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Dual Class Shares

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List of abbreviations

ADHGB	Allgemeines Deutsches Handelsgesetzbuch (general german commercial code)
AG	Aktiengesellschaft (corporation)
AktG	Aktiengesetz (German Stock Corporation Act)
BGBl	Bundesgesetzblatt (Federal Law Gazette)
CoCo-Bonds	Contingent Convertible Bonds (Zwangswandelanleihen)
ECJ	European Court of Justice
Ed.	Edition
DAX	Deutscher Aktienindex (German stock index)
GmbH	Gesellschaft mit beschränkter Haftung (comparable with ltd.)
HGB	Handelsgesetzbuch (commercial code)
IPO	initial public offering
MüKo	Münchener Kommentar
No.	Number
SE	Societas Europaea
Sent.	Sentence
Vol.	Volume
VWGmbHÜG	Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand (VW-Gesetz)

Topic No. 12: Dual Class Shares

Part 1: German Law

by: Gabriel Walter

"More equal than others." George Orwell's famous quote from "Animal Farm" also perfectly questions and criticises the dual class share system.

Introduction

It is easy to assume that all shares represent an equal percentage of a corporation, granting the same rights and duties to their shareholders. This consideration of a share-system is far wrong. Nowadays in a system of market economy and global financial policy corporations create financial products like "Contingent Convertible Bonds" (CoCo-Bonds), registered shares with restricted transferability (vinkulierte Namensaktien) and dual class share systems.

But this does not indicate that the "simple" "one-share, one-vote" system is outdated. This paper questions the importance and influence of dual class shares as a competitor to "one-share, one-vote" and how the structure impacts governmental regulation. Do dual class shares need to be state regulated or is the market able to regulate itself?

The paper starts with the presentation of the dual class share system. Therefore we will show the various possible structures of dual class shares in detail. After the introduction into the topic of dual class shares we will take a closer look to the origin of dual class shares in Germany and the historical development up to the current legal situation. Then different sections of the AktG (Aktiengesetz), enabling the creation of dual class shares and their restriction, are going to be constituted. Finally we end with a comparison of the pros and cons of dual class shares and "one-share, one-vote".

Dual Class Shares

What are dual class shares? To make dual class share system more understandable, a brief overview how shares were "traditionally" held in corporations, follows.

"One-share, one-vote"

Does a company have an intention to go public? The most common reason for an initial public offering (IPO) is to raise equity, to create a proper foundation for a future expansion of the company and to raise a potentially global awareness.[1]

Once a private company decides to make their IPO, it comes to the sale of corporation shares to the public.[2] The shares are offered on a stock exchange, in Germany for example the

[1] *Deutsche Börse AG*, Praxishandbuch Börsengang, P. 23.
[2] *Steve*, IPO Risk Management: Risks of an Initial Public Offering, P. 5.

Deutscher Aktienindex (DAX). These shares give the shareholder a proportional right to the corporation. These rights entitle the shareholder firstly to take part and vote in general corporation meetings, and secondly to participate at dividend payouts.[3] In a "one share-one" vote system, the shareholder has for each share he owns one vote.[4] And the amount of his dividend payout correlates to the percentage of shares he owns of the corporation.[5]

The intention behind the "one-share, one-vote" system is to create a balance between equity power and voting power. A shareholder holding most of the shares and therefore also most of the corporations equity should have most of the power when it comes to general decisions. In the "one-share, one-vote" system the shareholders can be considered owners of the corporation. Although they own the corporation they are normally not the ones running it. This is the manager's duty. The shareholders however, have the right to monitor the management and if it does not run the corporation to the best of the shareholders' interests, the shareholders can overrule the management's decision.[6] This way "one-share, one-vote" guarantees that decisions in the corporation are made on behalf of the shareholders' interests.

Class A and Class B shares – and their different Types

In a dual class share system the power of equity and the voting power can be separated. Corporations separating voting- and equity power do have two different classes of shares, and are therefore "dual class shares." The first class of shares, the class A shares – in Germany they are called common shares (Stammaktien) – have one vote per share.[7] The second type, the class B shares – in Germany they are called preference shares (Vorzugsaktien) – have no voting power.[8]

a) Dividend preference

The first question coming into mind is: "Why should someone buy a share without voting power?" There would be no cause for a reasonable investor to buy class B shares if he could also buy class A shares. Therefore class B shares offer an advantage over class A shares; they have a dividend preference.[9] Within this dividend preference there are four different types of preferences; the "dividend privilege" (Dividendenbevorrechtigung), the "off-dividend"

[3] *finanzen.net GmbH,* Rechte und Pflichten als Aktionär.
[4] *Henn/Frodermann/Jannott,* Handbuch des Aktienrechts, recital 229.
[5] *Id.* at recital 285.
[6] *Frey/Osterloh,* Successful management by motivation, P. 102.
[7] *Henn/Frodermann/Jannott,* Handbuch des Aktienrechts, recital 229.
[8] *Lange,* in: *Hennsler/Arnold* § 12, recital 5.
[9] *Doerks,* Der Kursunterschied zwischen Stamm- und Vorzugsaktien in der Bundesrepublik Deutschland, P. 7 f.

(Überdividende), the "highest dividend" (Höchstdividende) and the "cumulative dividend" (kumulative Dividende).[10]

In the case of a "dividend privilege" the class B shareholders get a dedicated part of dividend payment in advance which is fixed in the corporations statute; if there is more profit to be distributed, the class A shareholders get paid the same dividend as the class B shareholders and a remaining amount will be paid proportionally to the value of the shares.[11]

In the case of the "of-dividend" class B shareholders have the same fixed price preference as with the "dividend privilege" for one exception that they must get a fix bonus unlike the class A shareholders.[12] So with the "of-dividend" the class B shareholders receive a higher dividend distribution regardless of the distributed amount of money.

The "highest dividend" type allows a statutory set upper limit for class B shares.[13] That means, class B shares have a preference compared to class A shares up to a certain amount. After this amount has been paid, class B shares will be completely ignored in the dividend distribution.

"Cumulative dividend" is an additional rule that can but does not have to be used on "dividend privilege" or "of-dividend."[14] This means that if the preference distribution of class B shares has been absent in previous years it must be paid in full later.[15]

So class B shares can be a good stock type for investors, who only want to invest their money to make profit and have no interest in ruling the corporation. In a case like Volkswagen for example it makes no sense for a small investor to buy class A shares, because he would need to invest at least a couple of million euros to buy enough class A shares to create actual voting power.

b) Hostile takeover protection

The higher dividend distribution is an incentive for an investor buying class B shares. But why should a company create two different classes of shares and then only sell preference shares to the public? In the following the different issues that make dual class shares attractive to companies are going to be constituted.

One reason for a dual class share system is protection against hostile takeovers.[16] If a corporation has their entire firm value as common shares on the open market, competitors could

[10] *Id*. at 8.
[11] *Id*.
[12] *Id*.
[13] *Id*.
[14] *Id*. at 9.
[15] *Id*.
[16] *Partch,* Journal of Financial Economics 1987, 313, P. 316 f.

buy enough shares to obtain the 75% obstacle to achieve the absolute majority necessary for fundamental changes.[17] The absolute majority is for instance is needed to wind up the corporation (§ 262 I No. 2 AktG[18]) or to change the corporations statute (§ 179 II AktG[19]). Therefore dual class shares offer a corporation the opportunity to raise capital by only selling class B shares and keep the voting power by retaining the class A stock to make a potential hostile takeover impossible.

c) Preservation of power

Another way dual class shares are used is to keep the power over the company within a small exclusive circle after going public.[20]

Family owners

If for instance family owned companies go public and want the power to remain within the family they offer class B shares without voting power at their IPO.[21] A current German example for such power preservation is the IPO of Schaeffler AG in October 2015. The Company's shareholders are Maria-Elisabeth Schaeffler-Thumann and her son Georg F. W. Schaeffler together holding the entire voting power.[22] On October 8, 2015 the Schaeffler AG went public at the Frankfurt Stock Exchange and placed 75 million preference shares that contributed a capital of 938 million Euros.[23] These 75 million preference shares represent about 11% of the corporation's total value but 0% of the voting power.[24] Schaeffler's decision to sell a part of the corporation was inter alia to reduce their depts.[25] One can see that the Schaeffler AG wanted to raise capital but did not want to give power to a non-family member.

d) Heavy weight leader

But also founders having plans and visions about how their company should develop, often do not want to give away the power. The most famous example is Mark Zuckerberg who uses dual class shares as one way to retain the power over Facebook so that investors with short term interests cannot put pressure on him if he is making long term decisions.[26]

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[17] *Schneider/Heidenhain,* The German Stock Corporation Act, P. 14.
[18] Gesetz zur Reform des Verfahrens in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit (FGG-Reformgesetz) in the version of December 17th, 2008, BGBl I, 2008, 2586 (2732).
[19] Aktiengesetz (AktG), in the version of September 6th, 1965, BGBl I, 1965, 1089 (1135).
[20] *Andenæs/Wooldridge,* European comparative company law, P. 190.
[21] *Culpepper,* Quiet politics and business power, P. 42.
[22] Schaeffler Gruppe | Konzern | Gesellschafter.
[23] Schaeffler Gruppe | Pressewelt | Pressemitteilungen | Schaeffler schließt Börsengang ab.
[24] Schaeffler Gruppe | Pressewelt | Pressemitteilungen | Schaeffler startet Aktienplatzierung.
[25] Schaeffler Gruppe | Pressewelt | Pressemitteilungen | Schaeffler geht an die Börse.
[26] Here's how Mark Zuckerberg keeps Facebook's investors in check.

e) **Preservation of governmental interests**

A third way the dual class share system is, or better had been used in Europe, to preserve governmental interests.[27] Governments created so-called "golden shares,"[28] The most famous example for a golden share in Germany is Volkswagen AG.[29]

Few corporations in Germany are state-owned, respectively used to be state-owned companies. Back in 1960 the VWGmbHÜG was passed. Section 1 Sec. 1 VWGmbHÜG[30] directed to convert Volkswagen GmbH into Volkswagen AG. § 2 sec. 1 VWGmbHÜG[31] defined, that no shareholder may have more than 20 percent of the entire voting power even owning more shares. Moreover, § 4 sec. 1 VWGmbHÜG[32] gave the Federal Republic and the State Niedersachsen the right to delegate two members to the supervisory board. This gave the State Niedersachsen who holds around 20 percent of Volkswagen AG shares[33] a disproportionate influence on the corporation's policy.

But these rights do not exist anymore. In 2007 the ECJ declared the VWGmbHÜG violating European law.[34]

Historical background

In 1844 preference shares without voting power appeared on the German market for the first time.[35] Shareholder of a railway company that held such preference shares received an advanced dividend of 4 percent of their share value.[36] After that, preference shares did not gain much popularity and were only existing in railway companies until the late fifties when other economic sectors became aware of it.[37] At that time there was no law about common shares and preference shares whether a class of shares had voting power or not was set in the partnership agreement.[38] This arbitrariness changed in 1884 when the "Aktienrechtsnovelle" (corporation law amendment) determined that every share has the same voting power.[39]

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[27] *Winkler,* Das Stimmrecht der Aktionäre in der Europäischen Union, P. 14.
[28] *Id.* at 14 f.
[29] *Dr. Frank Jungfleisch, Dr. Jan Henning Martens,* Starke Minderheitsgesellschafter und „Goldene Aktien" | Recht | Haufe.
[30] Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand (VWGmbHÜG), in the version of July 27th, 1960, BGBl I, 1960, 585 (585).
[31] Zweites Gesetz zur Änderung des Gesetzes über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand (VWGmbHÜG), in the version of July 31st, 1970, BGBl I, 1970, 1149 (1149).
[32] Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand (VWGmbHÜG), in the version of July 27th, 1960, BGBl I, 1960, 585 (586).
[33] Volkswagen Konzern Aktionärsstruktur.
[34] *SPIEGEL ONLINE,* Urteil: Europäischer Gerichtshof kippt VW-Gesetz.
[35] *Bezzenberger,* Vorzugsaktien ohne Stimmrecht, P. 6.
[36] *Id.*
[37] *Id.*
[38] According to Article 224 II, 190 ADHGB of 1869.
[39] *Bezzenberger,* Vorzugsaktien ohne Stimmrecht, P. 7.

With the implementation of the HGB (commercial code) in 1887 corporations got the opportunity to create shares with multiple-voting rights.[40] Interestingly most people considered multiple-voting rights as bad and so they did not gain much popularity in Germany until after First World War when shares with more than twenty votes per share came up.[41] Corporation owners used the dual class share system to protect their corporation against foreign infiltration from both, abroad and inland.[42] The advantage of this corporation financing, other than with credits, meant a corporation only had to pay the shareholders if it made profit.[43] The number of corporations that held shares with multiple-voting rights varied particularly in that time. It first increased rapidly, so that in 1925 more than half of the 1600 listed corporations in Germany held such shares and decreased from then on to only a third of all listed corporations.[44]

The first time preference shares without voting power were legally regulated was in the AktG of 1937.[45] Sections 115 – 117 AktG[46] determined that preference shares without voting power could only be issued if the shareholders have a preference at the dividend payments. 1965 those sections were mostly assumed to the new AktG.[47] One important change was that a corporation could now have 50 percent of its value as preference shares without voting power.[48] But preference shares did not gain any popularity. In 1963 only 20 of all listed corporations in Germany had preference shares[49] and until the 1980s this number did not change much.[50]

That time hostile takeovers increased in Germany[51] and corporations found out that inventing a second class of shares without voting power and selling only these to the public would be an effective way of self-protection against hostile takeovers.[52] So the number of corporations with a dual class share system increased again, reached its peak in the 1990s and is decreasing since then.[53] At its peak 28 of the DAX-100 listed corporations had preference shares.[54]

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40 *Id*.
41 *Id*. at 8.
42 *Gerster,* Stimmrechtsaktien, P. 17 f.
43 *Feddersen,* in: Habersack, Festschrift für Peter Ulmer zum 70. Geburtstag am 2. Januar 2003, P. 107.
44 *Bezzenberger,* Vorzugsaktien ohne Stimmrecht, P. 8.
45 *Kriebel*, in: Die Aktiengesellschaft 1963, 175 (175).
46 Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien (Aktiengesetz), in the version of January 30th, 1937, RGBl I, 1937 107.
47 Aktiengesetz, in the version of September 6th, 1965, BGBl, 1965, 1089.
48 *Feddersen,* in: Habersack, Festschrift für Peter Ulmer zum 70. Geburtstag am 2. Januar 2003, P. 107.
49 *Kriebel*, in: Die Aktiengesellschaft 1963, 175 (176).
50 *Feddersen,* in: Habersack, Festschrift für Peter Ulmer zum 70. Geburtstag am 2. Januar 2003, P. 108.
51 *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P. 35.
52 *Partch,* Journal of Financial Economics 1987, 313, P. 316 f.
53 *Vins,* Die Ausgabe konkurrierender Vorzugsaktien bei der SE, P. 36.
54 *Feddersen,* in: Habersack, Festschrift für Peter Ulmer zum 70. Geburtstag am 2. Januar 2003, P. 108.

Unification trend of dual class shares at the turn of the century

In the beginning of the 21st century major listed corporations like Lufthansa, Metro, Puma, Sixt, RWE and SAP started to convert their preference into common shares and in 2003 the number of the DAX-100 listed corporations with preference shares decreased to 18.[55] RWE offered their preference shareholders to buy voting rights, and Lufthansa simply gave those rights for free.[56]

Since June 2002 corporations can only choose one class of shares for their admission to the German stock indices.[57] Only the chosen class of shares is considered to evaluate the corporation. Thus a corporation having a dual class share system on the index is underestimated compared to its actual value; therefore more Companies switched the division of their shares.

Growing trend of dual class shares today

In 2009, preference shares underwent a revival in Germany, spearheaded by Volkswagen AG and Fresenius SE.[58] Both companies are listed at the DAX and placed preference shares on the open Market in 2009.[59] In December 2009 Volkswagen replaced their common shares on the DAX with their preference shares.[60] Qatar had bought another stock of Volkswagen common shares so the number of free float shares dropped below 10%; and the DAX directives cause an exit of a share class if the number of free float shares go under that limit.[61]

With the amendment of the AktG in 2015 and the change of § 139 I AktG[62] corporations got the chance to create more attractive preference shares which made the dual class share system even more popular.[63] Before the amendment of § 139 I AktG the of-dividend was separated from the preference and therefore there was no obligation to pay the of-dividend back, if it had not been distributed in the previous year.[64] With the amendment this separation has been taken out of the AktG. That gives corporations the chance to put the preference (dividend privilege) and the of-dividend together, and if they cannot be distributed in one year, the

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[55] *Id*.
[56] *Die WELT*: „Die Vorzugsaktie als Auslaufmodell" (1998).
[57] *Senger and Vogelmann*, in: Die Aktiengesellschaft 2002, 193 (193).
[58] *Mohr,* Vorzugsaktien: Neue Blüte dank VW.
[59] *Id.*
[60] *Baron, Oliver,* VW-Vorzugsaktien kommen in den DAX.
[61] *Id.*
[62] Gesetz zur Änderung des Aktiengesetzes (Aktienrechtsnovelle 2016), in the version of december 22nd, 2015, BGBl I, 2015, 2565 (2566).
[63] *Anschütz David*: in Bucerius Law Journal 2015, 10 (14).
[64] *Id*.

corporation has the obligation to pay the missing of-dividend and the privilege dividend back in the next year.[65] This should guaranty shareholders a solid investment.

Nowadays 4 of the 30 listed corporations have issued preference shares on the DAX.[66]

Governmental regulation in Germany

The market share of preference shares on the DAX or other indices has always been connected to governmental regulations, as one can see at the historical development of dual class shares. In Germany the AktG is the most important law for corporations. Consequently the current legal situation of the AktG is going to be presented.

Regulations and stipulations of the AktG

The AktG is the legal basis for the existence of a dual class share system in Germany. The sections that determine the corporation's right to issue preference shares are going to be presented in detail in the following.

a) § 11 AktG[67]

Section 11 AktG is the basis for the existence of dual class shares. It gives the opportunity to create different membership rights and entitlements two of which are mentioned in sentence "one."[68] Whereby the two namely mentioned examples are not concluding.[69] Section 11 AktG only defines membership rights to be distinguished from creditor rights.[70] The difference in between these two rights are "Accessoriness", "the prohibition of separation" and "the possibility to amend." These features define membership rights.

"Accessoriness" means membership rights correlate with the membership.[71] Membership rights cannot be created without earning a membership. "The prohibition of separation" means membership rights cannot be separated from the membership.[72] Only the person being member can use the rights, they cannot be given or sold to someone else. But the shareholder does not have to vote personally.[73] The voting right can be used by a legal representative (§ 134 III AktG[74]), by a contractual representative (§ 135 AktG[75]) or by an

[65] *Id*.
[66] *Id*. at 15.
[67] Aktiengesetz (AktG), in the version of September 6th, 1965, BGBl I, 1965, 1089 (1093).
[68] *Lange,* in: *Henssler/Arnold* § 11, recital 1.
[69] *Solveen,* in: *Hölters* § 11, recital 1.
[70] *Heider,* in: *MüKo* § 11, recital 6.
[71] *Id*. at recital 7.
[72] *Id*. at recital 8.
[73] *Solveen,* in: *Hölters* § 12, recital 5.
[74] Gesetz zur Umsetzung der Aktionärsrechterichtline (ARUG), in the version of July 30th, 2009, BGBl I, 2009, 2479 (2483).
[75] Gesetz zur Umsetzung der Transparenzrichtline-Änderungsrichtline, in the version of December 20th, 2015, BGBl I, 2015 2029 (2042).

entitled third party on their own behalf (§ 129 III AktG[76]).[77] "The possibility to amend" means membership rights can be changed if the board of the corporation decides it at a general meeting.[78] The three features define membership rights in distinction to creditor rights.

One could think, § 11 AktG impinges the principle of equality set in § 53a AktG.[79] It says to treat shareholders alike under equal conditions. But since the different classes of shares create different, unequal conditions only shareholders of one class have to be treated equally. Yet the unequal treatment may not be arbitrarily, it has to be justified in the general meeting.[80]

Sentence "two" defines classes of shares. A class are all shares with same rights.[81] But this definition is incomplete, because shares are also of the same class if they have same duties.[82] A new class of shares exists if there is a share with different rights or duties.[83] Therefore it does not matter if these rights or duties existed from the beginning (conversion into a corporation) or have been added at a later time.[84]

b) § 12 AktG[85]

Section 12 AktG has three important regulations. The first sentence defines that every share has voting rights and that there is no voting right without a share.[86] But what are voting rights? Voting rights give the shareholder the opportunity to take part and vote at the general meeting.[87] His vote has that much power as the shares he owns grant; and the right to vote cannot be taken away against his will.[88] There is an exception as mentioned above that corporations which are not listed on an index can give "maximum voting rights" (Höchststimmrechte).[89] This exception will be discussed later under § 134 AktG.

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[76] Gesetz zur Umsetzung der Aktionärsrechterichtline (ARUG), in the version of July 30th, 2009, BGBl I, 2009, 2479 (2483).
[77] *Solveen,* in: *Hölters* § 12, recital 5.
[78] *Heider,* in: *MüKo* § 11, recital 9.
[79] Gesetz zur Durchführung der zweiten Richtlinie des Rates der Europäischen Gemeinschaften zur Koordinierung des Gesellschaftsrechts, in the version of December 13th, 1978, BGBl I, 1978, 1959 (1960); *Solveen,* in: *Hölters* § 11, recital 2.
[80] *Solveen,* in: *Hölters* § 11, recital 2.
[81] *Lange,* in: *Henssler/Arnold* § 11, recital 6.
[82] *Solveen,* in: *Hölters* § 11, recital 1.
[83] *Id*. at recital 14.
[84] *Koch,* in: *Hüffer* § 11, recital 7.
[85] Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), in the version of april 27th, 1998, BGBl I, 1998, 786.
[86] *Lange,* in: *Henssler/Arnold* § 12, recital 1.
[87] *Id.* at recital 3.
[88] *Id*.
[89] *Id*. at recital 5.

Sentence two defines the exception to the rule and sets that preference shares can be issued without voting rights. There are other exceptions,[90] but they are not pertinent for the topic of dual class shares and therefore they will be ignored.

Paragraph two prohibits multiple voting rights (Mehrstimmrechte).[91] Multiple voting rights were permitted in Germany throughout the 20th Century.[92] Since May 31, 2003, however, German stock corporation law has established the principle of "proportionate voting rights," under which every share grants one voting right, except for preference shares.[93] So statutory provisions that allow shares with more voting power than one vote per share are prohibited[94] and the statute is invalid if it allows multiple voting rights anyhow.[95] This restriction also includes non-listed corporations.[96]

c) § 23 AktG[97]

Section 23 III No. 4 AktG defines different things. First the statute has to clarify if the corporation has issued par value shares (Nennbetragsaktien) or unit shares (Stückaktien).[98] If the corporation has issued unit shares, the exact number of issued shares needs to be included in the statute as well.[99] If the corporation has issued par value shares the amount a share grants needs to be set in the statute.[100] If the corporation has issued different share classes, the different classes have to be mentioned and the number of shares each class holds.[101] This is a useful information for potential investors, because they can see in the statute of a corporation the percentage portion of each share class in comparison to the share capital, which makes the research prior to a potential stock purchase easier. The issue price of the different share classes, which may vary in between the classes, has also to be set in the statute.[102] If one of the requirements is missing in the statute, the corporation cannot be registered and if it is going to be registered anyway the registry court can initiate a legal proceeding against the corporation.[103]

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[90] *Id.* at recital 1.
[91] *Id.* at recital 7.
[92] *Vatter,* in: *Spindler/Stilz* § 12, recital 16.
[93] *Vatter,* in: *Spindler/Stilz* § 12, recital 26; *Solveen,* in: *Hölters* § 12, recital 11.
[94] *Lange,* in: *Henssler/Arnold* § 12, recital 7.
[95] *Solveen,* in: *Hölters* § 12, recital 13.
[96] *Lange,* in: *Henssler/Arnold* § 12, recital 9.
[97] Gesetz über die Zulassung von Stückaktien (Stückaktiengesetz), in the version of March 25th, 1998, BGBl I, 1998, 590 (590).
[98] *Solveen,* in: *Hölters* § 23, recital 25.
[99] *Koch,* in: *Hüffer* § 23, recital 29.
[100] *Pentz,* in: *MüKo* § 23, recital 59.
[101] *Limmer,* in: *Spindler/Stilz* § 23, recital 20.
[102] *Id.*
[103] *Pentz,* in: *MüKo* § 23, recital 133.

In the German stock corporation law the freedom of contract has no meaning.[104] Paragraph 5 defines the "statute stringency" (Satzungsstrenge), which means that the statutes can only deviate from the legal regulation of the stock corporation act if explicitly permitted.[105] This restricts the autonomy of the statute severely, but it also protects potential shareholders and guaranties the marketability of stocks.[106] Every shareholder can be sure that each statute fulfils the same requirements and has no unusual definition.[107]

It is important to distinguish between deviating- and additional statutory provisions.[108] A deviating statutory provision is only allowed if it is explicitly permitted in the Stock Corporation Act.[109] It is a deviation when the statue contains other regulations than the Stock Corporation Act.[110] A permitted deviation for instance is the determination of other, respectively higher majorities at the general meeting in § 52 V AktG.[111] It is an additional statutory provision if the law did not specify the questioned section, or the statutory provision only amends the law without changing the laws principle.[112] Thus an additional statutory provision is permitted if the law does not have a final provision for the questioned section.[113] Such a permitted additional statutory provision is, as mentioned above, § 11 sent. 2 AktG which allows corporations to issue shares of different classes.[114] If the statute of the corporation violates the provision of § 23 V AktG the corporation cannot be registered.[115]

d) § 134 AktG

Whereas § 12 AktG is giving shareholders the right to vote, § 134 AktG structures the exercise of these voting rights.[116] Section 134 I sent. 1 AktG implies that the full capital contribution has been made and declares how the voting power of a shareholder calculates.[117] For unit shares the voting power is calculated by the percentage of shares a shareholder owns.[118] As mentioned above § 134 I sent. 2 AktG distinguishes between listed and non-listed

[104] *Vetter,* in: *Henssler/Arnold* § 23, recital 22.
[105] *Id.*
[106] *Limmer,* in: *Spindler/Stilz* § 23, recital 28.
[107] *Pentz,* in: *MüKo* § 23, recital 158.
[108] *Id.* at recital 159.
[109] *Vetter,* in: *Henssler/Arnold* § 23, recital 23.
[110] *Id.*
[111] Gesetz zur Umsetzung der Aktionärsrechterichtline (ARUG) in the version of July 30th, 2009, BGBI. I, 2009, 2479 (2480).
[112] *Solveen,* in: *Hölters* § 23, recital 31.
[113] *Id.*
[114] *Limmer,* in: *Spindler/Stilz* § 23, recital 30.
[115] *Id.* at recital 31.
[116] *Koch,* in: *Hüffer* § 134, recital 1.
[117] *Liebscher,* in: *Henssler/Arnold* § 134, recital 2.
[118] *Rieckers,* in: *Spindler/Stilz* § 134, recital 6.

corporations. Non-listed corporations have the opportunity the give out “maximum voting rights.

Maximum voting power means that the voting power of a shareholder cannot be higher than a limit, which must be set in the corporation’s statute, independently of the share capital he owns.[119]

§ 134 II sent. 1 AktG sets that the voting power of a shareholder starts after the full capital contribution has been completed. This regulation is important to prevent emerging of multiple voting rights which has been abolished as mentioned above. If a shareholder had voting power before full capital contribution is done, this voting power would give him higher voting power proportionally higher than his equity participation, which would create de facto a share class similar to multiple voting rights.[120]

e) § 139 AktG

The general legitimacy to issue preference shares without voting power is set in § 12 AktG, as mentioned above and § 139 AktG regulates how and within which limits preference shares can be issued.[121] The conditions which are set in § 139 AktG are final and mandatory and the voting power must be either fully taken away or not at all.[122] It is not possible to give preference shares only partial voting power.

Section 139 I sent. 2 AktG requires that shareholders with preference shares either receive an advanced dividend payment or a higher dividend payment relative to shareholders with common shares. This requirement creates a loophole through which a corporation can grant preference shareholders an advanced dividend payment, while ultimately paying the common shareholders a higher dividend payment. Therefore, if a corporation has sufficient profit to make a dividend payment, although the preference shareholders may receive earlier payment than common shareholders, the common shareholders ultimately receive the higher payout.

Section 139 I sent. 3 AktG defines that unless a corporation’s statue provides otherwise the advanced dividend must be refunded. So if the preference has to be refunded the shareholders have a right to the entire preference dividend and a corporation cannot set in its statute to only refund partly,[123] and this right cannot become time-barred.[124]

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[119] *Koch,* in: *Hüffer* § 134, recital 4.
[120] *Winkler,* Das Stimmrecht der Aktionäre in der Europäischen Union, P. 15.
[121] *Schröer,* in: *MüKo* § 139, recital 1.
[122] *Id*. at recital 6.
[123] *Id*. at recital 16.
[124] *Hirschmann,* in: *Hölters* § 139, recital 14.

The voting power of preference shareholders is not fully extinct.[125] They still have a rudimentary voting power that resurges if the preference payout fails to appear or if special resolutions have to be decided.[126]

Section 139 II AktG defines that only half of the share capital can be issued as preference shares without voting power. This regulation is mandatory and cannot be changed in the statute.[127] This ensures that the majority of voting power cannot be represented by shareholders only holding a minority of capital.[128]

f) § 140 AktG[129]

Section 140 AktG defines the legal position of preference shareholders. Section 140 I AktG sets that preference shareholders enjoy the same rights as common shareholders except for the voting rights.[130] Section 140 II AktG addresses the question how the voting power resurges if the dividend payout has been absent. Here the law distinguishes between refundable and non-refundable dividend payouts.

With refundable payouts the voting power only does not resurge if the shareholder is payed the dividend payout missing in the previous year, and the payout due for the current year.[131] So if one of the two dividends cannot be payed, a preference shareholder's voting rights resurge to the same power as the power of a common shareholder.

Section 140 II sent. 2 AktG defines the requirements for the resurgence of the voting power of preference shares with non-refundable dividend payout-rights. Here the voting power only resurges if a corporation does not pay out the dividend to the preference shareholder in two years in a row.[132] So if a corporation does not pay a dividend in one year the preference shareholders remain empty-handed. As long as preference shares enjoy voting rights they also have to be taken into consideration for the calculation of the controlling interest of the corporation.[133]

Section 140 III AktG defines that if preference shares enjoy the right of refundable dividend payouts that right cannot be given up independently from the share without a change

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[125] *Heider,* in: *MüKo* § 12, recital 32.
[126] *Id.*
[127] *Hirschmann,* in: *Hölters* § 139, recital 24.
[128] *Id.*
[129] Gesetz zur Änderung des Aktiengesetzes (Aktienrechtsnovelle 2016), in the version of December 22nd, 2015, BGBl I, 2015, 2565 (2566).
[130] *Liebscher,* in: *Hennsler/Arnold* § 140, recital 1.
[131] *Schröer/Doralt,* in: *MüKo* § 140, recital 9.
[132] Gesetz zur Änderung des Aktiengesetzes (Aktienrechtsnovelle 2016), in the version of December 22nd, 2015, BGBl I, 2015, 2565 (2566).
[133] *Liebscher,* in: *Hennsler/Arnold* § 140, recital 7.

of the corporations statute.[134] According to § 141 I AktG[135] such a change of the corporations statute, changing the preference rights of one share class needs to be agreed by the affected shareholders.[136] Section 141 III AktG sets that the shareholders have to determine this agreement in a separate resolution.[137] Section 141 III AktG moreover requires a three-quarter majority for the separate resolution.[138] These majority requirements are mandatory and cannot be raised or reduced in the corporation's statute.[139]

Dual class shares versus "one-share, one-vote"

After seeing that the dual class share system is gaining popularity in Germany the question comes up if dual class shares are an actual competitor of the "one-share, one-vote" principle. In the following the question of an economic, ethical and moral justification of dual class shares is going to be asked and the pros and cons of both systems are going to be weighed against each other.

Justification of a dual class share system

A market always operates with the information that is available about a corporation. From an economic point of view the question is how dual class shares perform on the market compared to common shares.[140] The comparison of the DAX 30 corporations that have issued preference shares shows that the arbitrage between the share values of the share classes varies.[141] For a few corporations the share price of preference shares is higher, at others it is the same and at some it is lower.[142] This shows that preference shares perform about as well as common shares on the market. So corporations with a dual class share system have no minor performance on the market than corporations with "one-share, one-vote" which justifies the dual class share system from an economic point of view.

The question of an ethical justification of a dual class share system is not simple to be answered with yes or no in general. In fact every corporation needs to be considered individually. One can say that a corporation acts ethically correct when it follows the general corporate governance standards.[143] So the question comes up if it is ethically correct that in a corporation like Schaeffler the entire voting power is held by two people who only hold a way

[134] *Id*. at recital 8.
[135] Aktiengesetz (AktG), in the version of September 6th, 1965, BGBl I, 1965, 1089 (1122).
[136] *Liebscher,* in: *Hennsler/Arnold* § 141, recital 2.
[137] *Koch,* in: *Hüffer* § 141, recital 18.
[138] *Bormann,* in: *Spindler/Stilz* § 141, recital 55.
[139] *Id*. at recital 56.
[140] *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P. 5.
[141] *Kruse,* Stämme oder Vorzüge? So nutzen Sie die Spreads - Boersengefluester.
[142] *Id*.
[143] *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P. 8.

smaller part of the corporation's equity. In this case the shareholders need to trust the family to make responsible decisions in the best interest of the shareholders. But there are also stakeholders in a corporation whose interests also need to be considered. So a corporation with a dual class share system can be ethically justified if it acts in the best interest of the shareholders without voting power as well as in the best interest of its employees and managers.

In recent years claims came up to put a ban on dual class shares because the system of shares without voting power would be immoral.[144] But preference shares do not just bring the disadvantage of no voting rights, preference shares can also grant a higher dividend payout. So eradicating preference shares would also eradicate a good investment option for shareholders who are more interested in high returns than voting power.[145] A potential investor can inform himself prior to an investment and can decide whether he wants to invest to the given conditions or not. So if dual class shares are morally justified or not, is on every investor to decide for himself.

The advantage of a dual class share system

As mentioned before the dual class share system was used in the 1980s as a hostile takeover protection. But a corporation with a "one-share, one-vote" system is not completely defenceless. A corporation could issue registered shares only with restricted transferability (vinkulierte Namensaktien) instead of simple registered shares (Namensaktien) or bearer shares (Inhaberaktien). The difference between bearer shares and registered shares regards that the name of shareholders who hold registered shares is known whereas the shareholder of bearer shares stays anonymous.[146] In both classes the shares can change the shareholder without permission of the corporation. Registered shares with restricted transferability are different. A shareholder who holds such shares needs a statutory permission of the corporation to sell his shares to another shareholder.[147] So if a corporation only issues registered shares with restricted transferability it can control who holds the shares and can therefore prevent hostile takeovers.

As clarified one can see that corporations without dual class shares can also create a system that prevents hostile takeovers. But the most common reason why corporations are issuing preference shares arise from the need to raise capital while keeping the voting power within a small circle.

[144] *Id.* at 9.
[145] *Id.*
[146] *Fiebiger,* Inhaberaktien vs. Namensaktien – Definition und Unterschied.
[147] *Frankfurter Allgemeine Zeitung GmbH,* vinkulierte Namensaktie – Börsenlexikon der FAZ.

In recent years Contingent Convertible Bonds (CoCo-Bonds) gained popularity at financial institutes in Europe.[148] This increase's due to the European and national legislators who want financial institutes to be more resistant at financial crisis so that the taxpayers don't need to suffer under another bank rescue.[149] CoCo-Bonds are loan capital, which offer the lender a return of about seven percent.[150] But if the capital buffer of the financial institute goes beneath a threshold value the CoCo-Bonds are going to be either transferred into shares or written off temporarily.[151] So the loan capital is going to be transferred into equity.[152] The Deutsche Bank for instance chose to issue CoCo-Bonds that are not going to be transferred into shares but written off.[153] One can see that CoCo-Bonds have similar characteristics to shares, because if the corporation suffers financially CoCo-Bonds and shares are going to be worth less. But CoCo-Bonds have the advantage that no voting power has to be given away. So CoCo-Bonds are an instrument for corporations with "one-share, one-vote" to raise capital and still keep the power within a small circle. But this brings up the question whether CoCo-Bonds and registered shares with restricted transferability can be more easily justified than dual class shares, and whether they present greater ethical concerns. And again this question can mostly only be answered by every investor himself.

Dual class shares are in direct competition with the "one-share, one-vote" principle, but the market for capital structures is not zero sum. Dual class and "one-share, one-vote" structures can coexist. Each corporation must choose what type of structure to adopt and in response, investors can determine whether they want to invest their money in these structures or not.

[148] Tophoven in: *BaFin Journal*, 10/2014, 9 (10).
[149] *Id.*
[150] *Frankfurter Allgemeine Zeitung GmbH,* CoCo-Anleihen: Was sind das für merkwürdige Papiere?
[151] *Id.*
[152] *Littmann,* Schützen Coco-Bonds vor neuen Krisen?
[153] *Id.*

Part 2: US Law

by: Katie Bentel

Because dual-class-stock use implicates so many other areas of corporate governance, the conflict regarding its use has been drawn out and its resolution delayed to an even greater extent than would otherwise be the case.[154]

I. Introduction

Dual class stock creates a distinct type of controlled company that permits corporate insiders to retain majority voting control while allowing investors to share an economic stake in the company. Because of this unbundling of corporate governance and economic interest, dual class structures have received a significant amount of regulatory attention, with academics and policymakers advocating strongly both for and against their value as a governance mechanism. This has resulted, some argue, in a degree of regulation on the subject that is "disproportionate to the commonality of its use."[155]

Dual class structures are not limited to the United States. Such structures have received highly varied receptions across the globe. For instance, in European countries with domestic markets historically dominated by family-owned businesses, such as France and Italy, the dual class structure presents an attractive opportunity for these companies to engage with the public market, and its capital, without sacrificing the family-directed development of the corporation. In Asia, dual class stock is employed as a means to maintain centralized, insider control, but "controlling minority structures" that better obscure this tight grip, such as pyramid schemes and cross-ownership structures, are favored.[156] As is typical in the United States, in most of these instances, adopting a dual class structure permits a company to access the capital markets while also perpetuating its already-established control. However, in the U.S., adopting a dual class structure may also enable management to regain control of an already-public company with dispersed ownership. Efforts to reverse ownership dispersion are not endogenous to the U.S., but the already-dispersed nature of U.S. corporate ownership creates greater opportunities for recentralized control.

Conversely, some jurisdictions have policies restricting corporate structures to one-share, one-vote, including Russia, India, and South Korea. Hong Kong also maintains a one-share, one-vote standard but allows for exceptions to that rule on a case-by-case basis. However, the Securities and Futures Commission of Hong Kong chose not to permit an exception for

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[154] Douglas C. Ashton, *Revisiting Dual Class Stock*, 68 ST. JOHN'S L. REV. 863, 920 (1994).
[155] *Id.* at 867.
[156] Lucian A. Bebchuk et al., *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 298-99 (Randall K. Morck, ed., 2000).

Alibaba's 2014 listing, losing the largest IPO in history to the NYSE. The Hong Kong government supported the Commission's decision to reject Chinese e-commerce giant Alibaba's proposal for an exception to the one-share, one-vote rule, arguing that dual class stock is best suited for places like the U.S. because that have a deep institutional investor base as well as a litigious culture that can act as an additional check on company management.[157]

Permitting dual class stock, or its prohibition, has important ramifications for the shareholder-manager relationship and the cadre of policing mechanisms available. This section will address the rise of dual class stock in the United States and regulatory responses to its development. It will also consider the uniquely autonomous position occupied by the securities exchanges in the U.S. and their relationship to state corporate law, as well as an analysis of the ramifications, both positive and negative of permitting dual class structures.

II. Rise of Dual Class Shares

Dual class stocks were first utilized in media companies as a means to protect the journalistic integrity of the news. In the early 1900s, state corporation statutes began to adopt one-share, one-vote principles as a default rule, but dual class structures remained accessible and eventually grew in popularity as a tool for raising capital.[158] The use of dual class structures reentered common practice and expanded beyond the media industry in the 1980s during a period when the market corporate control became hotly contested.[159] Arguably, this trajectory reveals that management entrenchment is the true motivation for adopting a dual class structure. The current growth of dual class companies is stimulated by high-tech and social media companies, especially those managed by powerful, vision-driven CEOs.[160] For these companies, non-voting stock classes are especially attractive so as not to dilute the voting power of insider shareholders seeking to implement the corporate vision. Courts have upheld this justification under the theory of investors' freedom to contract.[161] However, the original concentration of dual class structures within the media persists. Over the previous decade the number of corporations in the S&P 1500[162] with a dual class structure increased substantially,

[157] Enda Curran, *Hong Kong Right to Reject Alibaba – Fund*, WALL ST. J. (May 12, 2014), http://blogs.wsj.com/moneybeat/2014/05/12/hong-kong-right-to-reject-alibaba-fund/.
[158] Ashton, *supra* note 154, at 891.
[159] Stephen M. Bainbridge, *The Scope of the SEC's Authority Over Shareholder Voting Rights* (Univ. of Cal. Los Angeles, Research Paper No. 07-16, 2007).
[160] Ji Li, *A Glance of Dual-Class Companies in the U.S.*, California State University-Bakersfield 1 *available at* https://www.csub.edu/kej/_files/KEJ3rdQuarter/DualClassCompanies.pdf.
[161] Ashton, *supra* note 154, at 892.
[162] The S&P 1500 is a stock market index of U.S. stocks, made by Standard & Poors: it combines the S&P 500, the S&P MidCap 400 and the S&P SmallCap 600, covering approximately 90% of the U.S. market capitalization.

rising from 87 in 2002 to 114 in 2012.[163] The S&P 1500 groups corporations by their industry; of the industry groups considered by the index, at 53 percent, the media industry has the highest percentage of companies with a dual class share structure.[164] Food, Beverage, and Tobacco, the industry with the second highest percentage of companies with a dual class structure, measures only 20.4 percent.[165]

III. SEC Regulation of Dual Class Shares

Shareholder voting rights are largely regulated by state law, despite the SEC's increasing influence on the shareholder-management relationship.[166] The Securities Exchange Act does not, on its face, empower the SEC to regulate matters of corporate governance, instead granting the SEC explicit regulating authority over trade and pricing.[167] However, the SEC maintains that "voting rights are fundamental and a majority of shareholders should not be able to vote to diminish or eliminate the voting rights of an opposed minority."[168]

In 1986, SEC Commissioner Charles C. Cox addressed the New York Stock Exchange on "Dual Class Capitalization: Solutions in Search of Problems" and discussed the viability of a one-share, one-vote rule. Commissioner Cox framed a one-share, one-vote rule as the potential answer to three concerns: competition between stock exchanges arising from disparate exchange-created rules, upholding the primacy of shareholder democracy, and discerning the SEC's proper role in corporate governance.[169] Commissioner Cox expressed his concern that the lack of uniformity between the exchanges was creating a "race to the bottom," with the exchanges furthering their own interests in attracting listings to the detriment of shareholders.[170] More broadly, Commissioner Cox warned that permitting non-voting or reduced-voting shares could trigger a "market failure" in which the price of shares does not accurately reflect their (restricted) attributes.[171] Commissioner Cox framed the adoption of a dual class structure as a disclosure concern, and thus under the SEC's purview.[172] Commissioner Cox's address raised foundational questions addressing the proper scope of shareholders' right to vote, including

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[163] INVESTOR RESPONSIBILITY RESEARCH CENTER, CONTROLLED COMPANIES IN THE STANDARD & POOR'S 1500: A TEN YEAR PERFORMANCE AND RISK REVIEW 9 (2012) [hereinafter IRRC Study].
[164] *Id*. at 7.
[165] *Id*.
[166] Ashton, *supra* note 154, at 890.
[167] Bainbridge, *supra* note 159, at 16.
[168] Ashton, *supra* note 154, at 904.
[169] Charles C. Cox, Comm'r, Sec. Exch. Comm'n, Remarks to the New York Stock Exchange Legal Advisory Committee: Dual Class Capitalization: Solutions in Search of Problems 2 (Dec. 19, 1986).
[170] *Id*. at 3.
[171] *Id*. at 3-4.
[172] *Id*. at 7. "The amount of disclosure to be required for a shareholder vote in this area is a classic SEC type of inquiry, and I don't believe anyone has questioned the proper role of the Commission in this area."

whether they should be empowered to "disenfranchise themselves" and whether, if the shareholder vote is indeed a fundamental right, the SEC regulate it as a norm.

Unsurprisingly, many have taken a more restrictive view of the SEC's regulatory authority. Bainbridge argues that the thrust of the SEC's regulatory efforts is on disclosure requirements, and that the Commission should leave the regulation of voting rights to the states.[173] Commissioner Cox's address to the NYSE precipitated the SEC's promulgation of Rule 19c-4 in 1988, the apex of the one-share, one-vote movement.[174] Rule 19c-4 focused on regulating transactions deemed to disenfranchise voters; it permitted issuers to issue new classes of non-voting stock, or a special class with limited voting rights, provided the issuance did not dilute the voting power of existing shareholders; Rule 19c-4 also permitted the issuance of a second class of stock in the context of a merger or acquisition with a bona fide business purpose.[175] Although Rule 19c-4 received strong support during the comment period (boasting an impressive 1000:10 letters in support of its passage), the D.C. Circuit determined that Rule 19c-4 was beyond the SEC's regulatory authority when the Business Roundtable challenged it in 1990.[176] The *Business Roundtable* decision dealt a hard blow to the SEC's perceived authority, as the rule was harshly criticized for going against principles of federalism.[177] Additionally, in the course of litigation the SEC damningly "conceded that it does not have 'unlimited authority to amend SRO rules in areas of 'corporate governance.'"[178] With the *Business Roundtable* decision, the SEC's authority to regulate dual class shares was strongly curtailed, leaving the responsibility to other interests, including the government and the exchanges themselves.

IV. Government Legislation

Academics and the government have long driven the discussion regarding a prohibition on dual class structures. The movement did not gain popular momentum until the Dillon, Reed & Company sold a combination of debentures, preferred and non-voting common stock in Dodge Brothers to retain control for itself in the mid-1920s.[179] In 1934, Congress promulgated an aspirational policy on corporate voting rights, noting that "[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[180]

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[173] Bainbridge, *supra* note 159, at 7.
[174] Grant M. Hayden and Matthew T. Bodie, One Share, One Vote and the False Promise of Shareholder Homogeneity, 30 CARDOZO L. REV. 445, 471 (2008).
[175] Ashton, *supra* note 154, at 899..
[176] Jason W. Howell, The Dual Class Stock Structure in the United States: A New Dataset and an Examination of Firms Who Leave the Structure 6 (2010) (Ph.D. dissertation, University of Georgia, *available at* https://getd.libs.uga.edu/pdfs/howell_jason_w_201005_phd.pdf).
[177] Ashton, *supra* note 154, at 899.
[178] Bainbridge, *supra* note 159, at 10.
[179] Ashton, *supra* note 154, at 892.
[180] H.R. REP. NO. 1383, at 13 (1934).

Fifty years later, the D.C. Circuit would interpret the legislative focus to be on full disclosure and fair solicitation, rather than regulating voting rights.

Because the SEC's power to regulate shareholder voting rights has been judicially restricted, any impetus for greater federal regulation will have to come either from Congress or the shareholders themselves. State corporation law occupies the gap left by federal regulators. Currently, most states maintain a default one-share, one-vote rule, but state "blue sky" provisions sometimes allow for the sale of shares with disparate voting rights, which can withstand judicial review.[181] As such, the principle of one-share, one-vote remains a "touchstone of corporate governance."[182] Because state law governs the legal viability of dual class structuring, an important relationship that exists between state corporate law and the stock exchanges.

V. Stock Markets: Regulator and Regulated

The prominence of the forum shopping that preceded Alibaba's record-breaking IPO serves as an apt reminder that the global securities exchanges exist in a competitive environment, and none has monopolistic power. They must constantly evaluate their competitive position amongst the exchanges both nationally and worldwide, as well as the competitive position of the firms they list.[183]

The U.S. securities markets have long wrestled with how best to address dual class structures. In 1924, the NYSE announced that dual class structures would be subjected to increased scrutiny;[184] in 1940, that policy hardened into a mandatory one-share, one-vote policy, setting itself apart from the other securities exchanges.[185] The 1940 Policy prohibited the issuance of non-voting stock and the Exchange maintained a case-by-case system of evaluating attempts to adopt a dual class structure, rejecting the majority of attempts. The 1940 Policy was not challenged until 1984 after General Motors was permitted to issue restricted shares in conjunction with its acquisition of Electronic Data Systems Corporation.[186] Although it was uncommon for companies to adopt a dual class structure at the time, the repercussions of this structural change by such a large corporation were sufficient to trigger a reevaluation.

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[181] Ashton, *supra* note 154, at 904-05; *E.g.*, Groves v. Rosemound Improvement Ass'n, Inc., 413 So.2d 925, 927 (La. App. 1982); Providence & Worcester Co. v. Baker, 378 A.2d 121, 122-24 (Del. 1977); Hampton v. Tri-State Fin. Corp., 495 P.2d 566, 569 (Colo. App. 1972); Shapiro v. Tropicana Lanes, Inc., 371 S.W.2d 237, 241-42 (Mo. 1963): Deskins v. Lawrence County Fair & Dev. Corp., 321 S.W.2d 408, 409 (Ky. 1959).
[182] Hayden and Bodie, *supra* note 174, at 471.
[183] Ashton, *supra* note 154, at 919.
[184] Joel Seligman, Equal Protection in Shareholder Voting Rights: the One Common Share, One Vote Controversy, 54 GEO. WASH. L. REV. 687, 687 (1986).
[185] Bainbridge, *supra* note 159, at 6.
[186] Ashton, *supra* note 154, at 893-94.

In 1985, the NYSE designated a Subcommittee on Shareholder Participation and Qualitative Listing Standards to recommend a policy for the NYSE to adopt regarding dual class listings. The proposed policy required two-thirds of shareholders to approve the creation of a second class of stock in addition to approval by a majority of independent directors (or the unanimous approval of all independent directors if the board does not have a majority of independent directors), the maintenance of a 10:1 ratio of voting rights between the enhanced shares and the second class of shares, and that all other rights be substantially the same.[187] The 1985 subcommittee proposal was developed under the assumption that shareholders should have substantial latitude to determine the corporate structure and that other safeguards (such as independent directors and auditors) are sufficient to ensure good governance.[188] More cynically interpreted, the policy could also reflect the competition the NYSE was facing from both AMEX and NASD, as well as listed companies' general dissatisfaction with the rigidity of the previous rule. The NYSE's 1985 proposition served as a trigger for the SEC's promulgation of Rule 19c-4.[189]

In 1990, AMEX followed the NYSE with a proposal of its own to replace the Wang formula, which had been adopted in 1976, which required a minimum of 10:1 voting rights between the classes of stock, disallowed the issuance of non-voting stock, and required the holders of reduced voting stock to determine 25% of directors.[190] The 1990 AMEX proposal sought to balance flexible capital structuring and managerial accountability by requiring the approval of either two-thirds of outstanding shares or a majority of shares unaffiliated with management or the controlling group.[191]

Presently, NASDAQ, NYSE, and AMEX each permit dual class stock listings by corporations as long as the dual class structure was in place at the time of the IPO.[192] Both the NYSE and NASD maintain standards "that embody the spirit of Rule 19c-4." However, the NYSE does not enforce this standard, instead providing interpretive guidance for listing companies.[193] This places competitive pressure on the other exchanges, particularly NASDAQ, which must enforce the 19c-4 standard in order to continue offering blue sky exemptions.

[187] *Id.* at 896-97.
[188] *Id.* at 897.
[189] Seligman, *supra* note 184, at 692.
[190] Ashton, *supra* note 154, at 896.
[191] Howell, *supra* note 176, at 6-7.
[192] Tian Wen, Comment, You Can't Sell Your Firm and Own it Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchanges, 162 U. PA. L. REV. 1495, 1496-97 (2014).
[193] Ashton, *supra* note 154, at 900.

Further, the NYSE's case-by-case analysis of the standards exacerbates the uncertainty already associated with dual class structures.[194]

Alongside Alibaba, several other highly valuable international corporations have also chosen to list on the NYSE in response to other exchanges' limitations on dual class listings, including British soccer team Manchester United and Chinese social media company Weibo. Dual class structures do not serve as the only attraction for foreign companies considering listing on a U.S. exchange, federal regulations such as the JOBS Act and Rule 405 of the Securities Act also incentivize international companies to choose U.S. markets. Despite the apparent policy continuity between the exchanges and the government, Wen cautions that "[w]e should be wary of the potentially disastrous consequences of welcoming companies that are listing in the United States solely to avoid their home countries' regulations or to avoid having to disclose information to investors."[195] This call to caution invokes the same concerns that motivated restrictive policies for domestic companies in the 1980s and indicates that the focus for exchanges is not on shareholder protection, but on setting minimum corporate governance standards.

VI. Dual Class Shares: An Analysis

The value, or danger, of dual class structures remains highly contested, with a myriad of interested parties contributing to the discussion. Regardless of the specific terms of a dual class stock proposal, the "effect would be to significantly unbundle corporate governance from economic participation."[196] Because shareholder voting arrangements are intimately connected with corporate governance policy, academics have enjoyed a prominent role in this conversation, mounting arguments both for and against dual class shares depending on whether they believe rules should serve to regulate all parties on a level playing field or to promote freedom to contract.[197] Some further argue that the corporation is a social and political institution as much as it is an economic institution, and should therefore operate for the public benefit as much as for the benefit of the shareholders and directors.[198]

1. Effect on Management & Corporation

Proponents of dual class structures argue that allowing insider, controlling shareholders to retain dominant voting rights enables company directors to promote a long-term vision for the company and encourages stronger investment in long-term considerations like research and

[194] *Id*. at 904.
[195] Wen, *supra* note 192, at 1508.
[196] Jeffrey N. Gordon, Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 CAL. L. REV. 1, 4 (1988).
[197] *Id*. at 918.
[198] *Id*. at 919.

development, which might not generate an immediate return on investment (as opposed to sales and advertising), without being limited by the short-term interests motivating retail shareholders. Often, the stock with enhanced trading rights cannot be traded or loses its enhanced voting rights when it is traded under a "sunset provision."[199] This further ensures a loyal base of committed investors, allowing founders pursue their long-term vision.

However, opponents counter that alternatives to dual class structures abound; managers can choose to finance their vision through debt, raise venture or equity capital, sell fewer shares so they retain control, or they can simply choose to remain a private company. Additionally, the benefits of dual class structures can be highly dependent on the particular managers in place when the structure is adopted. Often shareholders investing in shares with reduced voting power are investing in an individual's vision for the company, and the sacrifice of voting rights may become costly when the "next generation" of management gains control. The resulting "power vacuum" left by the exit of a particularly charismatic or innovative company leader can further exacerbate this effect.

The dual class structure serves as a powerful (and possibly bulletproof) defense against takeover bids. Wen argues that a dual class structure does not offer notably enhanced protection if companies already have other antitakeover mechanisms in place, and therefore the potential protective benefits are not sufficient to justify the shareholder disenfranchisement that results from a dual class structure.[200] However, the impenetrability of this structure also creates a mechanism for equally impenetrable management entrenchment, with no accountability measures through shareholder action available.[201] Indeed, even after they were criminally implicated in a phone-hacking investigation, their own voting power enabled Rupert and James Murdoch to retain their positions as Chairman and CEO, respectively, at News Corp.[202] Although a dual class structure cannot be implemented in response to a hostile advance,[203] it has been argued that such concentrated board voting power can negate the governance protections afforded by independent board members[204] and that management will no longer be incentivized to seek value maximization of the firm because there will never be a looming threat of takeover, ultimately resulting in reduced shareholder wealth.[205] However, empirical evidence that controlling shareholders do not act with the purpose of expropriating power and

[199] IRRC Study, *supra* note 163, at 4.
[200] Wen, *supra* note 192, at 1509.
[201] *Id*. at 1497.
[202] *Id*. at 1502.
[203] Ashton, *supra* note 154, at 888.
[204] Renée Adams and Daniel Ferreira, *One Share-One Vote: the Empirical Evidence*, 12 REV. OF FIN. 51, 70 (2008).
[205] Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 798 (2007).

wealth from minority shareholders exists[206] and argubly, were these structures wholly undesirable structures for the market, such a large quantity of corporations would not continue to operate (successfully) under dual class structures. Wen, however, further cautions that, because shareholders cannot effectively monitor boards in a dual class structure, that monitoring duty shifts to third parties such as the courts and regulatory bodies, with the resulting costs borne by the public.[207]

2. Effect on Shareholders

Some have argued that shareholders in a dual class structure are denied the opportunity to capitalize on the "control premium" that develops when management inefficiencies occur and a company's share price declines as a result.[208] In these instances, a corporate takeover can maximize corporate value quickly by correcting these inefficiencies, allowing shareholders to reap the benefits. This potential benefit is unavailable if management is able to continue poor governance practices without the threat of a takeover.[209] Empirical research seems to support the assumption that a control premium can develop in a dual class context; although controlled companies tend to outpace non-controlled companies in the short term, voting control that is disproportionately greater than managers' ownership stakes in the company weakens company performance.[210] One possible explanation for this is that shareholders with enhanced voting rights are reluctant to sell their shares to raise corporate funds for fear of diluting their influence. This theory of self-interested decision-making at the expense of the corporation is supported by empirical evidence that dual class structures demonstrably underperform relative to all other control structures (included single-share controlled companies)[211] and tend to be burdened with more debt than their single-class counterparts.[212]

Some view dual class stock as an "unnecessary evil" because other takeover defense mechanisms exist that do not also inherently implicate shareholder disenfranchisement. These critics argue that the only justification for choosing a dual class structure as a takeover defense is that it has the added benefit of management entrenchment.[213] However, some courts have interpreted management entrenchment as a violation of management's duty of care; as such, the choice to adopt a dual class structure should only be made when the purpose of the structure,

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206 Ashton, *supra* note 154, at 916.
207 Wen, *supra* note 192, at 1498.
208 Cox, *supra* note 165, at 4-5.
209 Ashton, *supra* note 154, at 915.
210 Paul A. Gompers et al., *Extreme Governance: An Analysis of Dual-Class Firms in the United States* 5 (Rock Center for Corporate Governance, Working Paper No. 39, 2008).
211 IRRC Study, *supra* note 163, at 8.
212 Gompers et al., *supra* note 207, at 10.
213 Ashton, *supra* note 154, at 889.

especially in the recapitalization context, is clearly not to perpetuate existing management. Recapitalizing under a dual class structure is subject to even greater scrutiny because although shareholders nearly always vote to approve a dual class recapitalization, arguably this vote cannot ever be truly informed (and therefore cannot be judicially enforced) because shareholders systematically undervalue their right to vote.[214] However, Barry et al. cite evidence contradicting this assumption, arguing that voting rights are highly valued by investors because shares conferring greater voting rights typically command higher prices.[215] Further, courts have historically enforced such votes, indicating that this perception is dominant.

Indeed, Ashton rejects the assumption that dual class structures lead to disenfranchisement, arguing "[i]t does not necessarily follow that an unequal relationship between voting power and residual interest invariably creates larger agency costs or inefficiencies."[216] This argument is corroborated by Adams and Ferreira, with limitation. Ashton presents the dual class structure as an opportunity to benefit some shareholders (those holding shares with enhanced voting power) without hurting others by manipulating the vote and the value attached to it so as to maximize the aggregate value of the firm, invoking the Coase theorem, which characterizes corporate restructuring proposals as a negotiation between existing shareholders and management that acts to reduce transaction costs in a regulatory environment that does not place restrictions on capital structuring.[217] Ashton asserts that in the absence of such costly regulations, shareholders and management would engage in voluntary exchanges, reducing transaction costs. While Adams and Ferreira agree that disparate voting rights are not *per se* disenfranchising, "it is only under very restrictive assumptions that maximizing social welfare coincides with maximizing shareholder value."[218]

An important criticism of dual class structures posits that the fiduciary duties of managers are owed to *all* shareholders, but a concentrated dual class ownership structure effectively limits accountability for that duty to the few shareholders in power.[219] Taken further, it is reasonable to anticipate that this limitation of accountability to shareholders will result in fewer shareholder proposals if controlling voting power is concentrated within the board, thereby further reducing the effectiveness of that avenue for shareholder monitoring.[220]

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[214] *Id.* at 909.
[215] Jordan M. Barry, John William Hatfield, and Scott Duke Kominers, *On Derivatives Markets and Social Welfare: A Theory of Empty Voting and Hidden Ownership*, 99 VA. L. REV. 1103, 1151-52 (2013).
[216] Ashton, *supra* note 154, at 869.
[217] *Id.* at 869, 871.
[218] Adams & Ferreira, *supra* note 201, at 81.
[219] Wen, *supra* note 192, at 1498.
[220] Ashton, *supra* note 154, at 912.

Under a dual class structure, some protections do remain for shareholders, including company disclosure, common law fiduciary duties, and public pressure (or shaming).[221] Importantly, public pressure can also present a reputational challenge and policy keel for exchanges hosting dual class corporations if public perception trends towards suspicion of the quality of the governance of either the corporations or the exchanges. However, it is questionable whether these alternate shareholder protections are sufficient to surmount the morals-driven public policy counterargument that voting rights are a "minimal, fail-safe constraint on the integrity, diligence and competence of those who manage publicly traded corporations."[222] An additional concern is that dual class structures can exacerbate the collective action, free riding, and passivity problems inherent in dispersed ownership – leading to further disenfranchisement.[223] Ashton argues that retail investors face heightened costs to oppose a dual class recapitalization proposal because dual class restructurings tend to occur in the family-owned companies or companies controlled by management and under the watch of less vigilant institutional investors. This cost of opposition deters action by individual shareholders and perpetuates the free riding problem.[224]

3. Effect on the Market

Regardless of the effect of dual class shares on an individual firm's value, dual class structures also implicate concerns for their effect on the market as a whole. Wen focuses on agency costs, rather than transaction costs, asserting that "[h]aving a proportionate economic interest is desirable because a market-oriented approach is the optimal way to lower agency costs."[225] Unbundling voting rights and profit claims has "potentially significant consequences" on market-wide agency costs because it reduces the potency of internal monitoring mechanisms available to shareholders as principals in the agency relationship.[226] Michael Jacobs argues that unbundling voting rights and economic interest will undermine capitalism because those making business decisions are betting with someone else's investment.[227] Additionally, financial risk accrues disproportionately to investors who don't have control of their investment, which is patently unfair. Jacobs describes dual class structures as a violation of the golden rule: "he who has the gold sets the rules."[228] One can imagine a worst-case scenario in which the perception of shareholder disenfranchisement and the risk of

[221] Wen, *supra* note 192, at 1502.
[222] Ashton, *supra* note 154, at 917.
[223] *Id*. at 907.
[224] *Id.* at 908.
[225] Wen, *supra* note 192, at 1501.
[226] Ashton, *supra* note 154, at 910.
[227] *Id*. at 917.
[228] MICHAEL T. JACOBS, BREAK THE WALL STREET RULE 139 (1993).

management entrenchment reach such as level that investors lose faith in the market and pull their investments out entirely.[229] The market-wide effects extend beyond investor confidence in the markets, and may also affect the perceived cost of capital. Shares issued with reduced voting power have a lower per-share value than they would if they also carried full voting power; this results in an increased cost of capital for the corporation to derive the same value from investors.[230]

Proponents of dual class stocks argue under the contract theory of rulemaking that the only risk is to those (informed) shareholders who choose to invest at the IPO stage, as any inherent shareholder risk or disenfranchisement has been priced into the IPO. They further assert that prohibitively regulating dual class structures competitively disadvantages firms for which the structure would be optimal and interferes with the market's natural enforcement mechanisms.[231] However, the current thrust of dual class listings is centered on popular, highly marketed corporations such as Google, Facebook, and Yelp, which are likely to attract a wider investment base, putting more retail investors at risk of disenfranchisement. Although it has been suggested that concerned investors may simply have to miss out on investing in a compelling business that elects to have a dual class structure,[232] in practice index investors and many institutions cannot actively avoid dual class companies.[233]

Institutional investors play a significant role in the American securities market and have shown distaste for dual class structures. However, the advised policies and actual practices of institutional investors differ significantly. Institutions still invest in dual class companies with great frequency and in high volume because a corporation's shareholder voting structure (and other corporate governance issues) is a relatively low priority for institutional investors in making investment decisions, especially at the IPO stage. As powerful participants in the markets, institutional investors provide important corporate governance oversight and can aid in overcoming the collective action problem associated with dispersed ownership. However, oversight by institutional investors is an incomplete monitoring mechanism because institutional investors are not incentivized to consider long-term managerial overreach or abuse, but rather to focus on short-term profit gain.[234] This results in mission misalignment between

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[229] Ashton, *supra* note 154, at 911.
[230] Howell, *supra* note 176, at 51-52.
[231] Ashton, *supra* note 154, at 868.
[232] Wen, *supra* note 192, at 1505.
[233] Stephen I. Glover and Aarthy S. Thamodaran, *Debating the Pros and Cons of Dual Class Capital Structures*, 27 INSIGHTS 1, 5 (2013)
[234] *Id.* at 914.

individual investors and institutional investors and requires individual investors to continue to serve a (potentially costly) monitoring function, particularly with a long-term perspective.

VII. Conclusion

The future of dual class shares in the U.S. is uncertain, even as regulatory bodies grapple with how to address the creation of dual class structures, new governance challenges loom. Among these challenges are how to regulate recapitalizations of dual class firms into single class corporations, as contemplated in *Levco Alternative Fund Ltd. v. Reader's Digest Association*,[235] and the development of other mechanisms for decoupling economic and voting rights, such as Google's introduction of a class of nonvoting shares as part of an employee stock incentive program in 2012[236] or the concept of "time-phased voting" or loyalty shares, which rewards long-term shareholders with increased voting power.[237] It is clear that there is not a universal structure that will best suit all corporate entities; instead, companies must engage in a lengthy process of trial and error.[238] This trial and error should be supported by clear regulatory guidance, though it is unclear what entity is best suited to navigate corporations through the uncertainties that permeate the dual-class structure.

[235] Levco Alt. Fund Ltd. v. Reader's Digest Ass'n, No. 466,2002, 2002 WL 1859064, at *1 (Del. Aug. 13, 2002) (requiring corporations to consider the fate of the corporate entity as well as the interests of both classes of shares when contemplating a single-class recapitalization); Glover & Thamodaran, *supra* note 227, at 6.
[236] Steven Davidoff Solomon, *New Share Class Gives Google Founders Tighter Control*, N.Y. TIMES (Apr. 13, 2012), http://dealbook.nytimes.com/2012/04/13/new-share-class-gives-google-founders-tighter-control/?_r=0.
[237] *See generally* Lynne Dallas and Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, 40 DEL. J. CORP. L. 541 (2015).
[238] Ashton, *supra* note 154, at 863-64.

Comparative Part by: Katie Bentel and Gabriel Walter

I. Introduction

After having shown how dual class shares are used and regulated in Germany and the U.S., the final section of this paper will compare the use and regulation of dual class shares in Germany to the system used in the U.S., as well as some of the distinctions between German dual class regulations and the regulations of other EU countries, assessing the implications for corporate law in each of these jurisdictions.

Beginning with the origins of dual class shares, we first discuss the varied incentives for corporations to issue dual class shares and why the respective governments permitted the issuance of dual class shares. We then consider the different voting classes permitted between Germany and the U.S. and the effect of these regulations on the behavior of dual class corporations in each country. We then assess the broader enforcement environment for corporate law in the EU and the U.S., considering the different uses of hard and soft law to induce compliance and the role of private enforcement through litigation in each jurisdiction. We finally compare the disparate rights granted to shareholders of different classes in Germany and the U.S., including the right to receive dividend payments and the right to resale shares.

We conclude with a view to the future of dual class structures in Germany and the U.S., predicting that global capital markets regulation will continue to converge and that corporations taking advantage of dual class structures are likely to continue to forge new pathways to disentangle economic and control rights of shareholders.

1. Origins of the Dual Class Structure

Railway corporations were the first to adopt dual class shares systems in Germany, beginning in 1844. A half-century later, towards the end of the 19th century, U.S. corporations also began to adopt dual class structures.[239] Between 1926 and 1985, the New York Stock Exchange (NYSE) prohibited dual class shares with few exceptions. One such exception was made for the Ford Motor Company, which still able to issue preference shares because its preference shares were not non-voting shares, but rather shares with minor voting power.[240] The American Stock Exchange (AMEX) did not adopt a similar prohibition against dual class shares, but also restricted their issuance.[241] These restrictions included, inter alia, that preference shares could only be issued with minor voting rights, making the AMEX

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[239] Howell, *supra* note 176, at 2.
[240] *Id*. at 3.
[241] *Id*. at 4.

practice nearly indistinguishable from the NYSE's prohibition in practice. Conversely, preference shares have never been prohibited in Germany and have been legally sanctioned by the German Stock Corporation Act since 1937. Nonetheless, from the 1920s until the early 1980s the dual class share system was limited to very narrow industries, such as transportation and media companies, in both Germany and the U.S.

During the 1980s, hostile takeovers increased in both Germany and the U.S., making the dual class share system an attractive and effective source of hostile takeover protection.[242] Whereas in Germany, neither the legislator nor the stock exchanges changed the necessary conditions for the issuance dual class shares, in the U.S. the NYSE responded to this increase in dual class structures by relaxing their prohibition, allowing the issuance of dual class shares on a case-by-case basis in an effort to remain competitive with the AMEX and the NASDAQ, which emerged in 1971.[243] During the 1980s, the increased threat of hostile takeover and the permissibility of dual class structures on all of the major stock exchanges led to an increase of the use of dual class shares in the U.S. and in Germany.

In Germany and other countries in Europe such as Italy and France, early dual class structures were often used by family owned companies, or companies that have family-like structures, such as Volkswagen AG. The dual class structure was attractive for founding families that had invested a significant amount of time, energy, and funding into their companies and that wanted to raise capital but did not want to give controlling power to foreign, unknown investors after going public.

In the U.S., the common motivation for adopting a dual class structure was ostensibly less self-interested. Most of the companies that took early advantage of the dual class structure were media companies like the Washington Post Company, the New York Times Company and News Corporation.[244] In these cases, the main motive for retaining voting control within the corporation was not to protect a founding family's interest, but to maintain journalistic integrity.[245] For example, the Twenty-First Century Fox Corporation still maintains a dual class structure that gives the founder Rupert Murdoch and his family over 40 percent of the voting power while holding only 12 percent of the corporation's equity.[246]

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[242] Bainbridge in: *WLR*, 1991, 565 (566).
[243] Howell, *supra* note 176, at 5.
[244] *Weirick/Feller/Chu,* Dual Class Stock Structures, P. 10.
[245] *Orsagh,* Dual-Class Shares: From Google to Alibaba, Is It a Troubling Trend for Investors?
[246] *Chow,* Double trouble – There is nothing equal about dual-class share structures.

2. Permissible Voting Classes

The distinctions between the regulation of dual class shares in the U.S. and Germany begin at the foundation of the dual class structure – the permissible voting classes.

As in the U.S., in Germany, dual class structures are both legal and common; however, unlike the U.S., the voting power granted to each class of shares is narrowly regulated in Germany. Since 1998, only one class of voting shares is permissible under German law.[247] Ordinary (voting) shares receive one vote, while preference shares are non-voting. This is because German corporate governance regulation is focused primarily on addressing potential conflicts of interest between controlling shareholders and preference shareholders, rather than between shareholders and management, as in the U.S.[248] The German focus on shareholder-shareholder relations is likely a reflection of its stakeholder approach to corporate governance, which places additional checks on the unilateral authority of management by aligning the interests of employees and management.[249]

The German approach, however, is inconsistent with the recent European trend, with both France and Italy passing legislation in the past two years promoting long-term shareholder investment through loyalty shares, which inherit double voting rights when held for over two years.[250] Similarly, the U.S. has focused regulatory efforts on the proper process and associated disclosure obligations for creating multiple classes of stock, rather than the permissible voting rights of each class. Federal regulation permits multiple classes of voting stock, permitting each class to be granted disparate voting rights, as well as the issuance of non-voting stock. However, the individual securities exchanges each maintain distinct regulations regarding shareholder voting rights. For instance the AMEX permits multiple classes of stock with voting rights, but requires that the ratio of voting power not exceed 10:1 between enhanced voting shares and common shares.[251]

In both countries, shareholders of classes with lesser voting rights are entitled to the same rights as those enjoyed by shareholders with enhanced voting rights, with the exception

[247] André Betzer, Inga Van den Bongard, and Marc Goergen, *Index Membership vs. Loss of Control: The Unification of Dual-Class Shares* 9 (2013), *available at* http://ssrn.com/abstract=1986224; NORTON ROSE FULBRIGHT, GERMAN STOCK CORPORATION ACT (English Translation as at Sept. 18, 2013) 7.
[248] Theodor Baums and Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 40 (2005).
[249] Roberto García-Castro et al., *Shareholder vs. Stakeholder: Two Approaches to Corporate Governance*, 17 BUS. ETHICS: A EUR. REV. 3 (2008).
[250] di Augusto Santoro et al., *Deviations from "One Share-One Vote" Principle in Italy: Recent Developments – Multiple Voting Rights Shares and Loyalty Shares*, 5 BOCCONI LEGAL PAPERS 141, 147 (2015); Adams & Ferreira, *supra* note 201, at 55.
[251] Ashton, *supra* note 154, at 896-97.

of the right to vote.[252] Additionally, any desired structural transformations after the company's initial offering must be approved by a majority of existing shareholders.[253] However, the votes that the German and American frameworks permit to be assigned to each class of shares are highly disparate and have significant effects on the shareholder voting apparatus in each country.

3. Hard law vs. soft law

Both the U.S. and the EU use hard and soft law to protect the voting rights of shareholders, but in highly disparate ways, and with disparate effect. Hard law refers to enforceable laws and binding legal instruments, such as treaties or customary laws, which create implementable rights and obligations.[254] Soft law refers to rules that have no legally binding force, but act instead as guidelines or policy declarations.[255] The term "soft law" is often criticised because it is not legally enforceable and is therefore only questionably "law."[256]

Whereas the use of hard law is more common in the U.S., the EU relies more heavily on soft law and individual corporate governance codes in each of its member countries.[257] While there are many effective analogies that can be drawn between the EU and the U.S. federal government and between the member countries and the individual U.S. states, the legal enforcement power of each are quite disparate. The EU emphasizes soft law more strongly because it is not a country, but a supranational institution.[258] As such, the EU does not have its own independent enforcement power to require corporations to comply with its directives; instead its individual member states are required to enact domestic (hard) laws implementing its directives and bylaws.[259] Comparatively, a company in violation of U.S. federal law may face federal civil or criminal penalties in addition to state sanctions.

In recent years there has been a shift towards greater EU-level decision-making regarding corporate law, and a corresponding challenge for member states to align their company law with these developments.[260] The European Commission, the executive arm of the EU, asserts that this increased EU-level governance is justified because "[m]ore and more

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[252] NORTON ROSE FULBRIGHT, *supra* note 247, at 68.
[253] Michael Gruson, *Global Shares of German Corporations and their Dual Listings on the Frankfurt and New York Stock Exchanges*, 22 U. PA. J. INT'L ECON. L. 185, 200 (2001); Gordon, *supra* note 196, at, 7.
[254] *U.S. Legal,* Soft Law, Law & Legal Definition.
[255] *Id.*
[256] *Marschik,* Subsysteme im Völkerrecht, P. 175.
[257] *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P. 97.
[258] *Sächsische Landeszentrale für politische Bildung,* Prinzipien und Leitbilder der EU.
[259] *European Parliament,* legislative procedures; *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P. 97.
[260] *Khachaturyan,* SSRN Journal 2006, P. 1.

European businesses operate on a cross-border basis and for that reason the corporate governance framework at national level is growing in importance," making it clear that the EU is pursuing harmonisation and enhanced coordination of the member states' corporate governance practices.[261] It is possible that greater synchronization could grant European authorities more actionable power to hold non-compliant companies accountable. However, attaining EU-wide harmonization is, unsurprisingly, easier said than done due to the various incentives and priorities motivating the many member states and the broad international cooperation necessary to pass EU legislation.

In the U.S., the implementation of enforceable policies does appear so insurmountable. At the federal level, the U.S. has focused regulatory efforts on disclosure, with enforcement powers delegated to the SEC, which regulates listed companies and can initiate investigations and legal action if a company is not in compliance.[262] The Dodd-Frank Act, passed in the wake of the global financial crisis of 2008, is a recent example demonstrating the stronger central regulatory enforcement power that the SEC possesses; it has significantly more expansive authority to execute its investigative and enforcement powers than the respective powers granted to the EU.[263]

Another noteworthy difference is that the conversation about a flat, "one-share, one-vote" requirement has already generated strong support in the EU. While European scholars and legislators are already contemplating the viability of a ban on dual class shares, in the U.S. this conversation is not receiving similar attention, likely because U.S. corporate law grants the individual states significant discretion in determining what standards to set, and many states already maintain a "one-share, one-vote" default rule. This demonstrates that the EU and the U.S. are approaching the role of the federal legislator in regulating share structures from very different perspectives.[264] Further, following the financial crisis, the U.S. pursued a fast, tailored legislative response aimed at better protecting shareholders' rights; conversely, the EU's approach has been more expansive, requiring more time to develop a new, long-term vision for corporate governance and consumer protection in Europe, not only because it is constrained by the myriad of interests that must reach consensus, but also

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[261] *European Commission,* Frequently Asked Questions: Consultation on the EU corporate governance framework.
[262] *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P 98.
[263] The "Dodd-Frank Wall Street Reform and Consumer Protection Act" is a law to ensure the stabilisation of the U.S. financial market enacted in response to the financial crisis of 2008.
[264] *Khachaturyan,* SSRN Journal 2006, II.

because the Commission is pursuing a potential overhaul of the foundation of the governance structure.[265]

Finally, despite the financial instability that characterized much of the past two decades, neither the EU nor the U.S. has specifically addressed the validity (or legality) of dual class structures in the lens of corporate governance. This relative silence from the legislative and regulatory bodies of both the EU and the U.S. would seem to indicate that, thus far, neither entity views corporate share structure as a sufficiently powerful intervening cause of financial crises, the concern for which has framed most of the recent major shifts in corporate law within the EU and the U.S., to merit stronger regulation.

4. Role of litigation as an additional check on corporate governance

Similar to the disparate uses of hard and soft law in the regulatory systems of the United States and Germany, the two also have fundamentally different approaches to the role of courts as a mechanism for regulating corporate governance.

German corporate law permits suits roughly akin to class action suits only in very narrow circumstances, making the process very time consuming and costly for individual shareholders.[266] Although there have been significant developments in the regulation of German capital markets that have pushed the German regulatory framework towards the Anglo-American model, including the empowerment of public and private enforcement mechanisms, these changes have strained German legal resources and "require immense effort in corporations, the government, law firms, and German academics."[267] Additionally, even as foreign institutional investors begin to acquire greater interest in German companies, high costs of "information, contact and action" deter institutional investors from pushing for strong corporate governance.[268] This would indicate that there is not likely to be significant pressure on German regulatory bodies to make shareholder derivative suits more accessible in the near future.

Some argue that the threat of litigation is a powerful enough mechanism in the U.S. to incentivise company directors to practice good corporate governance, even in the absence of minority shareholder-controlled voting or the threat of takeover. However, U.S. reliance on litigation as a mechanism of shareholder empowerment may be misguided because suits are

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[265] *Taylor,* Dueling shares: comparative EU-US corporate governance practices (2013), P 99.
[266] Ulrich Noack and Dirk Zetzsche, *Corporate Governance Reform in Germany: The Second Decade*, 16 EUR. BUS. L. REV. 1033, 1050 (2005).
[267] *Id*. at 1055.
[268] Baums and Scott, *supra* note 248, at 58.

often driven primarily by self-interested lawyers rather than self-empowered investors.[269] Admittedly, however, the scope and vigor of this enforcement is far greater than the SEC alone could obtain.[270]

Baums and Scott conclude that "…the ability of shareholders to enforce the legal rights they do have is inefficient at best in the US and even more so in Germany."[271] Indeed, both regulatory frameworks seek to empower shareholders through private enforcement mechanisms, but fail to truly harness the full potential of the court systems as tools of corporate governance.

5. Rights guaranteed to preference shareholders

As previously explored, in Germany preference shareholders are not granted voting rights. Instead, they are granted other preferences and priorities. In Germany multiple voting rights and multiple classes of voting shares are expressly prohibited, whereas in the U.S. shares enjoying multiple voting rights are both permissible and common.[272] In Germany, then, the dual class structure can only take one form: the share class with enhanced voting power has one vote per share, and the share class with minor voting power has zero votes per share. In the U.S., the enhanced voting class in the U.S. can have multiple votes per share and the share class with minor voting power has one vote per share. This demonstrates the distinct priorities between the German and the U.S. systems. A shareholder in the U.S. with minor voting shares can still maintain some amount of voting power, whereas a German preference shareholder cannot. While the U.S. does not prohibit the issuance of nonvoting shares, some U.S. stock exchanges, such as the AMEX, require the ratio of voting power between stock classes not exceed 10:1.

A unique element of German dual class structures is that a shareholder with minor voting power in Germany can assert their right to vote if corporation fails to pay the preference or priority dividend. If asserted, the shareholder's voting power remains in place until the corporation fulfils all of its duties. The U.S. does not have such requirements for shares with lesser voting power; instead, individual corporations can choose to structure the rights of the share classes, reasoning that the investing public can make an informed investment decision. In both countries, the rights of shares with minor voting power can be designed with different investment incentives. For example, a corporation can issue shares with minor power that are granted an earlier payout than shareholders with enhanced voting

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[269] Noack and Zetzsche, *supra* note 266, at 1050.
[270] Baums and Scott, *supra* note 248, at 46.
[271] *Id*. at 53.
[272] *George,* What happened during the Google Stock split?

rights and/or a higher payout, or minor voting shares that guarantee a dividend payment. Thus, even though the basic framework for dual class issuances is very different between Germany and the U.S., corporations in both countries retain some discretion in structuring the two classes so as to create different incentives for investors buying shares with minor voting rights.

6. Limitations on resale of shares with enhanced voting power

Much like the different rights accorded to shareholders with limited voting power in the United States and in Germany, so too are different rights guaranteed to holders of shares with enhanced voting power, particularly with respect to resale provisions. In both countries, the company founders have an interest in maintaining managerial control of the company. For many German corporations, this interest is in preserving familial control of the company; for many American corporations, this interest is in allowing founders to pursue their vision without interference from minority shareholders. These goals are accomplished by limiting the transferability of shares with enhanced voting power so as to ensure that voting power remains concentrated with the founders.

In Germany, the right to transfer ordinary shares can be restricted by distributing "registered shares" instead of "bearer shares."[273] For purposes of exercising shareholder rights, only registered shareholders are legally recognized.[274] Under restricted registered shares, the identity of the shareholder is linked to the share itself, and the corporation must approve any transfer.[275] The procedure for selling a registered share requires both an agreement to sell and an agreement to transfer.[276] However, given the frequency with which registered shares are employed, the capital markets have developed mechanisms to facilitate the transfer of registered shares, such as a presumption that "the person holding a registered share certificate containing an uninterrupted chain of endorsements…is the legitimate legal owner of the share"[277] and a system developed in 1997 to meet the requirement that the purchaser acquire "actual or constructive possession of the share" (the Central Application for Settlement, Clearing and Depository Expansion-Registered Shares).[278]

In the U.S., it is common for shares with enhanced voting power to be limited by "sunset provisions," which are triggered when a certain event occurs, such as the death of a

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[273] Gruson, *supra* note 253, at 199.
[274] NORTON ROSE FULBRIGHT, *supra* note 247, at 28.
[275] Gruson, *supra* note 253, at 199.
[276] *Id*. at 226.
[277] *Id*.
[278] *Id*. at 227.

founder, the passage of a certain period of time, or when the share is sold to a non-insider. Generally, these supervoting shares can only be transferred to family members or trusts of the beneficial owners. An impermissible transfer will convert the enhanced voting share into ordinary voting shares.[279] However, most sunset provisions are triggered by a "transfer of beneficial ownership," which has been broadly construed. For instance, if minority shareholders unite to collaboratively overcome the controlling shareholders, by unifying their minority interests, the corporation can assert that beneficial ownership was transferred to the insurgent group's interest, rather than the individual shareholders' thus triggering the conversion of the shares into limited voting stock.[280] Because super-voting shares are not readily transferable, and often convert upon transfer, their valuation is highly speculative.[281] Furthermore, Gordon questions whether such onerous limitations on the transferability of common stock are legally enforceable at all.[282]

The transferability of shares with enhanced voting rights in both Germany and the U.S. is controlled by the issuer and prioritizes the issuer's best interests. In both countries, policies on transferring supervoting shares can act as an additional mechanism to entrench company management. However, Germany has developed procedures to better facilitate the transfer of registered shares, whereas the U.S. has permitted sunset provisions to hold investors holding supervoting shares hostage, or risk losing the enhanced voting rights associated with the share.

II. Conclusion

From an economic point of view, the United States and Europe represent two of the biggest players in the global financial markets. As such, the policies they promulgate in relation to corporate governance, and dual class shares specifically, are of significant influence. Derived from different influences in their domestic capital markets, dual class shares have developed along different trajectories in Germany and the United States. As such, the permissible dual class structures in each country are different, and the cadre of enforcement mechanisms available within each jurisdiction is unique, with the U.S. regime relying more heavily on private enforcement mechanisms and hard law than the German regulatory framework, which derives its effectiveness through soft law. In both countries, limitations on the transferability of enhanced voting shares serve as an additional mechanism to protect against hostile takeover, though in practice the German usage of registered shares

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279 Gordon, *supra* note 196 at 40; Bainbridge, *supra* note 159, at 8.
280 Gordon, *supra* note 196, at 41.
281 *Id*. at 36.
282 *See generally* Gordon, *supra* note 196.

has been streamlined to better facilitate transfers, while American "sunset provisions" remain powerful transfer deterrents. As the capital markets become increasingly globalized, it is highly likely that these regimes will come to more closely resemble one another. As globalized institutional investors gain deeper footholds in the markets, they are also likely to demand greater continuity among the exchanges and their related enforcement regimes.

Declaration of Originality

We declare that we completed this paper on our own and that information which has been directly or indirectly taken from other sources has been noted as such.

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