal issues in UK context

In general, where an English company's constitutional documents already provide for weighted voting rights, shareholders are unlikely to have grounds for challenging the exercise of those weighted voting rights.⁶

However, where a company introduces a dual-class structure (with weighted voting rights benefitting only some of the existing shareholders), a minority shareholder could, in principle, have potential grounds for challenge. These could include claims that the establishment of the dual-class structure involves:

1. an amendment to the company's articles of association that was not made *bona fide* for the benefit of the members as a whole;
2. a breach of duty by the company's directors; or
3. a variation of a shareholder's class rights that has not been approved.

The first two areas of potential challenge overlap to an extent. Amendments to articles will generally be found to be made *bona fide* for the benefit of the members as a whole unless the majority has been motivated by a desire to harm the minority in making the amendments or the amendments discriminate against the minority without, in any way, benefitting the company as a whole. Similarly, in the context of a company introducing a dual-class structure pre-IPO, the directors will have to consider, in good faith, whether the introduction of the dual-class structure will promote the success of the company for the benefit of the members as a whole (*i.e.*, including whether or not it will detract from the company's listing prospects or its attractiveness to investors post-listing). The third area of challenge seems less likely unless the company's articles of association specify the introduction of weighted voting rights as a class rights issue.

Paradigms for London – Hong Kong and Singapore?

Both the Hong Kong Stock Exchange (**HKEx**) and Singapore Exchange (**SGX**) recently changed their listing rules to permit dual-class structures in certain circumstances. Both new regimes contain a number of safeguards and protections (some of which are summarised in more detail in the Appendix) against

⁴ See paper entitled "FTSE Russell Voting Rights Consultation – Next Steps" published by FTSE Russell in July 2017 (https://research.ftserussell.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf).

⁵ See announcement entitled "S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting

Rules" released by S&P Dow Jones Indices on 31 July 2017 (<https://www.prnewswire.com/news-releases/sp-dow-jones-indices-announces-decision-on-multi-class-shares-and-voting-rules-300496954.html>).

⁶ *Bushell v Faith* [1970] AC 1099.

some of the typical criticisms of dual-class structures. In principle, these safeguards, at a high level, include⁷:

- applicants needing to demonstrate the necessary characteristics of innovation and growth and needing to have a minimum market capitalisation (HKEx);
- restrictions on implementing dual-class voting arrangements after listing (HKEx and SGX);
- restrictions on holders of weighted voting rights (in the case of HKEx, at listing holders must be directors; and, in the case of SGX, holders and potential future holders must be identified at listing);
- sunset provisions including weighted voting rights ceasing on transfer (HKEx and SGX);
- voting power of weighted voting shares not exceeding 10 times the voting power of ordinary shares (HKEx and SGX);
- ordinary shares being entitled to at least 10% of votes at shareholder meetings (HKEx and SGX); and
- certain matters being reserved for one vote per share including changes to constitutional documents, variation of class rights, appointment/removal of INEDs/auditors and winding-up (HKEx and SGX).

The way forward in London?

Since the Financial Times reported in late 2019 that consultations on dual-class structures had surfaced, some institutional investors in London have already made very clear their opposition to these structures.⁸

However, the argument to introduce dual-class structures may be more compelling now given the introduction of similar regimes in Hong Kong and Singapore and the desire for London's Premium Segment to remain a competitive financial market post-Brexit, and to attract a higher proportion of high-growth tech companies.

Should the FCA (which administers the Listing Rules) launch a consultation on dual-class share structures, it seems possible that the parameters that HKEx and SGX have introduced could be considered to mollify dissenting institutional investors.

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⁷ Subject to exceptions and qualifications in certain cases.

⁸ See article entitled "*Big investors fight back over dual-class shares*" published by the Financial Times on 24 November

2019 (<https://www.ft.com/content/bc220535-5055-47ce-811d-fc4a56d32937>).

APPENDIX

Comparison of certain HKEx and SGX listing rules relating to dual-class structures

<i>Issue</i>	<i>HKEx</i> ⁹	<i>SGX</i> ¹⁰
<i>Eligibility or suitability criteria for dual-class structures</i>	<ul style="list-style-type: none"> Applicants are expected to demonstrate the necessary characteristics of innovation and growth and the contribution of the proposed beneficiaries of weighted voting rights.¹¹ Minimum market capitalisation requirement and, if that is not met, a lower requirement combined with a revenue test. Applicants must have previously received meaningful third party investment from at least one sophisticated investor. 	<ul style="list-style-type: none"> Applicants must be suitable to list with a dual-class structure.
<i>Conversion to dual-class structure</i>	<ul style="list-style-type: none"> Only new applicants may list with a dual-class structure. After listing, a company must not change the terms of a class of its shares carrying weighted voting rights to increase the weighted voting rights attached to that class, or increase the proportion of shares that carry weighted voting rights above the proportion in issue at listing. 	<ul style="list-style-type: none"> No shares with weighted voting rights may be issued post-listing. Exceptions for a rights issue, bonus issue, scrip dividend issue or consolidation/subdivision, in each case in conjunction with the issuance of ordinary shares and where approved by a special resolution.
<i>Restrictions on holders of weighted voting rights</i>	<ul style="list-style-type: none"> At listing, beneficiaries of weighted voting rights must be members of the company's board of directors. Beneficiaries of weighted voting rights must also beneficially collectively own at least 10% of the underlying economic interest in the company's total issued share capital at the time of initial listing (subject to any lower threshold that HKEx may accept). 	<ul style="list-style-type: none"> Company must specify the holders of weighted voting rights at the time of IPO. SGX may permit a group of persons or an entity (either, a permitted holder group) to hold shares carrying weighted voting rights, but the scope of any permitted holder group must be specified at the time of IPO. Either the holder must be a director or, in the case of a permitted holder group, a director must be appointed for that permitted holder group (in either case, a responsible director).

⁹ See the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/c/o/consol_mb.pdf), in particular Chapter 8A.

¹⁰ See the Mainboard Rules of the SGX-ST Listing Manual (http://rulebook.sgx.com/en/display/display_viewall.html?rbid=3271&element_id=4830), in particular Rules 210(10), 229A, 730B and 803A.

¹¹ See the Guidance Letter HKEX-GL93-18 published by HKEx (https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/g/l/gl9318.pdf) on factors that HKEx will take into account when considering an applicant's suitability for listing with a weighted voting rights structure.

		<ul style="list-style-type: none"> • Moratorium on transfer or disposal of any shares by a holder of weighted voting shares for at least 12 months after listing.
<i>Sunset provisions</i>	<ul style="list-style-type: none"> • Weighted voting rights cease if, at any time after listing the beneficiary is: <ul style="list-style-type: none"> ○ deceased; ○ no longer a director; or ○ deemed by HKEx (i) to no longer meet the relevant requirements for a director (set out in the HK Listing Rules) or (ii) to be incapacitated. • Weighted voting rights cease: <ul style="list-style-type: none"> ○ upon transfer (whether of any beneficial ownership, economic interest or voting control) to another person; or ○ if none of the beneficiaries at the time of initial listing have beneficial ownership of shares carrying weighted voting rights. 	<ul style="list-style-type: none"> • Automatic conversion on a one-for-one basis if: <ul style="list-style-type: none"> ○ shares are sold or transferred to any person (other than, in the case of a permitted holder group, to other members of that permitted holder group); or ○ a responsible director ceases service as a director, in each case unless approved by a shareholder resolution (on a one-vote, one-share basis, excluding the votes of the transferor, transferee, responsible director and their respective associates).
<i>Cap on weighted voting rights</i>	<ul style="list-style-type: none"> • Class of shares conferring weighted voting rights must not entitle the beneficiary to more than 10 times the voting power of ordinary shares. • Ordinary shareholders must be entitled to cast at least 10% of the votes eligible to be cast on resolutions at a general meeting. 	<ul style="list-style-type: none"> • Each share with weighted voting rights must not carry more than 10 votes per share (and the number of votes must be specified at IPO and not subsequently increased). • In any general meeting, the number of votes that may be cast by holders of ordinary shares who are not also holders of weighted voting shares must be at least 10% of the total voting rights.
<i>Matters reserved for one-share, one-vote</i>	<ul style="list-style-type: none"> • Changes to constitutional documents (however framed), variation of class rights, appointment/removal of INEDs/auditors and voluntary winding-up. 	<ul style="list-style-type: none"> • Changes to constitutional documents, variation of class rights, appointment/removal of INEDs/auditors, reverse takeover, winding-up and delisting.