

CONCEPT PAPER
WEIGHTED VOTING RIGHTS

August 2014



Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

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HOW TO RESPOND TO THIS CONCEPT PAPER

The Exchange, a wholly-owned subsidiary of HKEx, invites written comments on the matter discussed in this paper, or comments on related matters that might have an impact upon the matter discussed in this paper, on or before **30 November 2014**. You can respond by completing the questionnaire which is available at:

<http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082q.doc>

Written comments may be sent:

By mail or hand delivery to Corporate and Investor Communications Department
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Please mark in the subject line:
Re: Concept Paper on Weighted Voting Rights

Our submission enquiry number is (852) 2840 3844.

Respondents are reminded that we will publish responses on a named basis in the intended consultation conclusions. If you do not wish your name to be disclosed to members of the public, please state so when responding to this paper. Our policy on handling personal data is set out in **Appendix VIII**.

Submissions received during the consultation period by **30 November 2014** will be taken into account before the Exchange decides upon any appropriate further action and a consultation conclusions paper will be published in due course.

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HANG SENG INDUSTRY CLASSIFICATIONS

All Hang Seng Industry Classifications in this document are provided by the Hang Seng Indexes Company Limited.

DEFINITIONS

TERM	DEFINITION
“articles”	the articles of association of a company or otherwise its constitutional documents
“ASX”	Australian Securities Exchange
“BICS”	Bloomberg Industry Classification System
“B’ shares”	shares with voting power that is not proportionate to the equity interest of such shares when full paid
“CONSOB”	the Italian statutory securities regulator, Commissione Nazionale per le Società e la Borsa
“Committee”	the Listing Committee of the Exchange
“CSRC”	China Securities Regulatory Commission
“dual-class share structure” or “DCS”	authorised and/or issued share capital that includes two classes of ordinary shares carrying unequal voting rights at general meetings
“Exchange”	The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of HKEx
“FSDC”	Financial Services Development Council
“GEM”	The Exchange’s Growth Enterprise Market
“Government”	The Government of the Hong Kong Special Administrative Region of the PRC
“HKEx”	Hong Kong Exchanges and Clearing Limited
“HSIC”	the Hang Seng Industry Classification system provided by the Hang Seng Indexes Company Limited
“incumbent manager”	the person managing a company’s affairs when that company adopts a WVR structure
“information technology” or “IT” company	See separate table on page 4.
“IRRCi Study”	IRRC Institute and Institutional Shareholder Services <i>“Controlled Companies in the Standard & Poor’s 1500: A Ten Year Performance and Risk Review”</i> , (October 2012)

TERM	DEFINITION
“ISS Report”	Institutional Shareholder Services, Shearman & Sterling LLP, European Corporate Governance Institute, “ <i>Report on the Proportionality Principle in the European Union</i> ”, (2007)
“JPS for Overseas Companies” or “JPS”	Joint Policy Statement Regarding the Listing of Overseas Companies (27 September 2013) (see link to HKEx website)
“Korea”	the Republic of Korea
“limited voting shares”	ordinary shares that entitle the holder to less than one vote per share on matters that are subject to shareholder approval at general meetings
“Listing Rules” or “Rules”	The Rules Governing the Listing of Securities on the Exchange (both GEM and Main Board unless otherwise stated)
“LSE”	London Stock Exchange
“METI”	Japan Ministry of Economy, Trade and Industry
“MOF”	Singapore Ministry of Finance
“multiple voting shares”	ordinary shares that entitle the holder to more than one vote for each share held on all matters that are subject to shareholder approval at general meetings
“NASD”	The National Association of Securities Dealers
“NASDAQ”	NASDAQ Stock Market, LLC
“non-voting preference shares”	preference shares that do not entitle the holder to vote on matters that are subject to shareholder approval at general meetings
“non-voting shares”	ordinary shares that do not entitle the holder to vote on matters that are subject to shareholder approval at general meetings
“NYSE”	The New York Stock Exchange
“OECD”	Organisation for Economic Co-operation and Development
“OECD Principles”	OECD Principles of Corporate Governance
“OECD Report”	OECD, “Lack of Proportionality between Ownership and Control: Overview and Issues for Discussion”, (December 2007)

TERM	DEFINITION
“ordinary shares”	shares that entitle the holder to no preferential economic interest in a company (i.e. no pre-determined or preferential rights to a dividend and no superior claim on the residual economic value of a company on its winding-up)
“OSOV shares”	ordinary shares that entitle the holder to one vote for every share held on all matters subject to shareholder approval at general meetings
“overseas company”	a company to which the JPS for Overseas Companies applies (JPS, paragraph 16) (see link to HKEx website)
“person”	an individual, a company or other body
“PRC”	People’s Republic of China
“preference shares”	shares that entitle the holder to pre-determined or preferential rights to a dividend and/or a superior claim on the residual economic value of a company on its winding-up
“priority shares”	ordinary shares that entitle the holder to specific powers of decision or veto rights in a company (in particular, enhanced or exclusive director election rights)
“private benefits of control”	The monetary and non-monetary benefits that controlling shareholders may enjoy because of their position of control at a company that cannot be enjoyed by non-controlling shareholders (see also Appendix IV, paragraph 17)
“SEC”	U.S. Securities and Exchange Commission
“SFC”	Securities & Futures Commission of Hong Kong
“SGX”	Singapore Exchange Limited
“SME”	small or medium-size enterprise
“SSE”	Shanghai Stock Exchange
“Standing Committee”	The Standing Committee on Company Law Reform
“Takeovers Code”	The Codes on Takeovers and Mergers and Share Buy-backs of the SFC
“Takeovers Panel”	The Takeovers and Mergers Panel of the SFC
“TSE”	Tokyo Stock Exchange
“TSX”	Toronto Stock Exchange

TERM	DEFINITION
“UKLA”	UK Listing Authority, part of the UK Financial Conduct Authority
“World Bank Report”	The World Bank and International Finance Corporation’s “Doing Business 2014” measure of business regulations for small to medium sized enterprises.

Hong Kong Listed Companies		Overseas Listed Companies	
Companies that belong to the “information technology” industry under the Hang Seng Industry Classification system.		Companies that belong to the following sectors, industry groups and industries classified using the Bloomberg Industry Classification System (BICS Code in brackets).	
Sector	Sub-sector	Sector	Industry Group / Industry
IT Hardware	Telecommunication Equipment	Technology (18)	Hardware (1811)
	Computers & Peripherals		Technology Services (1814)
Software & Services	System Applications & IT Consulting	Consumer Discretionary (11)	E-Commerce Discretionary (111714)
	E-Commerce & Internet Services	Consumer Staple (12)	E-Commerce Staple (121211)
		Communications (10)	Internet Based Services (101014) & Internet Media (101015)
		Software	Technology (18)
Semiconductors	Semiconductors		Semiconductors (1812)

Table 1: Definition of an “Information Technology” or “IT” Company

EXECUTIVE SUMMARY

Purpose

1. This paper seeks views on whether, in concept, governance structures that give certain persons voting power or other related rights disproportionate to their shareholding (weighted voting right structures or “WVR structures”) should be permissible for companies currently listed or seeking to list on the Exchange.
2. The Listing Rules should “*reflect currently acceptable standards in the market place*”¹, and, as such, the Exchange has a responsibility periodically to review the Listing Rules to ensure that they do so. Almost 25 years have elapsed since the restriction on WVR structures was implemented in the Listing Rules as Rule 8.11 (see Chapter 2). The Listing Division has, in the recent past, both during and prior to 2013, received a number of enquiries from participants in the market on the acceptability of WVR structures. For these reasons the Listing Division initially sought the views of the Committee on the matter at its policy meeting on 15 April 2013. The Committee supported the Listing Division doing further work in this area with a view to developing a paper on this topic for public consultation.
3. The FSDC, established by the Government in January 2013, recently commented in its paper “Positioning Hong Kong as an International IPO Centre of Choice” that:
*... the “one share one vote” concept may be studied in more detail and re-considered with the benefit of public consultation... While there may be good reasons for the rule [Listing Rule 8.11] to be upheld, we believe the Government and the regulators should keep reviewing some of the fundamental underpinnings of the market, and to what extent modifications or partial relaxations may be appropriate. The regulators should continue to keep an open mind, which is crucial for ensuring our market is up to date.”*²
4. The Exchange considers that there is sufficient merit in WVR structures being the subject of a review, and further that this topic warrants a comprehensive public debate in Hong Kong. At this stage, however, the Exchange is not putting forward specific Listing Rule changes for consultation. Instead we seek views on the concept of WVR structures to promote a focused and coherent discussion. This concept paper is intended to be a neutral, factual and analytical presentation of the relevant issues and considerations.

Summary

Investor Protection

5. The fair and equal treatment of shareholders is a general principle of the Listing Rules³ to which the Exchange pays particular regard when considering the suitability of new applicants for listing⁴. In accordance with this principle, both new applicants and listed

¹ Main Board Listing Rule 2.03.

² FSDC, “Positioning Hong Kong as an International IPO Centre of Choice”, (18 June 2014), paragraph 4.9.2, page 58.

³ Main Board Listing Rule 2.03(4).

⁴ Main Board Listing Rule 2.06.

companies must ensure that the voting power of their shares bears a “reasonable relationship” to the equity interest of those shares.⁵ This means a shareholder cannot have greater voting power than another if both have the same amount of equity in a company. This is commonly known as the “one-share, one-vote” concept.

6. This concept of proportionality is broadly regarded as appropriate in relation to the fair and equal treatment of shareholders principle. It has, for many years, been seen as an important aspect of investor protection in Hong Kong in the sense that it helps align controlling shareholders’ interests with those of other shareholders and makes it possible for incumbent managers to be removed, if they underperform, by those with the greatest equity interest in the company. We discuss this in more detail in Chapter 1 (see paragraphs 54 to 63).
7. The World Bank and International Finance Corporation’s “Doing Business 2014” measure of business regulations ranks Hong Kong third (with a score of 9.0 out of 10) and the US sixth (with a score of 8.3 out of 10) in the area of investor protection.⁶ US exchanges NYSE and NASDAQ allow companies to list with WVR structures in the context of a different regulatory and legal regime to our own. This is discussed in more detail in Chapter 1 (paragraphs 67 to 74) and Appendix V. Reference should also be made to a report published by the OECD in 2007 (which has not since been updated) on “Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion”. This looked at “Proportionality-Limiting Measures” more generally (not just in the context of WVR structures) and is discussed further in Chapter 1 (paragraphs 64 to 66).
8. A number of arguments have been put forward by commentators and others as grounds for either maintaining the status quo or allowing WVR structures for companies currently listed or seeking to list on the Exchange. We summarise these arguments in Chapter 1. It is likely that those relating to Hong Kong’s competitive position vis-à-vis other markets, principally the US, require the most consideration and debate. Therefore the Exchange has focused on these in more detail (see Chapter 3). However, there may be other reasons that are equally or more forcefully persuasive, both against or in favour of WVR structures, which respondents may wish to propose. We will take note of any such views expressed in response to this paper.

Current Hong Kong Position

9. The Hong Kong Companies Ordinance (Cap 622) states that, on a vote by poll taken at a general meeting, every member of a company present in person or by proxy has one vote per share held. However, this is subject to provisions in a company’s articles.⁷ A company’s articles may permit the issue of share classes carrying more or less than one vote per share.⁸
10. The Listing Rules do not require each of a company’s shares to carry one vote and this is not a stated principle in the Rules. However, other than in “exceptional

⁵ Main Board Listing Rule 8.11. GEM Listing Rule 11.25.

⁶ The World Bank and International Finance Corporation, “Doing Business 2014 – United States”, page 62 and “Doing Business 2014 – Hong Kong SAR, China”, page 58.

⁷ Companies Ordinance (Cap 622), section 588(3)(a) and (4).

⁸ Companies Ordinance (Cap 622), section 588 and section 50(4) of the Companies (Model Articles) Notice.

circumstances”⁹ agreed with the Exchange, a company cannot list with shares that have voting power that does not bear a reasonable relationship to the equity interest of those shares when fully paid.¹⁰ To date, the Exchange has not listed any company using this exception.

Competitiveness of Hong Kong

Hong Kong as an International Financial Centre

11. Hong Kong’s broad competitiveness has been widely recognised by various international ranking reports. We have been ranked third worldwide as a global financial centre¹¹, fourth in terms of world competitiveness¹², and first in terms of financial development¹³. A Financial Services Action Group established by the Government in 2006 concluded that, from a strategic perspective, with an economy that is one of the largest in the world and rapidly growing, it is important that China should have an international financial centre of global significance, and one that is comparable to New York and London in terms of scale and scope of its financial services and instruments offered.
12. The Government and our regulatory authorities have sought continuously to bolster Hong Kong’s attractiveness to issuers and investors through enhancements to our regulatory regime. Recent examples include Government legislation that, on 1 January 2013, gave statutory backing to the obligation for listed companies to disclose inside information¹⁴ and the new sponsors regime came into effect on 1 October 2013 with the goal of ensuring that “...investors can be confident in the quality of sponsors’ work so as to maintain Hong Kong’s reputation as a leading international financial centre.”¹⁵

Competition for Mainland Chinese Company Listings

13. Hong Kong has established itself as the leading financial centre for the listing and trading of Mainland Chinese enterprises outside the Mainland itself. Mainland Chinese enterprises now account for 57% of total market capitalisation of the SEHK and 70% of total equity turnover.¹⁶
14. Hong Kong’s continued ability to attract a broad spectrum of Mainland issuers and its regulatory oversight of them could be important factors in ensuring Hong Kong’s relevance to the direction of future Mainland financial market liberalisation.
15. Nevertheless, as at 31 May 2014, 102 Mainland Chinese companies were primary listed

⁹ Main Board Listing Rule 8.11(1), GEM Listing Rule 11.25. See paragraph 81.

¹⁰ Main Board Listing Rule 8.11. GEM Listing Rule 11.25.

¹¹ Global Financial Centres Index 15.

¹² IMD World Competitiveness Yearbook 2014.

¹³ World Economic Forum Financial Development Index 2012.

¹⁴ Securities and Futures (Amendment) Ordinance 2012.

¹⁵ SFC, “*Consultation Paper on the regulation of sponsors*”, (May 2012), paragraph 34, page 8.

¹⁶ HKEx, data as at 31 December 2013. Includes H-share companies, Red-Chip companies and Mainland private enterprises. H-share companies are enterprises that are incorporated in the Mainland which are either controlled by Mainland Government entities or individuals. Red-chip companies are enterprises that are incorporated outside of the Mainland and are controlled by Mainland Government entities. Mainland private enterprises are companies that are incorporated outside of the Mainland and are controlled by Mainland individuals.

in the US (on NYSE or NASDAQ)¹⁷, rather than in Hong Kong. Over half (56%) of these companies listed since the beginning of 2010. Almost a third of these companies (29%) have a WVR structure (see Appendix II for a list of them). This third represents 70% of the market capitalisation of all US listed Mainland Chinese companies. The majority (70%) of Mainland Chinese US listed companies with a WVR structure are information technology companies.

16. The use of WVR structures by Mainland Chinese companies listing in the US has become more common. Since 2011, the number of Mainland Chinese companies listing in the US with these structures has been greater than those listing without them. Nine of the 12 Mainland companies to primary list on a US exchange in 2014 to date, did so with a WVR structure.
17. Other than the US, we also compete with Singapore and the UK for the listings of Mainland Chinese companies. Both of these jurisdictions restrict the use of WVR structures by listed companies and none of the Mainland Chinese companies primary listed in these jurisdictions have WVR structures.
18. There are 57 Mainland Chinese companies primary listed in Singapore; 11 primary listed in the UK.¹⁸ The pace of Mainland Chinese companies listing in these jurisdictions is much slower than in the US. Of the total 68 Mainland companies listed in these jurisdictions, only 14 listed since the beginning of 2010. All 11 of the UK listed Mainland Chinese companies are listed on the LSE's AIM market for smaller, growing companies.
19. The fact that Mainland Chinese companies choose to primary list on foreign markets that restrict the use of WVR structures (e.g. Singapore and the UK) indicates that there are other reasons these companies choose to list outside Hong Kong. Companies take many factors into account when choosing a listing venue. These include the profile and prestige gained from listing on a market, whether the geographical location of the company's revenues match with the listing location, the likelihood of being included in local indices, the existence of a group of benchmark companies already listed on the market and research coverage.¹⁹ These factors contribute towards the higher market valuations and liquidity that ultimately make it attractive to list on a particular market.

Competition for International Listings

20. Attracting overseas listings has been a high priority for HKEx. We have achieved some initial success. As at 31 May 2014, overseas issuers²⁰ had raised a total of HK\$86.6 billion through listing on the Exchange.²¹ Other jurisdictions, such as the US, UK and

¹⁷ Companies headquartered in Mainland China that raised funds via an IPO (excluding reverse mergers) through the issuance of ordinary shares (or depositary receipts over ordinary shares) by primary listing on the main or a junior board of the relevant exchange. Companies that are also listed in Hong Kong or Mainland China are excluded as are those that were suspended or de-listed as at 31 May 2014. Source: Bloomberg.

¹⁸ See footnote 17 for the criteria used to count these companies. Data as at 31 May 2014. Source: Bloomberg.

¹⁹ See Philippe Espinasse, "*IPO: A Global Guide*", (2011), pages 12 to 20.

²⁰ Issuers of ordinary equity securities incorporated outside the "recognised jurisdictions" of Hong Kong, the PRC, Bermuda and the Cayman Islands. Mainland Chinese companies are usually incorporated in a recognised jurisdiction and so are not considered overseas issuers.

²¹ Source: HKEx.

Singapore (which can categorise Mainland Chinese companies as overseas issuers) have had a longer history of success attracting a wider variety of listings from outside their own jurisdictions. In Hong Kong, overseas companies' issuance has been dominated by companies from the natural resources, consumer brands and financial services sectors. These issuers tend to have had some pre-existing connection to China. Global companies without a significant Chinese connection have, to date, not been attracted to list here. The FSDC recently commented that:

*"...as competition among the global markets remains intense and Hong Kong is at risk of over-reliance on Mainland China as the source of its IPO candidates. Our IPO market must make every effort to diversify its "client base" and actively open up to quality companies from all corners of the world."*²²

21. On 10 April 2014, the SFC and CSRC made a joint announcement regarding the in-principle approval for the development of the Shanghai-Hong Kong Stock Connect pilot programme. This will establish mutual stock market access between Mainland China and Hong Kong. The pilot programme will enable Mainland institutional investors and individual investors who meet certain criteria²³ to trade eligible Exchange securities.
22. HKEx has stated that Shanghai-Hong Kong Stock Connect is scalable in size, scope and market in the future²⁴ and cross-border capital raising may eventually be enabled through this programme, subject to regulatory approvals by the SFC and the CSRC. This would fundamentally alter Hong Kong's attractiveness as a listing venue for overseas companies, given the possibility of accessing Mainland investors directly through Hong Kong.
23. A number of the overseas companies attracted to list in Hong Kong could have WVR structures. These may be companies that are already listed in overseas jurisdictions that permit such structures. Appendix VII shows, as examples, the top 25 US listed companies by market capitalisation that have a dual-class share structure (listed since 2001). This list includes prominent companies such as Google, Visa, Mastercard and Facebook. Companies with dual-class share structures collectively represent 14% of the total market capitalisation of all large US listed companies.²⁵ Additionally, there may be privately owned overseas companies that may want Hong Kong to be the venue for their first public listing, with a WVR structure.

Jurisdictional Comparison and Empirical Studies

24. NYSE has permitted companies to list with dual-class share structures since the late 1980s when it lifted its 60 year restriction following competitive pressure from

²² FSDC, "*Positioning Hong Kong as an International IPO Centre of Choice*", (18 June 2014), "Section 5 Conclusion", page 60.

²³ Individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts.

²⁴ HKEx media presentation, 8 May 2014 (see [link](#)).

²⁵ US headquartered companies primary listed on NYSE or Nasdaq Global Select or Nasdaq Global Market or Nasdaq Capital Market with a market capitalisation greater than US\$2 billion. Excludes investment vehicles, private limited partnerships and limited liability companies. Data as at 31 December 2013. Source: Bloomberg and SEC company filings.

NASDAQ (see Appendix III, paragraphs 9 to 14). NYSE and NASDAQ both allow companies to list with these structures.

25. The Exchange has conducted an extensive review of practices in overseas jurisdictions and has also reviewed and analysed empirical studies on the effect dual-class share structures with unequal voting rights have on company performance (see Appendices III and IV respectively).
26. Practice in overseas jurisdictions varies. Some jurisdictions have permissive regimes (e.g. US, Canada and Sweden). Others prohibit both listed and unlisted companies from using WVR structures through their corporate law (e.g. Germany, Spain and Mainland China). Some, like Hong Kong, allow unlisted companies to use such structures but prohibit companies with, or seeking, a primary listing from using them (e.g. Australia, Singapore and the UK - for “premium” listed companies). We found no global trend towards or away from WVR structures.
27. The empirical studies are also inconclusive, although there is a consensus view that investors generally apply a discount to shares with inferior voting rights in a dual-class share structure.²⁶ The studies argue that this reflects the risks of consumption of private benefits by controllers, underperformance and management entrenchment (see paragraphs 58 to 61). However, there is a lack of consensus as to whether those risks actually result in a negative impact on a company’s performance. We found that different studies find evidence of outperformance, neutral performance and underperformance for companies with dual-class share structures (see Appendix IV, paragraphs 22 to 37).

Other WVR Structures in Use

28. Typically, in the US, a company will implement a WVR structure at the time of its IPO by issuing two share classes: “A” shares that carry one vote per share that are listed on an exchange; and “B” shares that carry multiple votes per share (most commonly 10 votes per share). These “B” shares are issued to the company’s incumbent managers and normally remain unlisted. However, variations on this structure exist. Some US listed companies grant certain persons the right to appoint directors, usually a majority, to the board in the relevant company’s articles (see Chapter 5). In the main, these rights are carried by shares but can be purely contractual. We found that only one US listed Mainland Chinese company, Autohome Inc, grants superior board appointment rights (see paragraph 143) to its controlling shareholder and does so solely through provisions in its articles.

Additional Considerations

29. The Standing Committee recommended, in 1987, that, if “B” shares were to be permitted by the Exchange in “exceptional circumstances” that this happens only when a company was first listed (see paragraph 94) as it would have no public shareholders at this point. For similar reasons both NYSE and NASDAQ only permit new applicants to use dual-class share structures and do not allow companies to implement such

²⁶ Most academic studies look at companies with a dual-class share structure as this is the most common form of WVR structure.

structures after listing if they may reduce or restrict the rights of existing shareholders.

30. As stated above, we principally compete with the US, as well as with Singapore and the UK, for the listings of Mainland Chinese companies (see paragraphs 121 to 125). The majority (70%) of Mainland companies listing in the US with WVR structures belong to the information technology industry. To address the competition concerns and limit the risks posed by WVR structures, one possible option would be to restrict their use, in Hong Kong, to listed companies belonging to particular industries (e.g. the information technology industry) or some other broader set of “innovative” companies. If such a restriction to certain industries or company types was put in place, the Exchange would have to find a definition of these with which the Hong Kong market community was comfortable (see paragraphs 155 to 164).
31. In the US, companies in many industries use a dual-class share structure with unequal voting rights (see Appendix VII); and this may be relevant to any consideration of whether to restrict these structures to particular industries. Over time, our competition with US markets may extend to other sectors and industries. We also note that no other jurisdiction, so far as we are aware, restricts WVR structures to a particular industry or to companies meeting pre-specified criteria.
32. We also note that US listed companies voluntarily impose certain restrictions upon WVR structures. Multiple voting shares must normally convert to OSOV shares on a transfer of beneficial ownership to a person that is not affiliated with the original holder. Some companies require the holders of multiple voting shares to maintain beneficial ownership of a certain percentage of the company’s share capital. If their holdings fall below this threshold, their multiple voting shares automatically convert into OSOV shares (see paragraph 153). We also note that at least one US listed company, Groupon, Inc, has a five year sunset clause after which its dual-class share structure falls away (see footnote 121 on page 48). If WVR structures were permissible for listed companies in Hong Kong, the Exchange could consider these or other restrictions and comments are welcomed.

GEM

Background

33. GEM was launched in November 1999 following the HKSAR Chief Executive’s 1998 Policy Address that committed to “study proposals for a Venture Board for smaller and emerging technology companies’ stocks”.²⁷ The launch of GEM coincided with the “dot-com” boom of 1999/2000 and great enthusiasm for technology companies that held out the promise of superior growth. Both SMEs and also the technology offshoots of Main Board companies applied to list on GEM. Four months after its launch, as of the end of March 2000, the market had already attracted 18 listings, a number of them being engaged in “new-economy” businesses.
34. When launched, GEM was a “Second Market” that operated on an “enhanced disclosure” basis (e.g. requiring quarterly reporting) and imposed less stringent entry requirements than the Main Board. This was to encourage the listing of SMEs and

²⁷ HKSAR Chief Executive, “The 1998 Policy Address”, (7 October 1998), paragraph 42.

growth enterprises. The original intention was for retail investor access to GEM to be restricted, in view of the higher risk involved in investing in such companies' shares. Listing documents of GEM companies have to carry "buyer beware" risk warnings. These state that the GEM market is designed to accommodate higher investment risk, is likely to be significantly more volatile than the Main Board, that liquidity may be low and that the market is more suited to professional and other sophisticated investors.²⁸

35. By late 2002, some GEM companies had failed and a few were implicated in scandals. In addition, after the "dot-com" bubble burst, many stocks declined in price. Some GEM companies experienced losses and/or long periods of suspension and their shares were often illiquid. Generally, there was a loss of confidence in the GEM market.
36. Against this background, the Exchange began a review of GEM in 2005. It explored the possibility of creating a new alternative market for growth companies, along the lines of London's AIM, which could have a more flexible vetting regime but stricter sponsor regulation, and might be restricted to professional investors only. The Exchange's consultation paper on GEM, published in July 2007, indicated that there was market support for the AIM model. However, the Exchange found, in discussion with practitioners, that there was little demand for a market restricted to professional investors only. The Exchange reported that retail investor participation is generally considered essential to GEM's success.
37. In July 2008, GEM was instead re-positioned as a "stepping stone" to the Main Board for growing SMEs, rather than as an AIM-like market or second board for high-tech growth enterprises. Similar "stepping stone" boards are used by exchanges in other international financial centres. For example, listed companies often graduate from NASDAQ's Global Market to its higher tier Global Select Market. On 27 March 2013, the LSE, in the UK, launched a "high growth" market segment designed to assist mid-sized European and UK companies raise capital as a stepping stone between AIM and a "standard" or "premium" listing on the LSE's Main Market.²⁹

Current Position

38. It has been suggested by some commentators that companies with WVR structures should be allowed to list on GEM. However, the GEM Listing Rules are now largely equivalent to the Main Board Listing Rules. The same restriction applies to the listing of multiple classes of shares with unequal voting power by GEM companies.³⁰ The fair and equal treatment of shareholders is also a general principle of the GEM Listing Rules.³¹ So, amendments to the GEM Listing Rules would be required to allow companies with WVR structures to list on GEM.
39. We have also noted suggestions that companies with WVR structures could be listed on a newly-created board that is restricted to professionals only. We are not aware of any

²⁸ HKEx, "*The Rules Governing the Listing of Securities on the Growth Enterprise Market*", First Edition, July 1999, Rule 2.20.

²⁹ See LSE website, "High Growth Segment" webpage.

³⁰ GEM Listing Rule 11.25.

³¹ GEM Listing Rule 2.06(4).

market that restricts the trading of ordinary equity securities to professional investors.³²

40. A further point to note is the proposal, publicised by CSRC on 7 March 2014, that the Shanghai Stock Exchange plans to launch a new board for “strategic emerging industries”. This proposal has been submitted to the Chinese People's Political Consultative Conference and CSRC, pending approval.³³ However, this board has not been established for the purpose of permitting WVR structures.
41. This concept paper does not address the more general question of the re-positioning of GEM or the creation of a professional (or other) board for companies with WVR structures. This would require the Exchange to conduct a much larger consultation exercise than this concept paper. However, we will take into account any views from the market submitted in response to this paper on the acceptability or desirability of using GEM, another separate board focused on, for example, specific sectors or companies with specified characteristics, or a professional board, to list companies with WVR structures (see Question 6(a)). This is bearing in mind the current positioning of GEM, the nature of the companies currently listed on GEM and the wider implications of a separate or a professional board.

Secondary Listing of Greater China Entities

42. We have also noted public debate on the acceptability of a secondary listing for Chinese companies with WVR structures that are already listed on US exchanges. The JPS for Overseas Companies (updated on 27 September 2013) issued by the Exchange and the SFC sets out the criteria that companies must meet to be considered suitable for a secondary listing. It states that the Exchange will not approve an application for secondary listing by a company that has its “centre of gravity”³⁴ in the Greater China region. The Exchange is the natural market for listings of Mainland and Hong Kong companies and the “centre of gravity” test reflects this. This is a longstanding policy position of the Exchange.
43. Without, therefore, a change to this policy, it is only acceptable for US listed Chinese companies to apply for a dual primary listing on the Exchange and a secondary listing is not available to them. As stated in the JPS, our longer term goal is to amend the Listing Rules following the further experience we gain listing overseas companies.³⁵ We intend to review whether Chinese companies should be permitted to secondary list as part of this future consultation.

³² In 2009, the SFC imposed conditions to the listing and trading of the shares of United Company Rusal (stock code: 486) on the Exchange which included, amongst others, that (a) its initial public offering was limited to professional investors who were willing to subscribe for or purchase at least HK\$1 million worth of the company's shares; and (b) required the company to implement a minimum board lot that resulted in a trading value, as at the listing date, of at least HK\$200,000. The company's IPO listing document was required to state prominently that the company's shares should only be bought and traded by persons who are particularly knowledgeable in investment matters and could afford to lose their investment (see [link](#)).

³³ www.csrc.gov.cn: 2014年3月7日新闻发布会.

³⁴ To determine a company's “centre of gravity”, factors that are taken into account include (among others): the company's place of incorporation; the location of its headquarters, its place of central management and control; the location of its main business operations and assets; and the nationality of its management and controlling shareholders or their country of residence (see [link](#)).

³⁵ SFC & HKEx, Joint Policy Statement Regarding the Listing of Overseas Companies, paragraph 12 (see [link](#)).

Overseas Companies

44. Hong Kong has achieved some initial success in attracting overseas companies to list shares on the Exchange. As at 31 May 2014, 33 overseas issuers had raised a total of HK\$86.6 billion through listings in Hong Kong.
45. The FSDC has commented that:
- “With the introduction of the Shanghai-Hong Kong Stock Connect pilot programme and the availability of mutual stock market access between Hong Kong and the Mainland, Hong Kong is poised to make substantial headway in further consolidating its position as China’s gateway to the world. More importantly, this may be an additional incentive for overseas companies to list in Hong Kong and thereby gain access to both the Hong Kong and Mainland capital markets. The regulators should consider the ways in which our market can optimise this unique opportunity for growth.”*³⁶
46. The FSDC’s recently published paper contains a number of proposals they state should be reviewed in detail and which may call for reform. The Exchange will need to consider these proposals, both individually and collectively and in conjunction with the SFC, and which will likely lead to further consultation in due course.
47. As stated above (see paragraph 43), we already plan to amend the Listing Rules to incorporate what we have learnt from the further experience we gain applying the JPS to overseas companies. However, only two overseas companies have listed since we revised the JPS in September 2013.³⁷ For this reason, we prefer to consult on whether overseas companies should be able to list with WVR structures as part of a future exercise, looking holistically at the listing regime for overseas companies, and this concept paper does not seek specific views on this question. Such further consultation will cover not only companies seeking a listing for the first time but also companies already listed on an overseas exchange and seeking a further primary or a secondary listing (see Question 6(b)). However, we will take note of any views that respondents may wish to submit in this area.

Questions

48. It is apparent from media commentary to date that there are a range of views in the market community on the appropriateness of WVR structures. By asking the following questions, we seek views on whether WVR structures should be permissible for companies with or seeking a listing on the Exchange.

We encourage you to read all of the following questions before responding.

Question 1: Should the Exchange in no circumstances allow companies to use WVR structures?

Please give reasons for your views.

³⁶ FSDC, “Positioning Hong Kong as an International IPO Centre of Choice”, (18 June 2014), “1.4 Possible Way Forward”, page 8.

³⁷ Feishang Anthracite Resources Limited (stock code: 1738), incorporated in the British Virgin Islands, and Fast Retailing Co., Ltd (stock code: 6288), incorporated in Japan.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

Question 2: Should the Exchange permit WVR structures:

- (a) for all companies, including existing listed companies; or
- (b) only for new applicants (see paragraphs 147 to 152); or
- (c) only for:
 - (i) companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162), please specify which industries and how we should define such companies;
 - (ii) “innovative” companies (see paragraphs 163 to 164), please specify how we should define such companies; or
 - (iii) companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons.
- (d) only in “exceptional circumstances” as permitted by current Listing Rule 8.11³⁸ (see paragraph 81) and, if so, please give examples.

Please give reasons for your views.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

Question 3: If a listed company has a dual-class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views.

Question 4: Should other WVR structures be permissible (see Chapter 5 for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

Question 5: Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V)? If so, please specify these changes with reasons.

Question 6: Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of this paper:

- (a) using GEM, a separate board, or a professional board to list companies with WVR structures (see paragraphs 33 to 41); and

³⁸ GEM Rule 11.25.

- (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47)?

Question 7: Do you have any other comments or suggestions regarding WVR structures?

Proposed Timetable and Next Steps

- 49. Responses to this concept paper and any other comments on related matters that might have an impact upon the matters raised in this paper should be submitted to us by 30 November 2014. The Exchange will take into account these responses and comments before deciding upon any further appropriate action, if any.
- 50. As noted above, there are divergent views on the topic of weighted voting rights. The responses to this concept paper may not, therefore, reveal a strong market consensus on a particular course of action. The Exchange nonetheless hopes that the consultation process will elicit comments and views from a broad cross-section of the market community, so that the Exchange can make a balanced decision on any further action in the best interests of the market overall.
- 51. Subject to comments and views elicited by the concept paper, we anticipate this paper may lead to one of two possible outcomes:
 - (a) A conclusion that no amendment to the Listing Rules to allow companies to use WVR structures is appropriate at this time and that current practice is supported. In this case, the Exchange would publish conclusions explaining the reasons for any such outcome.
 - (b) Support for a material change to the Listing Rules on the acceptability of WVR structures. In these circumstances, the Exchange would again publish conclusions. Any change to the Listing Rules would require a second stage formal consultation process including consultation on the details of the scope and language of any proposed Listing Rule changes.
- 52. WVR structures can have implications in relation to takeovers. This, therefore, requires special consideration. The Exchange has not consulted the Takeovers Panel in the development of this concept paper. The Exchange, will, as part of this consultation exercise, consult the Takeovers Panel as to their views on the implications for takeovers under the Takeovers Code of various WVR structures. In the event of outcome (b) above, it may be necessary to publicly consult on any possible changes to the Takeovers Code as part of, or in conjunction with, any follow-up consultation exercise.

Matters Outside the Scope of this Paper

- 53. At this stage, we do not seek views on the following matters:
 - (a) **Non-voting preference shares:**- the issue of these shares is common practice in Hong Kong and other jurisdictions. Companies normally have a clear commercial rationale for issuing them and the holders are compensated for the lack of voting rights through greater cash flow rights. A company's aim, in issuing non-voting preference shares, is not normally to ensure the control of incumbent managers and they therefore give rise to different considerations

from WVR structures.

- (b) **“Golden shares”**:- these are shares held by governments to protect sovereign ownership of a company. They typically give veto rights over specific decisions (e.g. the winding up of the company or change of business). Only one listed issuer on the Exchange, Vale SA (6210), currently has “golden shares” in issue, held by the Brazilian government.
- (c) **Special rights granted to pre-IPO investors**:- we require most of these rights to lapse at listing, including the right of a pre-IPO investor to nominate or appoint director(s) to the board. We have published guidance on this matter on the HKEx website.³⁹

³⁹ See HKEx, “Guidance on Pre-IPO Investments (HKEx-GL43-12)”, (October 2012)(Updated in July 2013) (see [link](#)) and “Guidance on Pre-IPO investments in convertible securities (HKEx-GL44-12)”, (October 2012) (see [link](#)).

CHAPTER 1: INVESTOR PROTECTION

Current Rules and Principles

54. The fair and equal treatment of shareholders is a general principle of the Listing Rules. Rule 2.03(4)⁴⁰ states: “*The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:- ... all holders of listed securities are treated fairly and equally.*”
55. The Exchange pays “particular regard” to these general principles when considering the suitability of an issuer for listing. Listing Rule 2.06⁴¹ states that “*Suitability for listing depends on many factors. Applicants for listing should appreciate that compliance with the Exchange Listing Rules may not of itself ensure an applicant’s suitability for listing. The Exchange retains a discretion to accept or reject applications and in reaching their decision will pay particular regard to the general principles outlined in rule 2.03. ...*”.
56. The “one-share, one-vote” policy, implemented through Listing Rule 8.11 (see paragraph 81), aims to ensure the fair and equal treatment of shareholders by aligning voting power with equity interest. We explore some of the reasons put forward for this in the paragraphs below.

Proportionality

57. Shareholders are normally entitled to one vote for every ordinary share they hold. This is because, by purchasing additional ordinary shares they put more of their own capital at risk and are entitled to a greater *proportion* of the future cash flows of a company. The additional vote they gain for each share purchased ensures that they have a greater say in who manages the company for the purpose of producing future capital gains and cash flows (principally through the election or removal of directors). It also means they have a proportionate say on whether cash flows will be paid out as dividends.⁴² It is considered fair that shareholders with the same interest in these things have an equal say on matters that affect their value.

Alignment of Shareholders’ Interests

58. Empirical studies argue that controlling shareholders may be more likely to extract benefits from a company for themselves (e.g. excessive salary, expensive perks), at the expense of other shareholders, as their economic interest in a company falls.⁴³ This is on the basis that they can enjoy 100% of the benefits they take out of a company whilst suffering a smaller downside (through the reduction in the value of their equity stake in the company resulting from their extraction of private benefits). It is argued that a

⁴⁰ GEM Listing Rule 2.06(4).

⁴¹ GEM Listing Rule 2.09.

⁴² Iain G MacNeil, “*An Introduction to the Law on Financial Investment*”, (2012), ISBN: 978-1-84946-050-7, page 134.

⁴³ For example, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer and Robert W. Vishny, “*Investor Protection and Corporate Governance*” (1999); Stijn Claessens, Simeon Djankov and Larry H.P. Lang, “*The separation of ownership and control in East Asian Corporations*” (2000); and Mara Faccio and Larry H.P. Lang, “*The ultimate ownership of Western European corporations*” (2002).

dual-class share structure allows controlling shareholders to maintain control whilst holding a relatively small equity interest in a company; consequently, they may have less of a disincentive to extract private benefits of control (see Appendix IV, paragraphs 15 to 20).

59. Also, a smaller equity interest may potentially incentivise controlling shareholders to move quality assets away from a listed company to other companies in which they have a higher stake, and vice versa (known as “tunneling” or “value shifting”).⁴⁴ This may place a greater burden on the connected transaction Listing Rules that aim to prevent such actions. In Hong Kong, listed companies conduct a large number of connected transactions. These are carried out, mainly, between listed companies, on the one hand, and groups controlled by their major shareholder, on the other.⁴⁵

Entrenchment Risk

60. A further reason put forward is that it is impractical for shareholders to make decisions collectively on a day-to-day basis, so they are required to delegate this decision making power to managers and vote to decide on only the most important decisions, such as the election or removal of those “managers” (i.e. directors). In theory, the knowledge that they can be removed by shareholders means managers are incentivised to act in the best interests of the company as a whole, and to perform well.
61. If a company has a superior voting right structure, its managers are insulated (to a degree that depends on the nature of the WVR structure) from the threat of removal. For example, “minority” shareholders with superior voting rights have a greater ability to vote down takeover proposals at general meetings. This means that no matter how poorly they perform, it is difficult for the company’s fortunes to be revived by an outside bidder replacing management, without management consent (see also Appendix IV, paragraph 21).

Importance of High Regulatory Standards

62. The continued improvement of market quality to further Hong Kong’s development as a major international financial centre has long been a Government aim. The Financial Services and the Treasury Bureau has stated, as part of its policy initiatives, that “[a] sound and effective regulatory regime is of paramount importance in maintaining investor confidence and our standing as a pre-eminent financial centre. Over the years, the Government has been making continuous enhancements to our regulatory regime in the light of operational experience, market development and evolving international standards.”⁴⁶
63. Investor protection is central to Hong Kong’s high regulatory standards. The “one-share, one-vote” policy has, for many years, been seen as an important aspect of

⁴⁴ Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, “Tunnelling”, (2000), *American Economic Review* 90, 22–27.

⁴⁵ These represented about 75% of the connected transactions announced in 2011. Source: HKEx data.

⁴⁶ Legislative Council of Hong Kong website: Legislative Council Panel on Financial Affairs (Papers), “*Information Note for LegCo Panel on Financial Affairs Policy Initiatives of the Financial Services and the Treasury Bureau*”, CB(1)35/07-08(01), (October 2007), paragraph 20.

the fair and equal treatment of shareholders principle to mitigate the risks described above and, hence, to protect investors.

OECD Report on Proportionality

64. In December 2007, the OECD⁴⁷ Steering Group on Corporate Governance issued a paper on proportionality between ownership and control for listed companies.⁴⁸ The OECD Report reached the following conclusions:
- (a) subject to certain conditions (see paragraph 65 below), there is nothing “a priori”⁴⁹ onerous about separating ownership and control, although those benefiting from a disproportionate degree of control may have incentives to seek private benefits at the cost of non-controlling shareholders;
 - (b) the cost of regulating proportionality would be considerable, and simply ruling out voting right differentiation on companies’ shares would neither be effective nor efficient. This is because a number of alternative “proportionality limiting mechanisms” could be used to achieve a similar effect;
 - (c) strengthening corporate governance frameworks is a better alternative; and
 - (d) specific problems can be dealt with through carefully targeted regulation.
65. The OECD Report identifies three conditions it states appear of vital importance:
- (a) liquid and well-informed capital markets that are able to price correctly the likely disadvantage of “proportionality limiting mechanisms” to outside shareholders;
 - (b) laws and regulations preventing extraction of private benefits from reaching socially unacceptable levels; and
 - (c) proper implementation mechanisms, including prompt and affordable legal recourse for all shareholders.⁵⁰
66. With reference to points (b) and (c) above, the OECD suggests preventative measures that may include connected transaction regulation, pre-emptive rights, qualified majorities for certain shareholder decisions and the ability of minority shareholders to convene a meeting of shareholders. The OECD also suggests post-event means of redress including derivative and class action suits and enforcement and investigation by regulatory authorities (see the discussion in paragraphs 67 to 74 directly below).

Hong Kong and US Approaches to Investor Protection

General

67. As we explain in Chapter 3, we principally compete with US exchanges for Mainland Chinese listings. These exchanges permit WVR structures. However, the permissive

⁴⁷ The OECD is an organisation of countries that aims to stimulate economic progress and world trade. It has 34 member countries that include those from North and South America to Europe and the Asia-Pacific region.

⁴⁸ OECD, “*Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion*”, (December 2007).

⁴⁹ Knowledge reached without experience in practice.

⁵⁰ OECD Report, paragraph 7.3, page 40.

nature of the the US regime has to be put in the context of the rights of shareholders, investing in such companies, enjoy under relevant US corporate and securities laws and the different characteristics of the Hong Kong and the US markets.

68. The World Bank and International Finance Corporation’s “Doing Business 2014” measure of business regulations ranks Hong Kong third in the world for investor protection (the US is ranked sixth) and awards a particularly high score, nine out of 10, to Hong Kong for regulation of connected transactions that aim pre-emptively to stop controlling shareholders from extracting private benefits through “value-shifting” (see paragraph 59).⁵¹ The average for all OECD high income economies for this measure is seven out of 10.
69. However, the World Bank Report ranks the US higher than Hong Kong for the ease by which shareholders can obtain legal redress for damages. The US is given a score of nine out of 10 compared to Hong Kong’s score of eight out of 10. The OECD rich economy average score is 5 out of 10. This suggests that the US and Hong Kong are actually quite closely matched in providing shareholders with legal means of redress through private actions.
70. Both the US and Hong Kong place a high priority on investor protection but achieve this goal differently. The US regime places greater emphasis on the ease by which shareholders can take private action to achieve redress for damages after abuse has occurred. The SEC, as the US federal securities regulator, is primarily responsible for ensuring that listed companies disclose all information that is necessary for investors to make informed investment decisions. Disclosure is also central to our Listing Rule requirements and private legal actions are possible here but are more difficult to take, for the reasons set out below. In Hong Kong, greater reliance is placed on Rules to prevent the abuse of control before it occurs (e.g. through connected transaction Rules) and post-event legal action, involving listed companies, is primarily carried out on shareholders’ behalf by the SFC.
71. In Hong Kong, the SFC, as Hong Kong’s statutory securities regulator, has, as noted by the FSDC “*repeatedly broken new ground by conducting “surrogate” actions*” on behalf of listed company shareholders using various powers given to it under sections 212 to 214 of the SFO:⁵²
 - (a) Under section 212, in 2013, the SFC applied to the court for an order to wind up China Metal Recycling Holdings Limited (stock code: 773) to protect the interests of shareholders and creditors and the investing public. The court granted provisional liquidators extensive powers to investigate and manage the company’s affairs;
 - (b) Under section 213, the SFC obtained an interim order to freeze the assets of Hontex International Holdings Company Limited (now de-listed) and obtained a further order for a shareholders-approved, court-administered HK\$1.03 billion share buy back scheme; and

⁵¹ The World Bank and International Finance Corporation, “Doing Business 2014 – United States”, page 62 and “Doing Business 2014 – Hong Kong SAR, China”, page 58.

⁵² FSDC, “*Positioning Hong Kong as an International IPO Centre of Choice*”, (18 June 2014), paragraph 4.4.3, page 44.

- (c) Under section 214 the SFO has applied to the court for remedies in cases of unfair prejudice to the interests of members of listed corporations, which has issued disqualification orders against directors.⁵³ The SFC 2012/13 annual report states that it had ongoing section 214 actions against 19 persons and completed actions against five persons.⁵⁴

Shareholders' Private Litigation Rights

72. The two main methods for minority shareholders to bring private actions against listed companies in Hong Kong are the unfair prejudice remedy and the derivative action. Under the former, a member of a company (including a non-Hong Kong incorporated listed company) can petition the court for an appropriate order if the affairs of the company have been carried out in a manner which is unfairly prejudicial to the interests of all or some of the members. In a derivative action a member of a company can bring an action on behalf of a company against a wrongdoer (e.g. a director).⁵⁵ Both of these remedies have statutory backing.⁵⁶
73. In the US, such shareholder litigation is relatively common. Private plaintiffs can initiate a class action lawsuit for violation of federal securities laws and this is more common than SEC enforcement action. In Hong Kong, there is currently no class action regime. Private actions (as referred to above) require considerable cost, time and effort to bring and so, practically speaking, they are much less available. In the US, shareholders are able to retain counsel on a contingency fee basis and a company is required to pay the shareholders' legal fees in a derivative action if the lawsuit is successful. We explain these differences in more detail in Appendix V. Whilst the US class action system is subject to some criticism, it is generally recognised that this regime results in heightened scrutiny of corporate actions and generally acts as a deterrent to mis-governance.

Different Characteristics of the US and Hong Kong Markets

74. Retail investors still make up a significant proportion of minority shareholders in Hong Kong compared to the US. The HKEx Retail Investor Survey 2011 found that a relatively large proportion of the adult Hong Kong population, 34% (or 2,035,000 individuals), were shareholders.⁵⁷ This compares to 15% of families in the US that are

⁵³ In March 2012, The Court of First Instance ordered the founder and former chairman of Styland Holdings Ltd and his wife, a former executive director, to pay compensation totalling over HK\$85 million to the company for their misconduct. In September 2012, The Court of First Instance ordered, the former chief executive officer of Medical China Limited (now China Asean Resources Limited (China Asean Resources)), to pay HK\$10.7 million in compensation to the company resulting from his misconduct.

⁵⁴ SFC Annual Report 2012-13, Table 9, page 127.

⁵⁵ An action taken by shareholders on behalf of a company against third parties (usually directors). Directors have contractual and fiduciary obligations to a company. A company has contractual obligations to shareholders. However, there is no direct contractual relationship between directors and shareholders. If directors wrong the company and, by doing so, damage shareholders' interests, it is for the company, not the shareholders, to take action. The company may not be willing to do so because it is controlled by the directors.

⁵⁶ Section 214 of the SFO (unfair prejudice) and sections 168BA to 168BK of the former Companies Ordinance (sections 731 to 738 of the new Companies Ordinance) (derivative action).

⁵⁷ HKEx, "Retail Investor Survey 2011", (April 2012), pages 1 and 5 (see [link](#)).

shareholders.⁵⁸ In Hong Kong, retail investors represented 22% of all cash market trading for the 12-month period from October 2012 to September 2013.⁵⁹ In the US, trades by retail investors represent, on average, less than 2% of NYSE trading volume for NYSE listed firms.⁶⁰

Other Considerations

75. The OECD Report (see paragraphs 64 to 66) reaches the following additional conclusions:
- (a) Investors are mostly sophisticated enough to assess the risks and expected losses that may arise from WVR structures. They state that the empirical evidence suggests investors extract a price for assuming these risks in the form of a discount (see also Appendix IV).
 - (b) The cost of regulating proportionality may outweigh the regulatory benefits if all structures that separate ownership from control (e.g. pyramid structures, cross-holdings and shareholder voting agreements) are prohibited.
76. For the sake of completeness, we mention that a number of further arguments have been put forward by commentators and others as grounds for allowing WVR structures for companies currently listed or seeking to list on the Exchange. These include the arguments that:
- (a) WVR structures may promote long-termism as they give incumbent managers the freedom to run a business for the purpose of maximising growth and value for shareholders over the long term and to combat the short-termism of markets.
 - (b) Restricting WVR structures limits investors' ability to invest in companies with a WVR structure; makes the Exchange a less efficient marketplace for ensuring the effective allocation of capital from investors to listed companies; and prevents controlling shareholders from diversifying their wealth into other entrepreneurial projects for the benefit of the market as a whole.
 - (c) Fast growing companies seeking an IPO may already have had one or more rounds of private equity or debt financing and exhausted their ability to grow through private investment. As a result, the founders may have diluted their own stake in the company. A WVR structure at IPO enables the company to grow further whilst maintaining continuity of management.
77. In summary, it is clear that the "one-share, one-vote" concept has been seen as important to investor protection in Hong Kong and there are good reasons why that is the case. On the other hand, it is not a universal norm of investor protection and commentators differ as to its appropriateness or rigid application in all circumstances.

⁵⁸ Source: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances", (June 2012), page 28. The definition of a "family" in this report includes a single person with no children.

⁵⁹ HKEx, "Cash Market Transaction Survey 2012/13", (February 2014), page 7 (see [link](#)).

⁶⁰ Alicia Davis Evans, "A Requiem for the Retail Investor?", Virginia Law Review, Vol. 95, No. 4:1105, (June 2009).

78. The globalisation of financial markets has meant that Chinese companies and overseas companies seeking to raise capital with a WVR structure have the option to list elsewhere rather than list in Hong Kong. Similarly, Hong Kong investors can trade shares on foreign exchanges through their broker or using online services. For these reasons, it is likely that arguments relating to the Exchange's competitive position vis-à-vis other markets, principally the US, but also Singapore and the UK, require the most consideration and debate; the Exchange has, therefore, focused on this issue in more detail in Chapter 3.

CHAPTER 2: CURRENT HONG KONG POSITION

The Restriction

79. The Hong Kong Companies Ordinance (Cap 622) allows a Hong Kong incorporated company to provide, in its articles, for the issue of multiple classes of shares with different voting rights.⁶¹ However, a company is not permitted to list on the Exchange with shares that have a voting power that does not bear a reasonable relationship to the equity interest of those shares.
80. This restriction also applies after listing. The effect is to prohibit the listing of companies with multiple voting shares, inferior par value shares and non-voting ordinary shares, as well as the listing of new classes of these shares by existing listed issuers. A company can list with such shares only in “exceptional circumstances”. To date, the Exchange has not listed a company using this exception.
81. Listing Rule 8.11⁶² states:
- “The share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid (“B Shares”). The Exchange will not be prepared to list any new B Shares issued by a listed issuer nor to allow any new B Shares to be issued by a listed issuer (whether or not listing for such shares is to be sought on the Exchange or any other stock exchange) except:-*
- (1) in exceptional circumstances agreed with the Exchange; or*
- (2) in the case of those listed companies which already have B Shares in issue, in respect of further issues of B Shares identical in all respects with those B Shares by way of scrip dividend or capitalisation issue, provided that the total number of B Shares in issue remains substantially in the same proportion to the total number of other voting shares in issue as before such further issue.”*
82. Although this Listing Rule refers to “voting power”, we interpret this to be intended to restrict all WVR structures, including those that give enhanced or exclusive director election rights (see Chapter 5). This would also apply if such rights were embedded in the articles of the relevant company through a mechanism that did not involve the creation of two classes of shares, if the effect was the same.

History of the Restriction

1970s – the first “B” share issues

83. The restriction described above was implemented in the 1989 edition of the Listing Rules. In the previous decade, between January and August 1972, five companies in the Wheelock Marden group of companies, a conglomerate with real estate, shipping

⁶¹ Companies Ordinance (Cap 622), section 588(4) and section 50(4) of the Companies (Model Articles) Notice.

⁶² GEM Listing Rule 11.25 is broadly the same as Main Board Rule 8.11 but does not have an exemption for companies that already have “B” shares in issue. No GEM listed company has “B” shares in issue.

and other interests, conducted issues of “B” shares to raise capital.⁶³ Two other companies, Local Property and Printing Company Limited and Swire Pacific Ltd (stock codes: 19/87), followed Wheelock’s example and also issued “B” shares in 1972 and 1973 respectively.

84. These “B” shares entitled the holder to one vote per share and so had equal voting power to the company’s existing “A” shares on matters subject to a shareholder vote at general meetings. However, the “B” shares had a lower par value and consequently entitled the holders to a fraction of the dividends that “A” shareholders could claim. “B” shares were issued with an entitlement to either a fifth or a tenth of “A” share dividends. This meant these “B” shares traded at prices lower than the “A” shares, in proportion to their lower dividend entitlement. For example, Swire Pacific Ltd’s “B” shares trade at about a fifth of the price of its “A” shares, matching the fact that five of its “B” shares are equivalent, in terms of dividend payments, to one “A” share.⁶⁴
85. “B” share issuers stated, at the time, that their intention was to raise money for the purchase of real estate and to expand their businesses. For example, Lane Crawford Limited, one of the Wheelock group companies, said it planned to use part of the funds raised by its “B” share rights issue to redevelop Lane Crawford House.⁶⁵ Also, Wheelock Marden and Company Limited stated that they were issuing “B” shares *“in order to attract smaller investors and to provide a wider market in the shares of the company”*.⁶⁶ Similarly, Local Property and Printing Company Limited stated it *“considered that the low denomination new ‘B’ class of share [would] increase the flexibility of the company’s finances and by appealing to the smaller investor should create a wider market for the company’s shares”*.⁶⁷

1980s – Prohibition on listing of “B” Shares

86. In late March 1987, each of Jardine Matheson Holdings Limited, Cheung Kong (Holdings) Ltd (stock code: 1) and Hutchison Whampoa Ltd (stock code: 13) announced their intention to offer “B” shares via a bonus issue. Like the earlier issues by the Wheelock group, these “B” shares would have equal voting rights to the company’s existing ordinary shares, but a fraction of their par value and dividend entitlement. The Hang Seng Index fell by 3.7% after the announcement of these proposals. Having closed at 2,799 on Friday 27 March 1987, the date of Jardine Matheson’s announcement, the Hang Seng Index finished at 2,696 on Wednesday 1 April 1987, following the “B” share announcement of Hutchison Whampoa the day before.
87. On 8 April 1987, the Exchange and the then Office of the Commissioner for Securities issued a joint announcement that the listing of “B” shares would no longer be permitted. The market rebounded following this announcement, with the Hang Seng Index rising to the month’s high at 2,785 on 9 April (up 2.0% from the previous day’s close at 2,730

⁶³ Wheelock Marden and Company Limited, Wheelock Maritime International Limited, Hong Kong Realty and Trust Company Limited, Realty Development Corporation Limited and Lane Crawford Limited.

⁶⁴ Swire Pacific Ltd website, “Investor Relations”, “Share Price”.

⁶⁵ Lane Crawford Limited, 1972 annual report, page 5.

⁶⁶ Wheelock Marden and Company Limited, 1972 annual report, page 11.

⁶⁷ Local Property and Printing Company Limited, 1972 annual report, page 5.

and 4.5% from a low of 2,665 on 7 April, the day before the joint announcement). The announcement stated that this decision was made “*in light of the disadvantages likely to occur in listing such shares and because of the strong opposition by both Hong Kong and overseas brokers*”.⁶⁸

Standing Committee on Company Law Reform Review

88. Following the events of April 1987, the then Financial Secretary, Sir Piers Jacobs, asked the Standing Committee to consider the question of “B” shares. The Standing Committee published its findings in July 1987.⁶⁹ That report forms Appendix I.
89. The Standing Committee report noted that, at the time, five companies had a dual-class share structure.⁷⁰ The Committee stated that it had been asked to consider “... *whether or not the present ability of companies to issue shares with voting rights disproportionate to their nominal value is in the general interest of shareholders, and in the public interest, and if not, to identify whether any changes to the present legislative framework are desirable.*”

US Securities and Exchange Commission Inquiry

90. The Standing Committee report also noted that, in the US, a SEC inquiry had begun seven months earlier, into the NYSE proposal to change its then long-held practice of refusing to list companies with dual-class share structures. It stated that it had obtained copies of the submissions made to that inquiry. This inquiry is described in more detail in Appendix III, paragraphs 9 to 14.

Standing Committee Recommendations

91. The Standing Committee report stated that, in the circumstances, the possibility of a hostile takeover bid was probably the reason for a company to issue “B” shares. As the “B” shares issued by Hong Kong companies carried one vote per share but traded at a lower market price (because of their lower dividend entitlement), they were a cheap way for controllers to purchase voting power and consolidate their control. The Standing Committee said it was understandable that companies controlled by founding families or entrepreneurs should wish to retain that control, yet still have the opportunity to employ equity financing when needed.
92. The Standing Committee report also noted that in the context of Hong Kong’s reversion to Chinese sovereignty in 1997, the issue of “B” shares could be used by a majority interest to free substantial portions of its capital for transfer overseas while still maintaining actual control within Hong Kong. A controller could achieve this by selling “A” shares and, at the same time, purchasing “B” shares in equal proportion. The adoption of such a practice to any significant extent could “*easily lead to a lessening of confidence in Hong Kong as a major financial centre*”. For this reason, the Committee was opposed to the indiscriminate issue of “B” shares.

⁶⁸ Stock Exchange of Hong Kong “Securities Bulletin”, May 1987, page 32.

⁶⁹ “Third Interim Report of the Standing Committee on Company Law Reform: B Shares”, July 1987

⁷⁰ Swire Pacific Limited, Hong Kong Realty and Trust Co. Ltd, Lane Crawford Ltd, Local Property Co. Ltd and Realty Development Co Ltd. Wheelock Marden Company Limited (see paragraph 83) had been acquired and privatised in 1985 by World International founder Sir Yue-kong Pao.

93. The Standing Committee report commented that it would be difficult to draft effective controls over differential voting rights in legislation. This would also be a radical departure from established legislative policy in Hong Kong and similar jurisdictions. The inherent inflexibility of any such legislation may also cause other unforeseen problems.
94. The Standing Committee report stated that it was “...*opposed to the indiscriminate issue of shares of this kind. Nevertheless it is felt that there is a legitimate need for their continued availability in exceptional circumstances of the kind mentioned above and perhaps in others* (emphasis added).” The circumstances mentioned earlier in the report are:
- “Other factors, for example, national security or the interests of the community as a whole, may also in particular circumstances make it desirable that ultimate control should be concentrated in particular hands, although there is support for the view that the use of B shares for these purposes is normally acceptable only when a company first applies for a listing and there is no question of protection for minority shareholders.”*⁷¹
95. The Standing Committee concluded that control over “B” share structures should be maintained by approval on a case-by-case basis governed by the Listing Rules. This was the solution advocated by several companies and organisations that submitted their views on the subject. The Standing Committee also recommended that the issue of “B” shares should be approved by a substantial number of a company’s shareholders, excluding the controlling shareholder.

Restriction Codified in Listing Rules

96. The restriction on the listing of “B” shares announced on 8 April 1987 (see paragraph 87), together with most of the Standing Committee’s recommendations, were codified in the December 1989 edition of the Main Board Listing Rules, as Rule 8.11.⁷² To date, this Listing Rule has not changed. The Rule takes up the wording of the 1983 NYSE Listed Company Manual and states that the share capital of a new applicant must not include shares of which the proposed voting power does not bear a “reasonable relationship to the equity interest” of such shares (see paragraph 81).⁷³ It operates to prevent the listing or issue of new “B” shares other than in “exceptional circumstances”.

⁷¹ See Appendix I, paragraphs 8 and 12.

⁷² The Exchange and the Securities Commission had also issued a joint announcement on 14 September 1988 stating that, “as a general rule”, the Exchange would not list any new “B” shares and would not permit listed companies to issue any new “B” shares other than exceptional circumstances agreed with the Exchange and the Commissioner for Securities. This announcement was substantially the same in form to Rule 8.11.

⁷³ NYSE Listed Company Manual § 3 (1983) rule 313.00(D).

CHAPTER 3: COMPETITIVENESS OF HONG KONG

Hong Kong as an International Financial Centre

97. Hong Kong has successfully established itself as an international financial centre and a leading venue for the listing of shares. The total market capitalisation of the companies listed on the Exchange has grown more than fourfold over the past decade to almost HK\$24 trillion as at 31 December 2013⁷⁴ and, in each of the past five years, Hong Kong has ranked among the top four IPO markets globally in terms of funds raised.⁷⁵
98. A Financial Services Action Group was established by the Government, in 2006, following the Economic Summit on “China’s 11th Five-Year Plan and the Development of Hong Kong”. Its report concluded that, from a strategic perspective, with an economy that is one of the largest in the world and rapidly growing, it is important that China should have an international financial centre of global significance, and one that is comparable to New York and London in terms of scale and scope of its financial services and instruments offered.⁷⁶
99. Key factors underlying Hong Kong’s success have included our common law system, rule of law upheld by an independent judiciary, a robust regulatory regime, and a simple and transparent taxation system.⁷⁷ The Government and the regulatory authorities have continuously sought to bolster Hong Kong’s attractiveness to issuers and investors through enhancements to our regulatory regime. Recent examples include, Government legislation that, on 1 January 2013, gave statutory backing to the obligation for listed companies to disclose inside information.⁷⁸ In 2013, corporate announcements about inside information increased by 52% and profit alerts and warnings went up 16% from 2012.⁷⁹ In addition, the new sponsors regime came into effect on 1 October 2013 with the goal of ensuring that “...investors can be confident in the quality of sponsors’ work so as to maintain Hong Kong’s reputation as a leading international financial centre.”⁸⁰
100. In January 2013, the FSDC was established by the Government to formulate proposals to promote the further development of Hong Kong’s financial services industry and map out the strategic direction of Hong Kong as an international financial centre. The FSDC noted that Hong Kong still faces fierce competition from other financial centres including New York, London and Singapore.
101. The FSDC stated in a report published in November 2013, that the regulatory framework and approach of Hong Kong have been effective in protecting investors, upholding market integrity, and ensuring financial stability. Nevertheless, the FSDC

⁷⁴ Source: HKEx Fact Book 2013, “Market Capitalisation 1986 – 2013”, page 27. Market capitalisation figure as at the end of 2003 and 2013 was HK\$5,478 billion and HK\$23,909 billion respectively (see [link](#)).

⁷⁵ Source: World Federation of Exchanges website, Monthly Statistics Table 1.5.

⁷⁶ “Report of the Focus Group on Financial Services”, (January 2007), paragraphs 1.09 to 1.10.

⁷⁷ *Hong Kong: China’s Global Financial Centre*, (November 2013), published by the Government of the HKSAR.

⁷⁸ Securities and Futures (Amendment) Ordinance 2012.

⁷⁹ SFC Website, News, “One year into statutory regime on disclosure of inside information”, (9 January 2014).

⁸⁰ SFC, “Consultation Paper on the regulation of sponsors”, (May 2012), paragraph 34.

concludes that, as the financial services sector develops in its sophistication and diversity, certain areas of our regulatory regime would deserve periodic reviews to ensure that it catches up with the development of the market.⁸¹ The FSDC recently commented in its paper “Positioning Hong Kong as an International IPO Centre of Choice” that:

*“If the right balance can be struck between market efficiency and high regulatory standards, introducing a suitable level of flexibility in the rules may help attract more types of enterprises to the market and diversify the range of companies listed in Hong Kong.”*⁸²

Competition for Mainland Chinese Company Listings

102. Hong Kong is the leading securities market for the listing and trading of Mainland Chinese enterprises outside the Mainland itself. In 2010, the Exchange hosted the world’s largest IPO, Agricultural Bank of China Limited (stock code: 1288) which raised US\$22 billion by issuing H-shares in Hong Kong and A-shares in Shanghai. The IPOs of Mainland Chinese companies, on average, accounted for 73% of all the funds raised on the Exchange through IPOs in the last 10 years. As at the end of 2013, these companies represented 50% of all listed companies, 57% of total market capitalisation and 70% of total equity turnover.⁸³
103. Proximity, both geographically and politically, has played a role in Hong Kong’s success in attracting Mainland issuers. This success, however, could not have been achieved without international regulatory standards that have helped underpin investor confidence in our market. A brochure issued by the Government states:

*“Hong Kong has been the best place to share in the Mainland’s economic expansion by investing in Mainland equities under international regulatory standards in Hong Kong.”*⁸⁴
104. Hong Kong should be the natural first choice for Mainland Chinese companies wishing to raise funds from both international investors and local investors familiar with their products and services. However, the Financial Services Action Group noted, in 2007, that all international finance centres were keen to capture the Mainland’s international financial transactions and are able to do so given the increasing globalisation of financial markets.
105. The FSDC has recently recommended that Hong Kong consolidate its position as the premier international capital raising centre for Mainland Chinese companies, both

⁸¹ FSDC, Research Paper No.1, “*Strengthening Hong Kong as a Leading Global International Financial Centre*”, (November 2013), paragraphs 9(b) and (g) and 31.

⁸² FSDC, “*Positioning Hong Kong as an International IPO Centre of Choice*”, (18 June 2014), “1.4 Possible Way Forward”, page 8.

⁸³ Source: HKEx. Includes H-share companies, Red-Chip companies and Mainland private enterprises. H-share companies are enterprises that are incorporated in the Mainland which are either controlled by Mainland Government entities or individuals. Red-chip companies are enterprises that are incorporated outside of the Mainland and are controlled by Mainland Government entities. Mainland private enterprises are companies that are incorporated outside of the Mainland and are controlled by Mainland individuals.

⁸⁴ *Hong Kong: China’s Global Financial Centre*, (November 2013), published by the Government of the HKSAR.

state-owned and private, by ensuring that our listing regulations are competitive, while maintaining our quality standard.⁸⁵

Mainland Chinese Companies Listed in the US

106. Although it is Hong Kong's strategy to be Mainland Chinese companies' first choice when seeking to raise capital in an international financial centre, several have instead chosen to primary list in the US. As at 31 May 2014, 102 Mainland Chinese companies were primary listed on US exchanges. Almost a third of these (30 of 102 companies) have a WVR structure (see Chart 1).

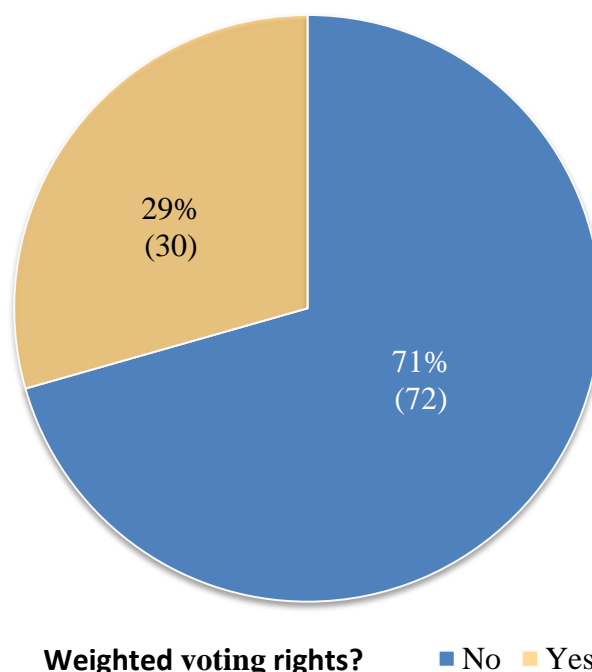


Chart 1: Percentage of US Listed Mainland Chinese Companies with WVR Structures⁸⁶

107. WVR structures have recently become more popular for Mainland Chinese companies listing on US exchanges. From 2011 to 31 May 2014, the number of Mainland Chinese companies listing in the US with WVR structures has been greater than those listing without them (see Chart 2). In 2014 to date, nine of the 12 Mainland Chinese companies to list in the US have done so with a WVR structure.

⁸⁵ FSDC, Research Paper No.1, "Strengthening Hong Kong as a Leading Global International Financial Centre", (November 2013), paragraphs 9(b) and (g) and 31.

⁸⁶ Companies headquartered in Mainland China that raised funds via an IPO (excluding reverse mergers) through the issuance of ordinary shares (or depositary receipts over ordinary shares) by primary listing on the main or junior boards of NYSE or Nasdaq. Companies that are also listed in Hong Kong or Mainland China are excluded as are those that were suspended or de-listed as at 31 May 2014. Source: Bloomberg. Data as at 31 May 2014.

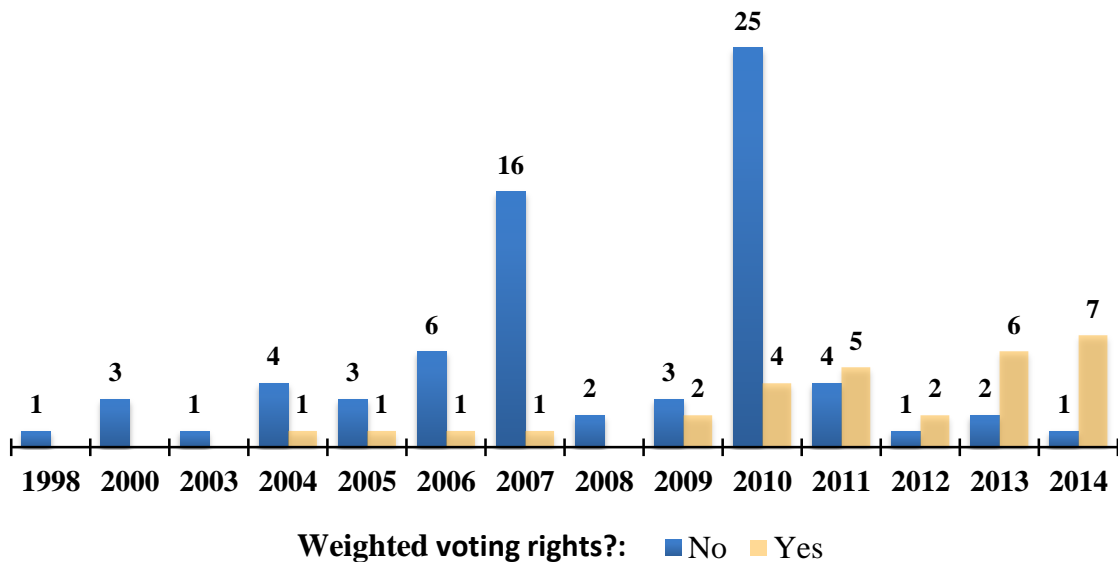
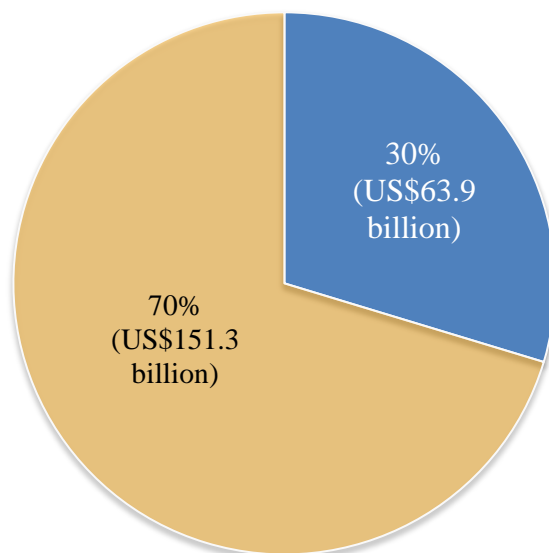


Chart 2: Numbers of Mainland Companies Listing on US Exchanges with WVR structures: 1998 to 2014⁸⁷

108. Although they represent only a third by number (see Chart 1), US listed Mainland companies with WVR structures have a combined market capitalisation of US\$151.3 billion which is 70% of the total market capitalisation of all US listed Mainland Chinese companies (see Chart 3). They raised US\$8.5 billion in funds through their US IPOs which represents almost half (48%) of all IPO funds raised by US listed Mainland companies (see Chart 4).

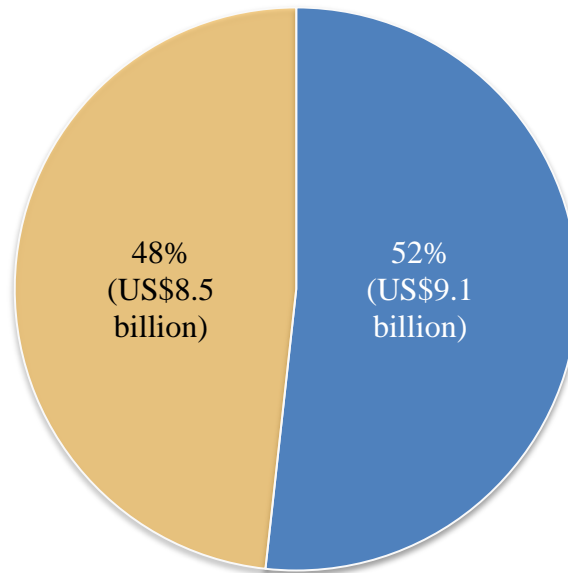


Weighted voting rights? ■ No ■ Yes

Chart 3: Market Capitalisation of US Listed Mainland Chinese Companies⁸⁸

⁸⁷ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies.

⁸⁸ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies.



Weighted voting rights? ■ No ■ Yes

Chart 4: Funds Raised by US Listed Mainland Chinese Companies⁸⁹

109. The majority (70%) of US listed Mainland Chinese companies with WVR structures are from the information technology industry (see Chart 5). These IT companies represent 90% (US\$136.7 billion) of the market capitalisation of all US listed Mainland Chinese companies with a WVR structure (see Chart 6). Representatives from a broad range of other industries make up the remainder of companies with a WVR structure.

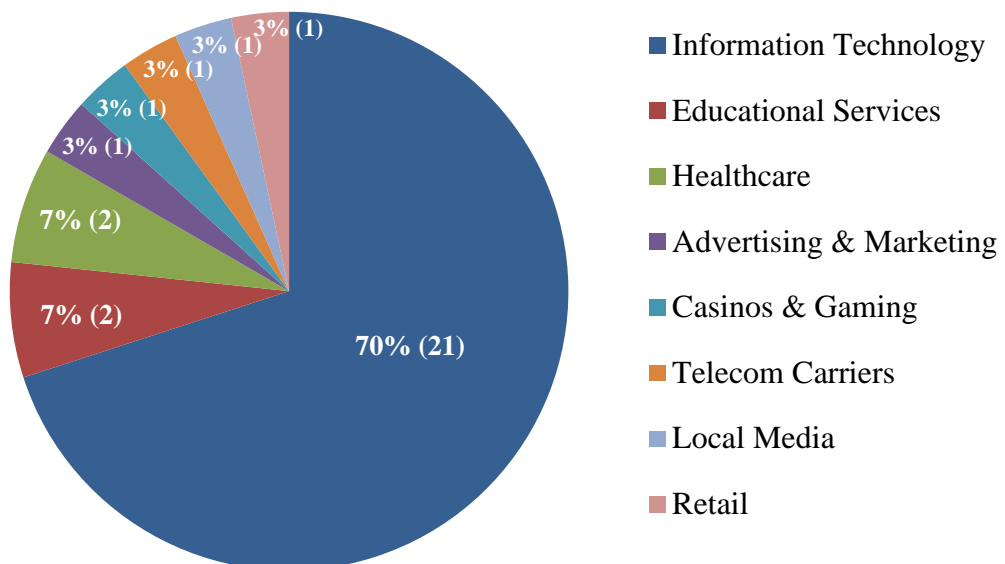


Chart 5: US Listed Mainland Chinese Companies with WVR Structures: Percentage by Sector⁹⁰

⁸⁹ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies.

⁹⁰ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies. Percentages do not add up to 100% due to rounding. “Healthcare” includes companies belonging to the BICS industry groups “Cardiovascular Devices” and “Health Care Services”.

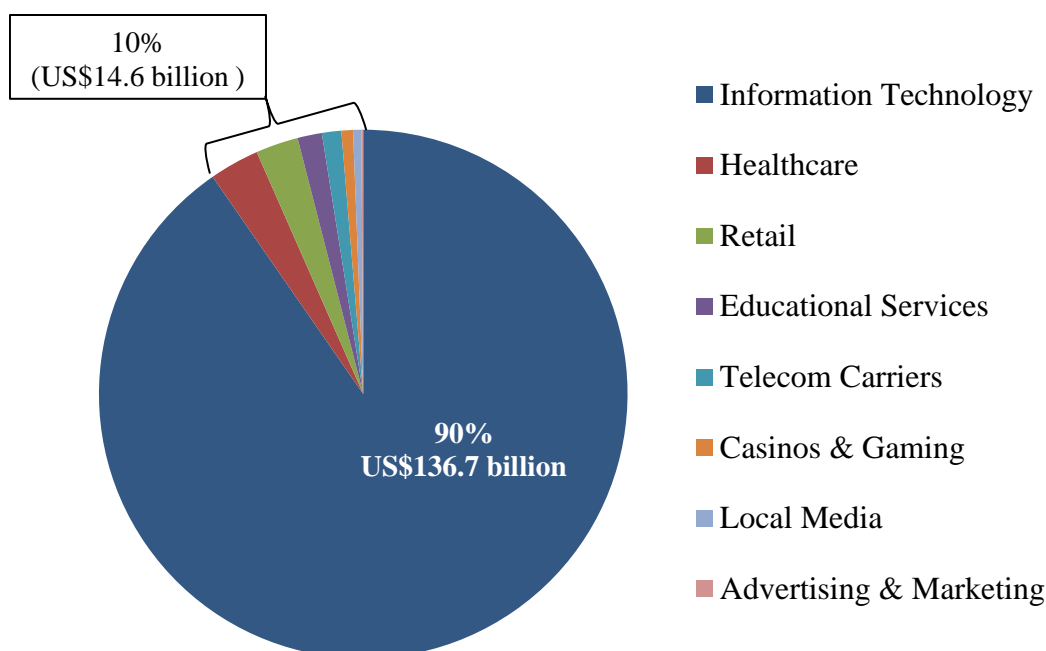


Chart 6: US Listed Mainland Chinese Companies with WVR Structures: Percentage of Total Market Capitalisation by Sector⁹¹

Information Technology Industry Representation on the Exchange's Markets

110. The information technology industry represents only 7% of the total market capitalisation of all listed companies in Hong Kong (see Chart 7). Financials and properties & construction are the two largest industries by market capitalisation.
111. Only two information technology companies (Tencent Holdings Limited (stock code: 700) and Lenovo Group Limited (stock code: 992)) are included in the 50 constituents of the Hang Seng Index, an index of the largest and most liquid stocks listed on the Main Board of the Exchange.
112. Of the 343 companies listed in Hong Kong between 1 January 2010 and 31 December 2013, only 22 (6%) were from the information technology industry.⁹²

⁹¹ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies. "Healthcare" includes companies belonging to the BICS industry groups "Cardiovascular Devices" and "Health Care Services".

⁹² Newly listed companies of ordinary equity on both Main Board and GEM, excluding transfers of listing between these boards. Industry classification as at listing date. Source: HKEx.

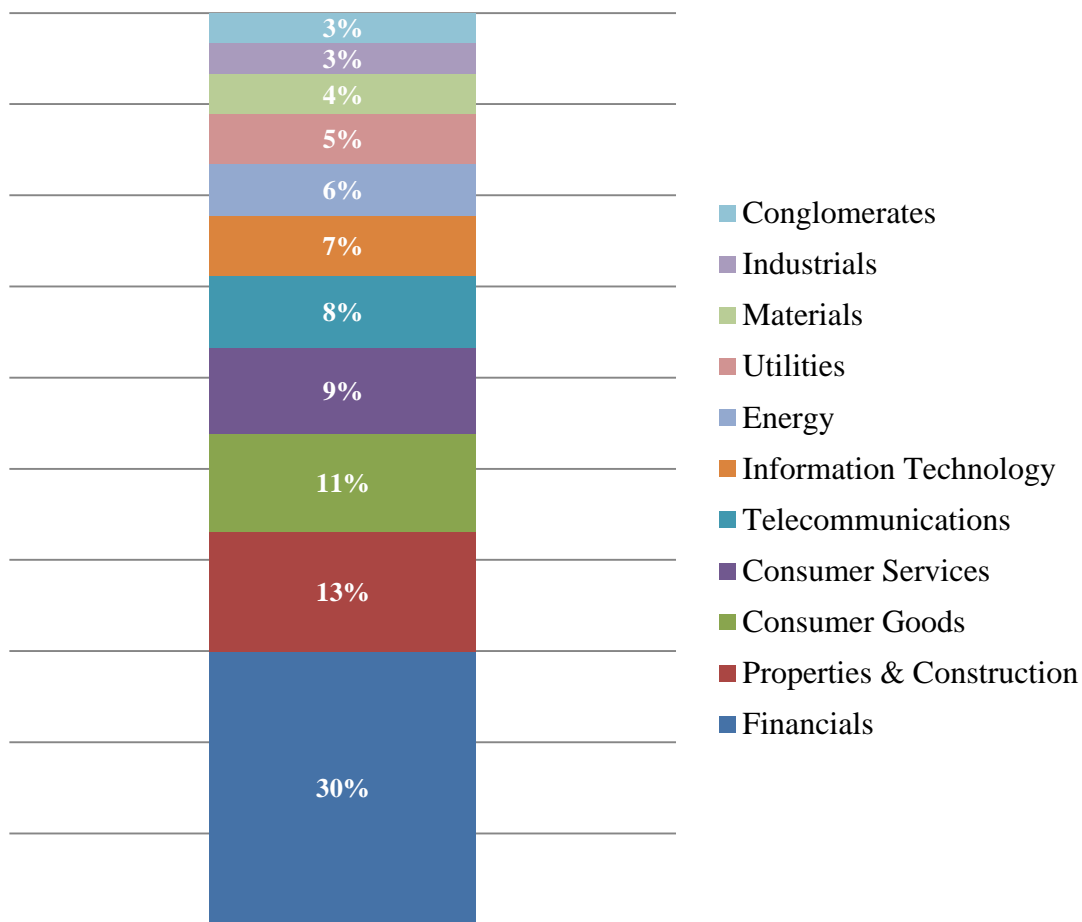


Chart 7: Breakdown of Hong Kong Market Capitalisation by Industry⁹³

113. US listed Mainland Chinese information technology companies had, as at 31 May 2014, a total market capitalisation that was almost equivalent to that of listed IT companies in Hong Kong (see Chart 8). However, this market capitalisation was generated by far fewer companies. The average market capitalisation of Mainland Chinese IT companies in the US, as at 31 May 2014, was US\$3.8 billion compared to an average of only US\$1.2 billion in Hong Kong.
114. As at 31 May 2014, 172 information technology companies were listed in Hong Kong and had a total market capitalisation of US\$211 billion. The size of this section of the market would be larger by 27% in number and 84% by market capitalisation had all US listed Mainland Chinese information technology companies chosen, instead, to list in Hong Kong.

⁹³ Source: HKEx data as at 31 May 2014. Industry classifications (HSIC) provided by Hang Seng Indexes Company Limited. Figures do not add up to 100% due to rounding.

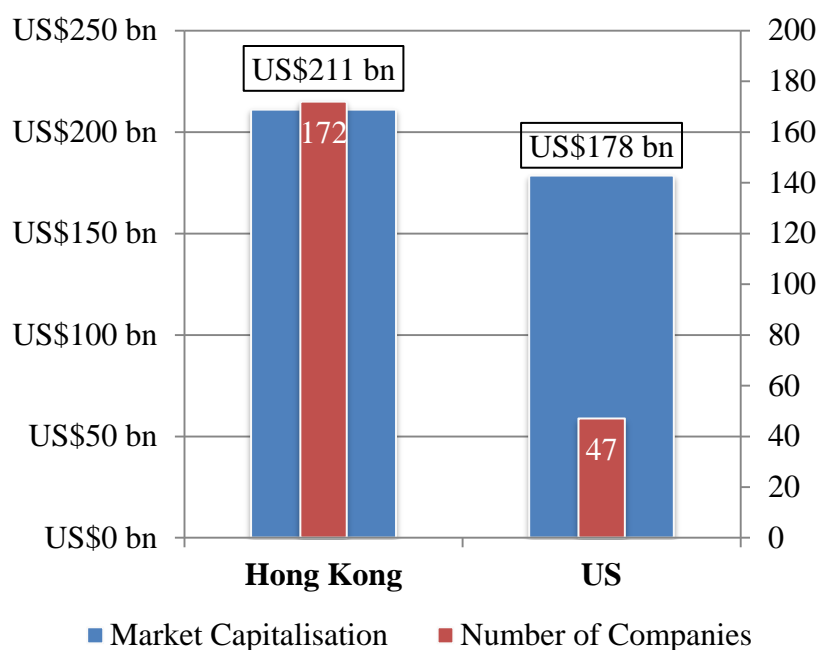


Chart 8: Hong Kong vs. US: Market Capitalisation and Number of Mainland Chinese Information Technology Companies⁹⁴

Competition for International Listings

115. Hong Kong has achieved some initial success in attracting overseas companies to list shares on the Exchange. As at 31 May 2014, overseas issuers⁹⁵ had raised a total of HK\$86.6 billion through listings in Hong Kong.⁹⁶ However, issuance has been dominated by companies from the natural resources, consumer brands and financial services sectors. These issuers tend to have had some pre-existing connection to China. Global companies without any significant Chinese connection have, to date, not been attracted to list here.
116. On 10 April 2014, the SFC and CSRC made a joint announcement regarding the in-principle approval for the development of the Shanghai-Hong Kong Stock Connect pilot programme. This will establish mutual stock market access between Mainland China and Hong Kong. The pilot programme will enable Mainland institutional investors and individual investors who meet certain criteria⁹⁷ to trade eligible Exchange securities.
117. HKEx has stated that Shanghai-Hong Kong Stock Connect is scalable in size, scope and market in the future⁹⁸ and cross-border capital raising may eventually be enabled through this programme, subject to regulatory approvals by the SFC and the CSRC.

⁹⁴ Source: HKEx and Bloomberg. Hong Kong data includes both Main Board and GEM. US data includes NYSE and NASDAQ markets. Data as at 31 May 2014.

⁹⁵ Issuers of ordinary equity securities incorporated outside the “recognised jurisdictions” of Hong Kong, the PRC, Bermuda and the Cayman Islands.

⁹⁶ Source: HKEx.

⁹⁷ Individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts.

⁹⁸ HKEx media presentation, 8 May 2014 (see [link](#)).

This would fundamentally alter Hong Kong's attractiveness as a listing venue for overseas companies, given the possibility of accessing Mainland investors directly through Hong Kong. The FSDC have stated that:

“With the introduction of the Shanghai-Hong Kong Stock Connect pilot programme and the availability of mutual stock market access between Hong Kong and the Mainland, Hong Kong is poised to make substantial headway in further consolidating its position as China’s gateway to the world. More importantly, this may be an additional incentive for overseas companies to list in Hong Kong and thereby gain access to both the Hong Kong and Mainland capital markets. The regulators should consider the ways in which our market can optimise this unique opportunity for growth.”⁹⁹

118. Consideration should also, therefore, be given to ensuring that the Hong Kong market is able to provide Mainland investors with a wide range of international investment opportunities. Appendix VII lists the top 25 US companies with dual-class share structures by market capitalisation (listed since 2001). They include global companies such as Google, Facebook, Visa and Mastercard. Companies with a dual-class share structure collectively represent 14% of the of the total market capitalisation of all large US listed companies.¹⁰⁰ Our current restriction on WVR structures would prevent any of these companies from listing in Hong Kong.
119. Also, as financial market liberalisations in the Mainland continue, there remain a number of competitive threats to Hong Kong's position as the leading gateway for investors into and out of Mainland China. This includes the risk of international companies bypassing Hong Kong if they are, in future, allowed to list directly on Mainland stock exchanges and/or international and Mainland investors gain more direct access to each other's markets.

Use of Alternative WVR Structures

120. As at 31 May 2014, 29 of the 30 Mainland Chinese companies listed in the US with WVR structures had two classes of shares that carry unequal voting rights at general meetings (see Appendix II).¹⁰¹ However, alternative WVR structures are used by other US listed companies. These are described further in Chapter 5. A 2012 report by IRRCi and Institutional Shareholder Services found that structures giving certain persons special rights to appoint a number (usually a majority) of directors to a company's board was particularly popular for media companies.¹⁰² Similarly, it would also be possible for a Mainland Chinese company to list in the US using an alternative

⁹⁹ FSDC, *“Positioning Hong Kong as an International IPO Centre of Choice”*, (18 June 2014), “1.4 Possible Way Forward”, page 8.

¹⁰⁰ US headquartered companies primary listed on NYSE or Nasdaq Global Select or Nasdaq Global Market or Nasdaq Capital Market with a market capitalisation greater than US\$2 billion. Excludes investment vehicles, private limited partnerships and limited liability companies. Data as at 31 December 2013. Source: Bloomberg and SEC company filings

¹⁰¹ LightInTheBox Holding Company Ltd has a single class share structure. However, its controlling shareholders have three votes per share on resolutions regarding a change of control that are subject to a shareholder vote at a general meeting (LightInTheBox Holding Company Ltd, articles of association, Exhibit 3.2 to Form F-1/A filed on 23 May 2013, paragraph 21.2).

¹⁰² IRRCi and ISS, *“Controlled Companies in the Standard & Poor's 1500: A Ten Year Performance and Risk Review”*, (October 2012).

structure to the conventional dual-class share structure. The alternative structures in use, or proposed, by US listed Mainland Chinese companies are described in paragraphs 142 to 146.

Competition with Other Jurisdictions

121. Other than the US, the Exchange principally competes with Singapore and the UK for the listings of Mainland Chinese companies.

Singapore

122. SGX in Singapore does not permit primary listed companies to have WVR structures (see Appendix III, paragraphs 82 to 84).
123. As at 31 May 2014, 57 Mainland Chinese companies were primary listed on SGX.¹⁰³ In 2010, seven currently listed Mainland Chinese companies raised a total of US\$368 million in funds by primary listing ordinary shares on SGX. There were no such listings in 2011 and one in 2012, that of mining company Sincap Group Ltd. This was the last fund raising IPO of a Mainland Chinese company primary listed on SGX.

UK

124. The UK prohibits the listing of “premium listed” shares with mechanisms designed to consolidate power in the hands of a small number of individuals.¹⁰⁴ WVR structures are permitted for “standard listed” shares (which includes primary listings) but institutional shareholders in the UK are generally hostile to these structures (see Appendix III, paragraphs 55 to 64).
125. The LSE has had recent success attracting Mainland Chinese companies to raise funds via a primary listing. Three Mainland companies listed in 2013 raising total funds of US\$56.4 million. These bring the total number of Mainland Chinese companies primary listed on the LSE to 11. All are listed on AIM, LSE’s market for smaller, growing companies.¹⁰⁵ None have weighted voting right structures.

Other Regulatory Considerations

126. The research and statistics referred to above indicate that the Exchange’s restriction on WVR structures may well be a factor in the decision by some Mainland Chinese companies to list on markets other than Hong Kong. It has been suggested that our track record requirements for both the Main Board (e.g. the profits test¹⁰⁶) and (less so) for GEM may also dissuade less well established companies from seeking to raise funds by listing on the Exchange.
127. However, it should be noted that the financial qualification and share distribution requirements of the NYSE and NASDAQ’s highest board (its Global Select Market) are generally more stringent than those required for the Exchange’s markets. So, these requirements may not be a significant factor. A comparison of the Exchange’s listing

¹⁰³ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies.

¹⁰⁴ A premium listing is a pre-requisite for entrance to certain FTSE indices, including the FTSE 100.

¹⁰⁵ Source: Bloomberg. Data as at 31 May 2014. See footnote 86 for the criteria used to count these companies.

¹⁰⁶ Main Board Listing Rule 8.05(1).

eligibility requirements to those of NYSE and NASDAQ are summarised in Appendix VI. 25 of the 30 US listed Mainland Chinese companies shown in Appendix II would have met the quantitative thresholds set out in the Listing Rules for admission to the Main Board or GEM.¹⁰⁷

¹⁰⁷ This conclusion is based solely on testing financial data presented by these companies in their US IPO prospectuses against the quantitative financial eligibility criteria of Main Board Rules 8.05(1) to (3) and GEM Rule 11.12A(1). We did not test against suitability requirements or non-financial eligibility criteria (e.g. management and ownership continuity requirements). Youku.com, Inc and Tudou Holdings Ltd merged on 23 August 2012 and are counted as one company for the purpose of these figures.

CHAPTER 4: JURISDICTIONAL COMPARISON AND EMPIRICAL STUDIES

128. The Exchange conducted an extensive review of: (a) rules and practices in other jurisdictions and (b) also reviewed and analysed empirical studies on the effect WVR structures have on company performance (see Appendices III and IV respectively).

Jurisdictional Comparison

129. We found a wide range of approaches to WVR structures are in use around the world. Some jurisdictions operate permissive regimes in both their corporate law and listing rules (e.g. US, Canada and Sweden). The company law regimes of other jurisdictions allow companies to have WVR structures but, like Hong Kong, have restrictions in place for listed companies (e.g. UK, Australia and Singapore). Some jurisdictions prohibit WVR structures in company law, meaning that both listed and unlisted companies cannot use them (e.g. Germany, Spain and Mainland China).
130. The UK has taken action to tighten its regime by allowing WVR structures for “standard listed” shares only (see Appendix III, 55 to 61). Italy has recently published a report stating that WVR structures may be beneficial in some circumstances (see Appendix III, paragraph 36). Singapore announced changes to its company law to remove the requirement for shares issued by public companies to have one vote per share. However, SGX still prohibits primary listed companies from using them (see Appendix III, paragraphs 82 to 84). In Sweden, many listed companies have a dual-class share structure but we understand it is now rare for companies to list with these structures (see Appendix III, paragraphs 49 to 52).

Empirical Studies

131. In Appendix IV we provide an overview of some of the empirical studies that have been carried out on the impact of a dual-class share structure. These studies generally focus on differences in the performance of companies with these structures. While there is considerable divergence in the results of these studies, there are a few points on which academics are generally in agreement:
- (a) First, that control has a value over and above the value of any equity held by a controller.
 - (b) Second, that the source of this value includes (i) the ability of a controller to consume private benefits that are not capable of being earned by other shareholders; and (ii) the ability to resist a change in control.
 - (c) Third, by creating a deviation between voting rights and cash flow rights, a dual-class structure decreases the disincentive to consume private benefits and makes it possible to resist a change in control with a smaller absolute investment, in each case compared to a company with a “one–share, one–vote” structure.
132. It seems that investors generally apply a discount to shares with inferior voting rights in a dual-class share structure and that this reflects the risks of consumption of private benefits, underperformance and management entrenchment. However, there is a lack

of consensus as to whether those risks actually result in a negative impact on a company's performance.

Findings

133. There is no strong consensus among empirical studies (Appendix IV) as to whether a WVR structure has a positive or negative impact on a company's performance. However, there is a consensus view that the presence of a WVR structure results in a discount in the price of a listed company's publicly traded shares.
134. Our jurisdictional comparison (see Appendix III) shows that a wide variety of approaches are in use. We could identify no consistent trend towards or away from WVR structures.

CHAPTER 5: OTHER WVR STRUCTURES IN USE

Introduction

135. Our review of US practice found that some US listed companies have WVR mechanisms in place that are different from a dual-class share structure (see paragraph 28). In particular, some have structures that give incumbent controllers enhanced or exclusive rights to elect directors (usually a majority) to the company's board.
136. We found that, as at 31 May 2014, only one US listed Mainland Chinese company, Autohome Inc, granted its incumbent managers the right to appoint a majority of directors to its board (see paragraph 143). We describe these alternative structures here as it is possible for a Mainland Chinese company to list in the US with these structures or other variations. We therefore wish to consult as broadly as possible on potential WVR structures. We seek views on whether these alternatives should be considered for companies with or seeking a listing in Hong Kong.

Dual-class Director Election

137. IRRCi and Institutional Shareholder Services (a provider of corporate governance analysis) together surveyed "controlled companies"¹⁰⁸ in the S&P 1500 Composite Index as at 1 January 2012.¹⁰⁹ The IRRCi Study found that 45 companies (3% of the Index) were controlled through shares that allow the holders to elect a fixed number or percentage (usually a majority) of board members.
138. The boards of 21 of these companies are split into two groups each of which is associated with a share class (i.e. "Class A" directors and "Class B" directors). The election of directors is decided at a general meeting where "Class A" shareholders vote to elect "Class A" directors and "Class B" shareholders vote to elect "Class B" directors. The holders of one class, typically the company's founders, will have the right to nominate a greater number of directors to the board than the other class of shareholders.
139. Examples of this sub-group include Nike Inc and the New York Times Company.

Non-voting Ordinary Shares

140. The IRRCi Study found 14 companies with classes of non-voting ordinary shares. These companies also have a class of shares carrying one vote each in issue, but these voting shares are mostly held by insiders. This means outside investors have very little say in major decisions made by the company. US listed examples of this group include Apollo Group Incorporated and Federated Investors Inc.

¹⁰⁸ The IRRCi Study defines a "controlled company" as one in which a person or a group collectively:

- (a) owns 30% or more of a company's voting power; or
- (b) has the ability to elect a substantial number (40% or more) of the board.

This definition is very close to the definition of a "controlling shareholder" in the Listing Rules.

¹⁰⁹ This index is a composite of the following three indices: S&P 500 (the largest listed US companies by market capitalisation), S&P 400 (a benchmark index of mid-cap listed US companies) and S&P 600 (a benchmark index of small-cap listed US companies).

Hybrids

141. The IRRCi Study also found hybrid structures. Nine companies had classes of stock in issue that entitled the holder to both multiple-votes per share and the exclusive right to elect a majority of the board. Examples of well-known companies with such hybrid structures include Expedia Inc, The Hershey Company and the Ralph Lauren Corporation.

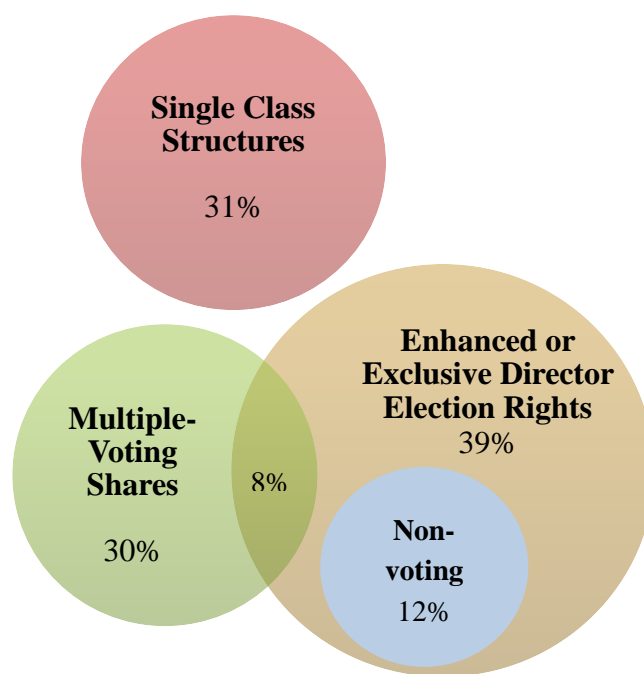


Chart 9: Breakdown of Ownership Structures used by Controlled Companies within the S&P 1500 Composite Index¹¹⁰

Other Possible Structures

142. The IRRCi Study looked at a representative sample of US listed companies but did not review them all. Also, it does not describe the control structures of the companies it sampled in detail. It is therefore possible that other structures are in use that are not described in this chapter.
143. A company may also list in the US using a WVR structure that grants special control rights to particular persons through provisions in its articles only without those rights attaching to a particular class of shares. The articles of Autohome, Inc., a Mainland Chinese online automobile sales company listed on NYSE in December 2013, state that, whilst the company's current controlling shareholders hold at least 39.3% of its total ordinary share capital, they are entitled, but not obligated, to appoint at least a majority of the directors to its board. They also have special rights to fill a vacancy following the removal of a director they appointed. Directors appointed by the controlling shareholder are not subject to retirement by rotation.¹¹¹

¹¹⁰ As at 1 January 2012. Percentages shown indicate the percentage each category represents of the 114 "controlled companies" within the S&P 1500 Composite Index. Source: IRRCi Study.

¹¹¹ Autohome, Inc, articles of association, Exhibit 3.2 to Form F-1/A, filed on 27 November 2013, paragraphs 87(1), 87(5) and 88(1).

144. We also note that the articles of JD.com (a Mainland Chinese online direct sales company) filed with the SEC as part of its application to list on NASDAQ, state that the quorum for a board meeting of the company is not achieved unless the founder is present.¹¹² The founder has a casting vote where directors cast an equal number of votes in favour or against a particular issue and he must approve any appointment of a director to fill a casual vacancy.¹¹³ JD.com also has a dual-class share structure (see Appendix II). The “B” shares held by the founder entitle him to 20 votes per share.
145. LightInTheBox Holding Company Ltd (a NYSE listed Mainland Chinese online retailer) has a single class share structure that entitles its shareholders to one vote for each share held on most resolutions subject to a shareholder vote at a general meeting. However, its articles state that its founders have three votes per share on any resolution concerning a change in control of the company.¹¹⁴
146. Alibaba Group Holding Limited disclosed in its SEC registration statement, filed for its US listing, that it will have a single class of ordinary shares in issue upon listing. Each of its ordinary shares is entitled to one vote on all matters upon which the ordinary shares are entitled to vote. The Alibaba Partnership will have the exclusive right to nominate a simple majority of the members of its board of directors. The election of each director nominee will be subject to the director nominee receiving a majority vote from its shareholders voting at an annual general meeting of shareholders.¹¹⁵

¹¹² A similar provision is found in the articles of Baidu, Inc which state that the attendance of Yanhong (Robin) Li, the company’s co-founder, is necessary to achieve a quorum at a board meeting (Baidu, Inc, articles of association, Exhibit 3.1 to Form F-1/A filed on 12/07/2005, paragraph 89).

¹¹³ JD.com, articles of association, Exhibit 3.2 to Form F-1/A filed on 19 March 2014, paragraphs 90(e), 112 and 114.

¹¹⁴ LightInTheBox Holding Company Ltd, articles of association, Exhibit 3.2 to Form F-1/A filed on 23 May 2013, paragraph 21.2.

¹¹⁵ Alibaba Group Holding Limited, Form F-1 filed on 6 May 2014, pages 187 and 206. An amendment to this Form F-1 filed on 11 July 2014 (page 206) states that if at any time the board of directors consists of less than a simple majority of directors nominated or appointed by the Alibaba Partnership for any reason, the Alibaba Partnership will be entitled (in its sole discretion and without the need for additional shareholder action) to appoint such number of additional directors to the board as necessary to ensure that the directors nominated or appointed by the Alibaba Partnership comprise a simple majority of the board of directors.

CHAPTER 6: ADDITIONAL CONSIDERATIONS

Possible Restriction to New Applicants

147. We note that the Standing Committee stated in its July 1987 report that classes of ordinary shares with disproportionate voting rights (then described as “B” shares) would be “... normally acceptable only when a company first applies for a listing and there is no question of protection for minority shareholders.”¹¹⁶ (See Appendix I, paragraph 8) If a company is able, after listing, to implement a WVR structure for the benefit of its controlling shareholder, the rights of its other shareholders may be unfairly restricted or reduced.
148. Investors in a company with a WVR structure at the IPO stage do so in full knowledge of the fact that their rights will be inferior to those given superior rights; and invest on that basis, as do any shareholders who invest subsequently on the secondary market. They normally do not have a prior stake in the company and so their existing rights are not restricted or reduced by the implementation of a WVR structure at the IPO stage.
149. In the US, NYSE and NASDAQ allow new applicants to list with WVR structures. However, they prohibit any listing of shares on their markets that may prejudice the interests of the existing shareholders of a company. The NYSE Listed Company Manual states:
- “Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of time phased voting plans, the adoption of capped voting rights plans, the issuance of super voting stock, or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer.”*¹¹⁷
150. The NASDAQ Stock Market Rules state:
- “Under the voting rights rules, a Company cannot create a new class of security that votes at a higher rate than an existing class of securities or take any other action that has the effect of restricting or reducing the voting rights of an existing class of securities.”*¹¹⁸

Circumvention Risk

151. If the Exchange were to implement a restriction that allowed only new applicants to have WVR structures, there is a risk that existing listed companies may attempt to circumvent this restriction. They may attempt to do so, for example, by transferring assets or businesses to a private company and then listing the private company with a WVR structure. They may try to spin-off assets or businesses as new listed companies with WVR structures or conduct reverse takeovers with such structures. They may even de-list so as to re-list later as a company with a WVR structure.

¹¹⁶ See Appendix I, paragraph 8.

¹¹⁷ NYSE Listed Company Manual, Rule 313(A).

¹¹⁸ NASDAQ Stock Market Rule 5640.

152. The Exchange could add general anti-avoidance provisions to the Listing Rules to deter and prevent existing listed companies from deliberately circumventing the restriction. However, there is a risk that this may not be successful in all cases. The Exchange would be required to make a subjective judgement as to whether a particular transaction constituted a circumvention of the restriction. Persons outside the Exchange may not hold the same view as the Exchange in a particular case.

Restrictions in Use on US Markets

153. The dual-class shares structures used by US listed companies have common characteristics that limit the rights enjoyed by holders of multiple voting shares. Table 2 provides a summary of these characteristics, at IPO, for the 30 Mainland Chinese US listed companies set out in Appendix II and includes some non-Chinese examples.

Characteristic	Description of Restriction	Prevalence in Mainland Chinese Companies	Non-Chinese Examples
Restriction on Transfers	<p>Multiple voting shares must convert into OSOV shares if beneficial ownership is transferred to persons who are not “affiliated” with the original holders.¹¹⁹</p> <p>Three companies (China Dangdang, Qihoo 360, and Qunar Cayman) also require conversion if an “affiliate” transfers the shares within six months of gaining beneficial ownership.</p> <p>One company (Mindray Medical) requires conversion if an “affiliate” transfers the shares at any time after gaining beneficial ownership.</p>	27 of 30 companies (all except Shanda Games, eLong and LightInTheBox)	Facebook, Google, LinkedIn, Zynga
Minimum equity threshold held by founders or others	<p>If at any time the founders of the company hold less than 5% of the multiple voting shares, all multiple voting shares in issue must convert into OSOV shares.</p> <p>One company (Autohome) sets this threshold at 39.3% of the sum of both classes of its shares and another (RenRen) sets it at 50% of the</p>	13 of 30 companies (58.com, Autohome, Baidu, China Dangdang, iKang Healthcare, JD.com, Jumei International, NQ Mobile, Perfect World, RenRen, TAL	AMC Entertainment Holdings, Inc (30% of all outstanding shares threshold)

¹¹⁹ “Affiliated persons” normally means: (a) the holder’s immediate family, a trust established for their benefit and companies wholly or partially owned by those family members; and (b) companies controlled by the holder.

Characteristic	Description of Restriction	Prevalence in Mainland Chinese Companies	Non-Chinese Examples
	<p>founders' total holding of both its share classes at IPO. iKang Healthcare sets this threshold at 8% of the company's total issued common stock. JD.com requires conversion of its B shares if its founder does not hold any.</p> <p>Two companies, in addition to the founder threshold above, require conversion of multiple voting shares if the holding of any non-founder changes by more than 50% (NQ Mobile and YY Inc). RenRen requires conversion if non-founders' total ordinary shareholding at IPO falls below 50%.</p>	Education, Weibo and YY)	
Change of control event	One company (Autohome) requires conversion of all multiple-voting shares into OSOV shares if there is a change in control of the company.	One of 30 companies (Autohome)	No example found
Retirement / incapacity / death of founder	One company (JD.com) requires conversion of all multiple voting shares into OSOV shares if the founder is no longer employed as the chief executive officer or cannot permanently attend board meetings due to his physical and/or mental condition.	One of 30 companies (JD.com Holdings)	Google ¹²⁰ , Zynga, LinkedIn, Groupon

¹²⁰ Unless the multiple-voting shares are transferred to another founder or to a trustee nominated by the founder prior to his death and approved by the board of directors (see Google, Inc certificate of incorporation, exhibit 3.01.2 to Form S-1/A filed on 9 August 2004, Article IV, Section 2(f)(iv)). Groupon has a similar provision in its certificate of incorporation (see Groupon, Inc certificate of incorporation, exhibit 3.2 to Form S-1/A filed on 1 November 2011, Article IV, Section 4(f)).

Characteristic	Description of Restriction	Prevalence in Mainland Chinese Companies	Non-Chinese Examples
Minimum threshold of shares outstanding	One company (Mindray Medical) requires conversion of its multiple voting shares into OSOV shares if the number of those shares outstanding falls below 20% of total share capital.	One of 30 companies (Mindray Medical)	LinkedIn, Zynga (conversion below minimum 10% of share capital threshold)
Vote of shareholders	A requirement for the conversion of all multiple voting shares into OSOV shares if holders of multiple voting shares vote for it.	None	Facebook (approval by majority of multiple voting shareholders) Groupon (approval by 66.6% of multiple voting shareholders)
Sunset clause	A requirement for the conversion of multiple voting shares into OSOV shares at a particular future date.	None	Groupon (conversion into OSOV shares after five years ¹²¹)

Table 2: Restrictions on the Multiple-Voting Share Structures of US Listed Companies¹²²

154. For the Exchange’s markets, additional restrictions may be appropriate for companies with WVR structures. These may include a requirement for warnings on all their corporate communications, an “X” in their stock short names, a cap on the number of votes that can be carried by one share and enhancing the powers of independent non-executive directors. The Exchange could also consider other circumstances, in addition to those set out in Table 2, that may require a company to unwind its WVR structure at either a shareholder or board level.

¹²¹ Groupon’s two classes of common stock will automatically convert into a single class of common stock on 9 November 2016, five years after the filing of their sixth amended and re-stated certificate of incorporation with the State of Delaware (Sources: Groupon, Inc, certificate of incorporation, exhibit 3.2 to Form S-1/A, filed on 1 November 2011, Article IV, Section 4(a)(iii) “Final Conversion Date” and (d) “Final Conversion of Class A Common Stock and Class B Common Stock”; and 2013 Proxy Statement (Form DEF 14A), filed on 29 April 2013, Note 1 to “Information Regarding Beneficial Ownership of Principal Shareholders, Directors and Management”).

¹²² Source: articles of association published by these companies as exhibits to registration statements filed with the SFC for the purpose of their IPO on a US exchange.

Possible Restriction to Companies in Particular Industries

155. Chapter 3 explains that the Exchange competes with US exchanges to list Mainland Chinese companies. Companies in the information technology industry account for the majority (70%) of the Mainland Chinese companies listing with WVR structures in the US and make up 90% of the total market capitalisation of these companies (see paragraph 109 and Chart 5 and Chart 6).
156. Information technology companies are relatively under represented among Hong Kong listed companies. Only two information technology companies (Tencent Holdings Limited (stock code: 700) and Lenovo Group Limited (stock code: 992)) are included in the 50 constituents of the Hang Seng Index, an index of the largest and most liquid stocks listed on the Main Board of the Exchange.
157. To address these competition concerns and limit the risks posed by dual-class share structures we could restrict their use to particular industries, such as in the information technology industry. We note, however, that no other jurisdiction we are aware of has such a restriction.
158. Although WVR structures are more prevalent in the information technology industry, these structures are used by companies from a broad range of industries. Between 2001 and 31 December 2013, 80% of US IPOs by companies with dual-class share structures were conducted by non-information technology companies.¹²³ These belonged, primarily, to the energy, financial and communications industries.
159. Appendix VII lists the top 25 US companies with dual-class share structures by market capitalisation (listed since 2001). Over half of these companies do not belong to the information technology industry. If competition with US exchanges is a valid reason to permit dual-class shares structures in Hong Kong, it may not be prudent to restrict their use to a particular industry, as, over time, that competition may extend to others.

Classification Issues

160. If the Exchange were to limit WVR structures to information technology companies, or other industries, we would need to clearly define these companies. One option would be to base any definition on the Hang Seng Industry Classification System.¹²⁴
161. However, this approach may exclude certain types of company that the market community may also consider “technology” companies. For example, bio-technology companies and companies belonging to the “clean energy” industry are not included within the HSIC definition of an “information technology” company (see Table 1 on page 4). Also, this definition does not include companies from the telecommunications industry.
162. Similar definition issues could arise if it was proposed to restrict the use of WVR structures to companies in other industries. So, it may be necessary to adjust a HSIC based definition on an industry by industry basis. Once an appropriate definition is

¹²³ Companies that conducted an IPO on NYSE or Nasdaq Global Select or Nasdaq Global Market or Nasdaq Capital Market between 1 January 2001 and 31 December 2013 whose issued share capital included two classes of ordinary shares carrying unequal voting rights at general meetings. Source: Bloomberg.

¹²⁴ This is available on the Hang Seng Indexes Company Limited website.

decided upon, the Exchange may still need to retain the ability to designate an applicant as an eligible company, in individual circumstances, if the applicant does not easily fall within the agreed definition. Also, a definition may need to change over time to reflect changes within a particular industry.

Possible Restriction to “Innovative Companies”

163. Commentators have suggested that one alternative may be to allow only “innovative” companies to use WVR structures. The intention would be to foster the listing of exceptional companies that may have transformative effect on their industry or society in general and that could, in time, produce significant benefits for the market as a whole and to the public.
164. Although it is possible to define “innovative”¹²⁵, it is likely that any decision as to whether a company fell within this definition would be highly subjective. Also, the definition would inevitably change over time as successful innovations quickly become commonplace.

¹²⁵ According to The Oxford English Dictionary, “innovative” means “adjective - (of a product, idea, etc.) featuring new methods; advanced and original.”

CHAPTER 7: QUESTIONS

165. We seek views on whether WVR structures should be permissible for companies with or seeking a listing on the Exchange.

We encourage you to read all of the following questions before responding.

Question 1: Should the Exchange in no circumstances allow companies to use WVR structures?

Please give reasons for your views.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

Question 2: Should the Exchange permit WVR structures:

- (a) for all companies, including existing listed companies; or
- (b) only for new applicants (see paragraphs 147 to 152); or
- (c) only for:
 - (i) companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162), please specify which industries and how we should define such companies;
 - (ii) “innovative” companies (see paragraph 163 to 164), please specify how we should define such companies; or
 - (iii) companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons.
- (d) only in “exceptional circumstances” as permitted by current Listing Rule 8.11¹²⁶ (see paragraph 81) and, if so, please give examples.

Please give reasons for your views.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

Question 3: If a listed company has a dual-class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views.

Question 4: Should other WVR structures be permissible (see Chapter 5 for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

¹²⁶ GEM Rule 11.25.

Question 5: Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V)? If so, please specify these changes with reasons.

Question 6: Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of this paper:

- (a) using GEM, a separate board, or a professional board to list companies with WVR structures (see paragraphs 33 to 41); and
- (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47)?

Question 7: Do you have any other comments or suggestions regarding WVR structures?

**APPENDIX I: THIRD INTERIM REPORT OF THE
STANDING COMMITTEE ON
COMPANY LAW REFORM:
B SHARES (JULY 1987) (EXTRACT)**

The phrase "B shares" is a convenient expression to describe shares of a company which, although forming part of its common stock, have been accorded greater or lesser voting rights, either by direct allocation or by being issued with a different par value from that of the other ordinary or "A" shares. The position is sometime referred to as "dual class capitalisation", especially in the United States of America.

2. Five companies so capitalised are presently listed on the Unified Stock Exchange -

1. Swire Pacific Limited
2. Hong Kong Realty & Trust Co. Ltd.
3. Lane Crawford Limited
4. Local Property Co. Ltd.
5. Realty Development Co. Ltd.

3. Recent proposals to follow suit by three further well-known companies, namely Jardine Matheson Holdings Ltd., Hutchison Whampoa Ltd. and Cheung Kong (Holdings) Ltd., caused considerable concern within the territory. The proposals have since been withdrawn, but the Standing Committee have been asked to consider the situation and in particular "whether or not the present ability of companies to issue shares with voting rights disproportionate to their nominal value is in the general interest of shareholders, and in the public interest, and if not, to identify whether any changes to the present legislative framework are desirable".

4. Comments have been sought and received from the companies concerned and from professional and commercial organisations. An invitation through the press to the general public has brought answers from three interested individuals.

5. The Committee have also obtained, through the good offices of the Secretary for Monetary Affairs, copies of the many and detailed submissions made to the Securities and Exchange Commission of the United States of America in the course of that Commission's inquiry into a proposal by the New York Stock Exchange Inc. to resile from its normal practice of refusing listing to companies having classes of common stock with disparate voting rights. (We understand that the American Stock Exchange Inc. has less stringent voting rights requirements, while the National Association of Securities Dealers Inc. in this respect imposes no restrictions whatsoever.)

6. The quotation of companies with B shares on the London Stock Exchange, which we are told presently lists fifty-five such companies, including for example Reuters Holdings P.L.C., Great Universal Stores P.L.C. and Whitbread & Co. P.L.C., and the few exceptions on the New York Stock Exchange, such as Ford, General Motors and Dow Jones is largely historic. But the practice is common on other major American markets and in Canada. We understand too that legislation in many states of continental Europe permits equity financing by the issue of securities which do not carry voting rights at all.

7. The leading argument against B shares is that they breach the democratic principle of one share one vote and thus facilitate the control of a company by a self-perpetuating oligarchy. Academic submission to the Securities and Exchange Commission placed great emphasis upon this factor and suggested that with management being thus accountable to no one but itself, and having little financial stake in a company, the economic performance of the company would inevitably decline, to the detriment of the general shareholders. Research in the United States has shown that when B shares are issued as part of a recapitalization of an existing listed company, the A shares almost invariably suffer a fall in value, usually in the order of 5%. A further and more direct result would be the inability of the general shareholders to participate in the increase in share value which usually accompanies a take-over bid because a predator will normally prefer to concentrate on acquiring, probably at a higher price, the shares which carry the greater voting rights. He may even make no offer at all for the other shares. That however is unlikely to be the case in Hong Kong, for Rule 22 of the Code on Takeovers and Mergers provides that "the offeror must make arrangements to ensure that the interests of the holders of all classes of equity share capital are safeguarded and should make appropriate offers or proposals to those holders." In addition, the effect of Rule 33(1) of the Code is that where a person has acquired shares which carry 35% or more of the total voting rights of a company, he is obliged to make an offer for the shares owned by the other holders of any class of voting shares in which he already has a holding, and "a comparable offer shall be extended to the holders of any other class of equity share capital whether such capital carries voting rights or not". Rule 33(4) lays down how the offer price is to be calculated and specifically states that "the Committee (on Takeovers and Mergers) should also be consulted where there is more than one class of share capital involved".

8. In the present circumstances it is the possibility of a hostile take-over bid that will probably underlie the desire of a company to issue B shares. Such shares can be

effectively used to build up a sound, although not necessarily invincible, defence against an attack of that kind. And it is understandable that companies controlled by founding families or entrepreneurs should wish to retain that control, yet still have the opportunity to employ equity financing when needed. Other factors, for example, national security or the interests of the community as a whole, may also in particular circumstances make it desirable that ultimate control should be concentrated in particular hands, although there is support for the view that the use of B shares for these purposes is normally acceptable only when a company first applies for a listing and there is no question of protection for minority shareholders. In addition to these circumstances a flexible approach, which is not available in a one share one vote situation, can be useful with regard to corporate restructures and mergers.

9. Section 114A(1)(e) of the Companies Ordinance, Cap. 32, provides that "in the case of a company originally having a share capital, every member shall have 1 vote in respect of each share or each \$100 of stock held by him, and in any other case every member shall have 1 vote." This is reflected in Art. 64 of Table A which provides that "Subject to any rights or restrictions for the time being attached to any class or classes of shares, on a show of hands every member present in person shall have 1 vote, and on a poll every member shall have 1 vote for each share of which he is the holder".

10. However a company may provide by its own Articles for the allocation of voting rights in any way that it wishes. If so, the express provisions will displace those contained in the statute. Moreover a company always retains the ability to change its Articles and thus the voting rights attached to any particular class of shares. The method of doing so will be governed by its Memorandum or Articles, and further statutory provisions are to be found in Section 63A of the Ordinance. There are both statutory and common law safeguards against the unfair use of the power to change a company's Articles. Firstly, Section 64 of the Companies Ordinance provides that ten per cent of the holders of a special class of shares may appeal to the court against any change in the Articles varying their rights. Secondly, under Section 168A of the Ordinance, any shareholder can apply to the court for protection where he considers that his interests are being unfairly prejudiced. Thirdly, the common law provides that any change in a company's Articles must be made not only in accordance with the technical provisions of the Companies Ordinance, but also bona fide for the benefit of a company as a whole. The provisions of Section 63A of the Companies Ordinance are extremely complicated and in themselves alone illustrate how difficult it would be to

draft effective controls over differential voting rights. It would also be a radical departure from established legislative policy in this and similar jurisdictions. Moreover the inherent inflexibility of any such legislation might well give rise to other problems as yet unforeseen.

11. If legislation controlling such a basic fundamental as voting rights were justified in principle, it would logically have to apply to all companies incorporated under the Ordinance, and the Committee are firmly of the view that private and unlisted public companies should remain free to arrange their constitutions according to their own needs and desires. A similar view was expressed by all those whom the Committee consulted and who had addressed their minds to this particular aspect.

12. The Committee have to accept that in the particular circumstance of Hong Kong's reversion to Chinese sovereignty in 1997 an issue of B shares could be used by a majority interest to free substantial portions of its capital for transfer overseas while still maintaining actual control within the territory. The adoption of such a practice to any significant extent could easily lead to a lessening of confidence in Hong Kong as a major financial centre. The Committee are therefore opposed to the indiscriminate issue of shares of this kind. Nevertheless it is felt that there is a legitimate need for their continued availability in exceptional circumstances of the kind mentioned above and perhaps in others. For the reasons given the Committee do not think that suitable restrictions can be satisfactorily achieved by legislative amendment. It is felt that control should be maintained instead by approval on a case to case basis governed by listing rules promulgated by the Securities Commission under Section 14 of the Securities Ordinance, Cap. 333. Such a course was advocated by several companies and organisations in their submissions to the Committee.

13. The Committee do not wish to seem to usurp the function of the Commission to establish the appropriate criteria but would respectfully suggest the consideration, *inter alia*, of a requirement that the issue be supported by the prior approval of a substantial number of shareholders, other than those who hold a controlling interest in the company, and perhaps that of a specific ratio between the B and other shares. (Such suggestions would, of course, be dependent upon the passing of legislation of the kind proposed by the Securities (Disclosure of Interests) Bill 1987 published last month following recommendations in our First Interim Report of December 1985). A requirement that any new issue of B shares must in any event be offered to all existing shareholders on a pro rata basis would be in line with several comments we received.

14. The Committee do not feel that any particular action is necessary with regard to the five companies which have already issued B shares. These have been accepted by and incorporated into the existing market. Furthermore, to interfere with established contractual rights would be contrary to general principle and might raise questions of compensation. Any future issue of further B shares by the companies would, of course, require approval in the manner suggested.

15. For these reasons the Committee do not recommend any change to primary legislation.

D. Cons
Chairman

July 1987.

APPENDIX II: MAINLAND CHINESE COMPANIES WITH WVR STRUCTURES LISTED ON US MARKETS

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
NASDAQ						
JD.com	21/05/2014	Online direct sales company	Class A (listed): one vote Class B (unlisted): 20 votes	Founder holds: - 20.7% of equity; and - 83.7% of voting power.	IPO Price: US\$19.00 Latest Price: US\$26.58	30.7
Tuniu Corporation	09/05/2014	Online leisure travel company	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers as a group (including two co-founders) hold: - 75.2% of equity and - 85.7% of voting power	IPO Price: US\$9.00 Latest Price: US\$16.30	0.8
Weibo Corporation	16/04/2014	Social media platform	Class A (listed): one vote Class B (unlisted): three votes	SINA Corporation holds: - 59.8% of equity; and - 81.7% of voting power.	IPO Price: US\$17.00 Latest Price: US\$18.54	3.7
iKang Healthcare Group, Inc.	08/04/2014	Private healthcare provider	Class A (listed): one vote Class C (unlisted): 15 votes	Founder holds: - 14.3% of equity; and - 35.9% of voting power.	IPO Price: US\$14.00 Latest Price: US\$16.50	0.9

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
Tarena International, Inc.	03/04/2014	Professional education provider	Class A (listed): one vote Class B (unlisted): 10 votes	Founder holds: - 26.3% of equity; and - 28.3% of voting power Goldman Sachs holds: - 21.5% of equity and - 30.7% of voting power	IPO Price: US\$9.00 Latest Price: US\$9.90	0.5
Sungy Mobile Limited	21/11/2013	Provider of mobile internet products and services	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers as a group (including two co-founders) hold: - 59.0% of equity; and - 73.1% of voting power.	IPO Price: US\$11.22 Latest Price: US\$12.98	0.4
Qunar Cayman Islands Limited	01/11/2013	Online travel	Class A (unlisted): three votes Class B (listed): one vote	Baidu, Inc holds: - 54.1% of equity; and - 58.6% of voting power.	IPO Price: US\$15.00 Latest Price: US\$24.02	2.7
YY Inc.	20/11/2012	Online social platform	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers as a group (including two co-founders) hold: - 38.4% of equity; and - 79.2% of voting power	IPO Price: US\$10.50 Latest Price: US\$65.21	3.6

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
21Vianet Group, Inc.	20/04/2011	Internet datacenter service provider	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers collectively (including one co-founder) hold: - 22.0% of equity; and - 62.8% of voting power.	IPO Price: US\$15.00 Latest Price: US\$27.43	1.8
Charm Comms. Inc	04/05/2010	Advertising agency	Class A (listed): one vote Class B (unlisted): 5 votes	Founder holds: - 57.9% of equity; and - 69% of voting power	IPO Price: US\$9.50 Latest Price: US\$4.50	0.2
Shanda Games Ltd	24/09/2009	Online game developer and operator	Class A (listed): one vote Class B (unlisted): 10 votes	Shanda Interactive holds: - 70.8% of equity; and - 96.0% of voting power	IPO Price: US\$12.50 Latest Price: US\$6.70	1.8
Changyou.com Ltd	01/04/2009	Online game developer and operator	Class A (listed): one vote Class B (unlisted): 10 votes	Sohu holds: - 67.9% of equity; and - 83.0% of voting power	IPO Price: US\$16.00 Latest Price: US\$26.64	1.5
Perfect World Co Ltd	25/07/2007	Online game developer and operator	Class A (unlisted): 10 votes Class B (listed): one vote	Founder holds: - 17.1% of equity; and - 56% of voting power	IPO Price: US\$16.00 Latest Price: US\$18.17	0.9

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
Baidu, Inc.	04/08/2005	Online search engine	Class A (listed): one vote Class B (unlisted): 10 votes	Founder holds: - 15.9% of equity; and - 53.5% of voting power	IPO Price: US\$27.00 Latest Price: US\$172.34	58.1
eLong Inc	27/10/2004	Online travel service provider in China	Class A (listed): one vote Class B (unlisted): 15 votes	Expedia holds: - 65.0% of equity; and - 82.4% of voting power	IPO Price: US\$13.50 Latest Price: US\$13.66	0.5
NYSE						
Jumei International Holding Ltd	16/05/2014	Online beauty products retailer	Class A (listed): one vote Class B (unlisted): 10 votes	Founder holds: - 35.6% of equity; and - 75.7% of voting power	IPO Price: US\$22.00 Latest Price: US\$29.69	3.9
Cheetah Mobile Inc	8/05/2014	Security software producer	Class A (listed): one vote Class B (unlisted): 10 votes	Kingsoft Corporation Limited (stock code: 3888) holds: - 48.5% of equity; and - 53.5% of voting power	IPO Price: US\$14.00 Latest Price: US\$19.75	2.5

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
Autohome Inc.	10/12/2013	Online automobile sales	Class A (listed): one vote Class B (unlisted) one vote per share but carries right to 51% of voting power if controller holds below 51% but above 39.3% of total equity of the company	Telstra holds: - 65.4% of equity; and - 65.4% of voting power	IPO Price: US\$17.00 Latest Price: US\$35.71	3.6
500.com	22/11/2013	Online sports lottery service provider	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers collectively (including one founder) hold: - 33.8% of equity; and - 39.7% of voting power	IPO Price: US\$13.00 Latest Price: US\$33.98	1.1
58.com	30/10/2013	Online classified advertising site	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers collectively (including one founder) hold: - 70.3% of equity; and - 89.5% of voting power	IPO Price: US\$17.00 Latest Price: US\$40.84	3.3

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
LightInTheBox Holding Co., Ltd	06/06/2013	A global online retail company	One class of shares entitling the holder to one vote per share on most matters. Founders have three votes per share on a vote on a change in control.	On change of control matters, founders have 43.0% of the voting power whilst holding 20.1% of the equity.	IPO Price: US\$9.50 Latest Price: US\$5.32	0.3
Youku Tudou Inc	Youku.com Inc merged with Tudou Holdings Ltd on 23/08/12	Online video	Class A (listed): one vote Class B (unlisted): four votes	Founder holds: - 21.3% of equity; and - 51.5% of voting power	<i>Not applicable. Listed as two separate companies.</i>	3.3
Phoenix New Media Limited	12/05/2011	Media content provider	Class A (listed): one vote Class B (unlisted): 1.3 votes	Phoenix TV holds: - 52.8% of equity; and - 59.2% of voting power	IPO Price: US\$11.00 Latest Price: US\$10.07	0.8
NQ Mobile Inc.	04/05/2011	Mobile and Internet security products	Class A (listed): one vote Class B (unlisted): 10 votes	Three founders hold: - 21.6% of equity; and - 44.8% of voting power	IPO Price: US\$11.50 Latest Price: US\$9.35	0.5

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
Renren Inc.	04/05/2011	Social networking Internet platform	Class A (listed): one vote Class B (unlisted): 10 votes	Founder holds: - 25.7% of equity; and - 47.2% of voting power Softbank holds: - 37.6% of equity; and - 42.4% of voting power	IPO Price: US\$14.00 Latest Price: US\$3.33	1.3
Qihoo 360 Technology Co. Limited	29/03/2011	Internet and mobile security products	Class A (listed): one vote Class B (unlisted): five votes	All directors and executive officers collectively (including two co-founders) hold: - 40.4% of equity; and - 64.9% of voting power.	IPO Price: US\$14.50 Latest Price: US\$85.54	11.6
eCommerce China Dangdang Inc	07/12/2010	Online B2C commerce platform	Class A (listed): one vote Class B (unlisted): 10 votes	Founders hold: - 35.3% of equity; and - 83.3% of voting power	IPO Price: US\$16.00 Latest Price: US\$10.39	0.8
TAL Education Group	19/10/2010	K-12 tutoring services	Class A (listed): one vote Class B (unlisted): 10 votes	All directors and executive officers collectively (including two co-founders) hold: - 46.5% of equity; and - 82.8% of voting power.	IPO Price: US\$10.00 Latest Price: US\$24.64	1.8

COMPANY	IPO DATE	BUSINESS	SHARE STRUCTURE	CONTROLLING SHAREHOLDERS	SHARE PRICES (Latest price is at 30/5/2014)	MARKET CAPITALISATION (US\$ Billion) (as at 30/5/2014)
SouFun Holdings	16/09/2010	Online real estate marketing	Class A (listed): one vote Class B (unlisted): 10 votes	Founder holds: - 27.8% of equity; and - 72.1% of voting power	IPO Price: US\$42.50 Latest Price: US\$11.19	4.9
Mindray Medical International Ltd	25/09/2006	Developer, manufacturer and marketer of medical devices worldwide	Class A (listed): one vote Class B (unlisted): five votes	All directors and executive officers collectively hold: - 28.8% of equity; and - 64.2% of voting power.	IPO Price: US\$13.50 Latest Price: US\$31.00	3.7

Data is as at 31 May 2014 unless specified. Sources: listing venue, IPO date, share prices and market capitalisation information from Bloomberg. Business description, share structure and controlling shareholder information from SEC company filings. Ownership information is as at date of the company's last proxy statement, annual report or IPO prospectus, whichever is later.

APPENDIX III: JURISDICTIONAL COMPARISON

1. This section describes the regulatory treatment of WVR structures in jurisdictions that have developed markets for trading listed securities.

Americas

US

Multiple Voting Shares

2. The IRRCi Study found that 43 companies included in the S&P 1500 Composite Index (3%) have multiple voting shares in issue.¹²⁷
3. The “one-share, one-vote” concept is provided as a default rule under Delaware company law but companies can opt out from it.¹²⁸ US companies with multiple voting shares normally adopt this capital structure at the time of their IPO on NYSE or NASDAQ. These exchanges permit companies with pre-existing WVR structures to list on their markets. The rules of these exchanges do not permit an issuer, once listed, to implement a WVR structure that would reduce or restrict the interests of existing shareholders (see main paper, paragraphs 149 and 150).

Limited/Non-voting Shares

4. The IRRCi Study found that 18 companies in the the S&P 1500 Composite Index (1.2%) had shares in issue with limited or no voting power. These shares may have also carried enhanced or exclusive director election rights (see this Appendix, paragraph 8).¹²⁹
5. Delaware company law permits the issuance of non-voting shares¹³⁰ and NYSE rules state that the listing of the ordinary voting shares of a company with non-voting shares already in issue is permitted. The non-voting shares can also be listed. However, certain safeguards must be provided to holders of listed non-voting shares:
 - (a) The non-voting shares must meet the listing standards applicable to ordinary shares;
 - (b) the non-voting shares must have substantially the same rights (except for voting) as ordinary shares; and

¹²⁷ 43 of the S&P 1500 Composite Index. IRRCi Study, pages 4 and 5 (34 with “super voting shares” plus nine with “super voting shares” that also have “enhanced or exclusive director election rights”).

¹²⁸ Delaware General Corporation Law §212(a) states: “*Unless otherwise provided in the certificate of incorporation...each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.*”

¹²⁹ IRRCi Study, page 5 (14 with non-voting shares plus four with limited voting shares).

¹³⁰ Delaware General Corporation Law §151(a).

- (c) holders of non-voting shares must receive all communications, including proxy voting material, sent to ordinary shareholders, even though they are not entitled to vote.¹³¹
6. NASDAQ rules do not specifically address non-voting shares.
7. Listed companies can also issue shares with limited voting rights. A notable example is Berkshire Hathaway Inc., which has two classes of share in issue. Its “Class A” shares entitle holders to one vote per share and its “Class B” shares carry only 1/10,000th of a vote.

Enhanced or Exclusive Director Election Rights

8. The IRRCi Study found that there were 45 companies in the S&P 1500 Composite Index (3%) where holders of at least one class of stock are entitled to elect a fixed number or percentage of board members. At 15 companies, the controller held shares that entitled it to elect a majority of the directors to the board (see also Chapter 5).¹³²

US Experience and History

9. In the 1920s, an increasingly vocal opposition to WVR structures emerged.¹³³ This opposition came to a head following NYSE’s 1925 decision to list Dodge Brothers, Inc. This company was controlled by an investment banking firm, which paid US\$2.25 million for the ordinary voting shares of the company while selling a total of US\$130 million worth of bonds, preference shares and common shares to the public with no voting power. By doing so, the bank controlled 100% of the voting power of the company by putting up, proportionately, less than 2% of the funds raised from the public. This led to public outrage and stoked pre-existing anti-banker sentiment.¹³⁴
10. US stock exchanges subsequently started to refuse to list companies with WVR structures. The NYSE implemented an informal ban in January 1926. This policy gradually hardened, until the NYSE, in 1940, formally announced an official rule against such listings.¹³⁵
11. By 1985, NASDAQ was successfully competing with NYSE. On 12 June 1985, Gordon Macklin, NASD president, testified that there were 600 to 700 NASDAQ securities that met the financial criteria for listing on the NYSE but chose, instead, to be traded on NASDAQ.¹³⁶ NASDAQ rules did not require companies to have classes of

¹³¹ NYSE Listed Company Manual, Rule 313(B).

¹³² These companies include K-Swiss Inc, Nike Inc, The Hershey Company, The New York Times Company and The Washington Post Company. IRRCi Study, pages 19 to 22.

¹³³ William Z. Ripley, a Harvard professor of political economy, was the most prominent and outspoken proponent of equal voting rights. In a series of speeches and articles, he argued that non-voting stock was the “crowning infamy” in a series of developments designed to disenfranchise public investors (see Stephen M. Bainbridge, “*The Scope of the SEC’s Authority over Shareholder Voting Rights*”, (May 2007), page 6).

¹³⁴ See Stephen M. Bainbridge, “*The Scope of the SEC’s Authority over Shareholder Voting Rights*”, (May 2007), page 6.

¹³⁵ See Stephen M. Bainbridge, “*The Scope of the SEC’s Authority over Shareholder Voting Rights*”, (May 2007), page 6.

¹³⁶ Joel Seligman, “*Equal Protections in Shareholder Voting Rights: The One Common Share, One Vote Controversy*”, (August 1986) 54 Geo.Wash.L.Rev.687.

shares with equal voting rights.

12. In January 1985, the NYSE put forward a recommendation to counter this competition threat and retain the attractiveness of its markets for companies wishing to defend themselves against hostile takeovers. The NYSE board recommended that an issuer with securities listed on its market should not have to delist if it adopted charter provisions creating two classes of common stock with different voting rights. This was as long as this proposition was approved by two-thirds of all its shares entitled to vote and the ratio of voting power between the two classes was no more than one to 10.¹³⁷ The NYSE stated that it would have preferred to retain its current prohibition, but only if other exchanges adopted it or were forced to do so by federal regulation.¹³⁸
13. On 16 and 17 December 1986, the SEC held two days of public hearings on the NYSE's proposal.¹³⁹ Approximately 50 witnesses testified at those hearings.¹⁴⁰ SEC Chairman John Shad reportedly noted that those that testified were "*overwhelmingly opposed*" to the NYSE proposal on the basis that it would curtail management accountability to shareholders.
14. The SEC consistently opposed the NYSE's decision and, in 1988, adopted Rule 19c-4 prohibiting listed companies from disenfranchising existing shareholders by issuing multiple voting shares. In 1990, a Court of Appeals for the District of Columbia Circuit invalidated the SEC rule on the grounds that the SEC lacked the authority to promulgate it.¹⁴¹ Subsequently, the US stock exchanges voluntarily agreed to a listing standard similar to Rule 19c-4, albeit with some greater flexibility.¹⁴²

Canada

Multiple Voting Shares

15. As at July 2013, 41 of 1,555 companies listed on TSX (3%) had listed shares that had inferior voting power at annual meetings compared to a class of shares with superior voting power issued by the same company.¹⁴³
16. Under Canadian company law,¹⁴⁴ the "one-share, one-vote" concept applies unless the company's articles provide otherwise.¹⁴⁵ Companies may provide in their articles for

¹³⁷ Joel Seligman, "*Equal Protections in Shareholder Voting Rights: The One Common Share, One Vote Controversy*," (August 1986) 54 Geo.Wash.L.Rev.687.

¹³⁸ Daniel R. Fischel, "*Organized Exchanges and the Regulation of Dual Class Common Stock*", (1987), page 121.

¹³⁹ SEC news digest Issue 86-237, 10 December 1986.

¹⁴⁰ NASD Press Release, "87-32 Request for Comments on Shareholder Voting Rights Proposal For NASDAQ Companies", 30 June 1987.

¹⁴¹ *Business Roundtable v. SEC.*, 905 F2d 406 (D.C.Cir.1990). Also see Stephen M. Bainbridge, "*The Short Life and Resurrection of SEC Rule 19c-4*", (1991).

¹⁴² NYSE will consider, among other things, the economics of such actions or issuances and the voting rights being granted. NYSE's interpretations will be flexible, recognizing that both the capital markets and the circumstances and needs of listed companies change over time. (NYSE Listed Company Manual, §Rule 313.00(A)).

¹⁴³ TSX July 2013 eReview, Chapter 5, page 1.

multiple classes of shares and set out the rights, privileges, restrictions and conditions attaching to each class of shares.¹⁴⁶ There is no restriction on the number of votes that each share may carry.

17. TSX allows the listing of “subordinate voting shares” - shares with inferior voting power at an annual meeting to another class of shares issued by the same company.¹⁴⁷
18. TSX does not allow a company, after listing, to issue securities that have greater voting rights than those of a class of voting securities already listed unless they are offered, on a pro rata distribution basis, to all holders of the existing listed voting securities. This is intended to prevent transactions which would reduce the voting power of existing shareholders through the issue of shares carrying superior voting rights.¹⁴⁸

Limited/Non-voting Shares

19. Under Canadian company law, a company can issue a class of securities to the public with no voting rights or a restricted right to vote at an annual meeting.¹⁴⁹
20. TSX rules allow the listing of:
 - (a) non-voting shares; and
 - (b) “restricted voting” shares (which carry a right to vote subject to some limit or restriction).¹⁵⁰
21. As at July 2013, 31 TSX listed companies had non-voting shares in issue.¹⁵¹ Three had “limited voting” shares in issue and seven had “variable voting” shares in issue. In total, 41 companies of 1,555 listed on TSX (3%) had shares in issue with “restricted voting” power.

Enhanced or Exclusive Director Election Rights

22. A “restricted voting” share (see this Appendix, paragraph 20(b)) may limit the number of directors that can be elected by a particular class of shareholders.
23. Prior to its amalgamation with JLL/Delta Canada Inc on 11 March 2014, the holders of Patheon Inc’s (a TSX listed pharmaceutical company) unlisted “special preferred voting shares” had the exclusive right to vote to elect three directors of the company’s nine person board but no right to vote on any other matters at annual meetings. The holders of the company’s listed “restricted voting” shares could vote to elect persons to

¹⁴⁴ The Canadian corporate law regime is regulated by provincial law and federal law. This section sets out requirements under federal corporate law (Canada Business Corporations Act). The Canadian securities market is regulated by provincial laws.

¹⁴⁵ Canada Business Corporations Act, section. 140(1).

¹⁴⁶ Canada Business Corporations Act, sections. 6(1)(c) & s. and 24(3) to (4).

¹⁴⁷ TSX Company Manual, Part I, Interpretation and Part VI(H), Section 624.

¹⁴⁸ TSX Company Manual, Part VI (H), Section. 624(m).

¹⁴⁹ Canada Business Corporations Act, sections 6(1)(c), 24(4)(b) and 176(1).

¹⁵⁰ TSX Company Manual, Part I, Interpretation and Part VI(H), Section 624.

¹⁵¹ TSX July 2013 eReview, Chapter 5, page 1.

the remainder of the company's board and on other matters at annual meetings.¹⁵² Patheon Inc's "restricted voting" shares have now been de-listed from TSX and its "special preferred voting shares" purchased for cancellation by the company.

¹⁵² See Patheon, Inc, SEC Proxy Statement (Form DEF14A), filed on 4 February 2014, pages 169, 201, 208 and 210.

Europe

France

Multiple Voting Shares

24. The ISS Report¹⁵³ found that 58% of the 40 French companies it sampled had multiple voting shares in issue.¹⁵⁴ This multiple voting power was derived, in all but one of these companies, from the loyalty schemes described below.¹⁵⁵
25. In France, fully paid up shares registered in the shareholder's name accumulate a maximum of two votes per share over time, usually after at least two years of ownership (known as "loyalty shares").¹⁵⁶ The double voting rights are lost when ownership of the share is transferred.¹⁵⁷ This is except for a transfer on succession or on the partition of property jointly owned by spouses, or a gift between living persons to a spouse or a relative entitled to inherit to the donor's estate.
26. These "loyalty shares" differ from conventional multiple voting shares because they do not form a separate class of shares and are not held exclusively by controllers. However, controllers, as long term investors, would benefit from the additional votes awarded for their long-term ownership.
27. Multiple voting shares other than "loyalty shares" are prohibited.¹⁵⁸

Limited/Non-voting Shares

28. There are no specific provisions in French law relating to non-voting shares without preference rights. It is debatable whether such shares can be issued under French law¹⁵⁹. We are not aware of any French listed companies that have issued limited or non-voting shares.

Enhanced or Exclusive Director Election Rights

29. A company may issue preference shares which confer special rights of various kinds, defined in the articles of a company, including superior board nomination or appointment rights. Rights attached to preference shares may be increased for a

¹⁵³ The ISS Report (see definitions) studied the prevalence of WVR structures in the EU and their regulation in each member state to determine whether the EU should harmonize its approach to these structures. Based on its findings and reports from other EU bodies, the European Commissioner for the Internal Market and Services, Charlie McCreevey, decided there was no need for action at an EU level on this issue.

¹⁵⁴ ISS Report, page 38.

¹⁵⁵ The remaining company, L'Air Liquide S.A., had dual classes of shares in issue (ordinary shares and preference shares) with equal voting rights (see ISS Report, page 68).

¹⁵⁶ French Commercial Code Article L.225-123.

¹⁵⁷ French Commercial Code Article L.225-124.

¹⁵⁸ The French Commercial Code provides that, with the exception of time-phased double voting right shares, voting rights attached to capital or dividend shares shall be in proportion to the share of the capital they represent and each share shall entitle the holder to at least one vote (Article L.225-122).

¹⁵⁹ Exhibit C (Part I) to the ISS Report, page 244.

determined or determinable period.¹⁶⁰ We found no examples of French listed companies that have granted enhanced or exclusive director election rights.

Germany

Multiple Voting Shares

30. Multiple voting shares are not permitted by law in Germany.¹⁶¹
31. German company law banned the introduction of new multiple voting shares in 1937. Prior to this, many companies had shareholders with extremely high voting power, sometimes with more than 1,000 or even 10,000 votes per share. The excessive use of multiple voting shares led to abuse and the erosion of shareholder rights for the sole benefit and entrenchment of management.¹⁶² Even after the 1937 reform, an exceptional permission to issue multiple voting shares, in the public interest, could be granted by the competent German state ministry of business.¹⁶³ In 1998, legislation was adopted to abolish this exception from 1 May 1998.¹⁶⁴
32. All multiple voting shares previously in existence expired on 1 June 2003. This was unless a shareholders' meeting, held prior to that date, approved their continuation by a majority vote of at least three-quarters of the share capital represented in the passing of the resolution. Holders of multiple voting shares were not allowed to vote in favour of such a resolution.¹⁶⁵

Limited/Non-voting Shares

33. Non-voting shares without preferential rights to dividends are prohibited under German law.¹⁶⁶

Enhanced or Exclusive Director Election Rights

34. Under German law, specific shareholders or holders of certain shares can be granted the right to appoint members of the supervisory board under a company's articles. In the latter case, such shares must be registered and can be transferred only with the consent of the company. These rights must entitle the beneficiary to appoint no more than one third of shareholder representatives in the supervisory board.¹⁶⁷ ThyssenKrupp AG (a conglomerate) is an example of a prominent German incorporated listed company that has granted this right.

¹⁶⁰ French Commercial Code Articles L. 228-11 to L. 228-20.

¹⁶¹ Section 12 (2) of the German Stock Corporation Act.

¹⁶² Wolf-Georg Ringe, "Deviations from Ownership-Control Proportionality—Economic Protectionism Revisited", (2010), pages 217-218.

¹⁶³ Section 12(2) of the German Stock Corporation Act of 1937 (see Wolf-Georg Ringe, "Deviations from Ownership-Control Proportionality—Economic Protectionism Revisited", (2010), page 226).

¹⁶⁴ Corporate Sector Supervision and Transparency Act, Article 1(32) (see Exhibit C (Part I) to the ISS Report, page 95).

¹⁶⁵ Introductory Act to the German Stock Corporation Act, Section 5(1) which regulates transitional provisions regarding existing superior voting rights (see Exhibit C (Part I) to the ISS Report, page 95).

¹⁶⁶ German Stock Corporation Act, Sections 12(1), and 139 to 141.

¹⁶⁷ German Stock Corporation Act, Section 101, paragraph (2).

Italy

Multiple Voting Shares

35. Italian law prohibits the issue of multiple voting shares for joint stock companies (the standard type of listed company).¹⁶⁸
36. On 13 January 2014, the CONSOB announced its publication of the fifth edition of its legal journals, entitled “*Deviation from the “one share - one vote” principle and multiple-vote shares.*”¹⁶⁹ This document assesses the advantages and costs that would derive from the introduction into Italian legislation of multiple-vote shares. CONSOB states that “[o]n the basis of the review carried out, enabling the issue of special categories of shares with multiple votes may facilitate both listing on the stock exchange and more efficient recapitalisation operations;” The document also proposes the introduction of “loyalty shares” (see this Appendix, paragraph 25). CONSOB stated that these “innovations” should be accompanied by the introduction of certain constraints and by greater monitoring to protect non-controlling shareholders.

Limited/Non-voting Shares

37. Shares with no voting rights or limited voting rights (e.g. for particular topics or under specific circumstances) are allowed under Italian law, so long as they do not, in aggregate, exceed half of the company’s share capital.¹⁷⁰ These are usually known as preferred or “savings shares”.
38. The Italian stock exchange rules state that classes of shares without the right to vote may be listed only if ordinary shares of the same issuer are already listed or are the subject of a simultaneous application for listing.¹⁷¹ However, we are not aware of any Italian listed company that has issued non-voting shares without preferential economic rights.¹⁷²

Enhanced or Exclusive Director Election Rights

39. The Italian Civil Code states that a company’s articles may provide for the creation of shares with voting rights that are limited to specific matters or dependent upon certain conditions.¹⁷³ In principle, priority shares with veto rights are permitted by law but the common view of lawyers is that they would not be applicable to resolutions regarding the appointment or removal of directors and any right to appoint directors should not be construed to be a right to appoint a majority of directors. We are not aware of any examples of a listed company incorporated in Italy that has granted these rights.

¹⁶⁸ Italian Civil Code, Article 2351(4).

¹⁶⁹ CONSOB, S. Alvaro, A. Ciavarella, D. D’Eramo, N. Linciano, Quaderni giuridici, “*La deviazione dal principio ‘un’azione – un voto’ e le azioni a voto multiplo*”, (January 2014).

¹⁷⁰ Italian Civil Code, Article 2351(2).

¹⁷¹ Rules of the markets organised and managed by Borsa Italiana, Article 2.2.2(5).

¹⁷² Exhibit C (Part I) to the ISS Report, page 322.

¹⁷³ Italian Civil Code, Article 2351(2).

The Netherlands

Multiple Voting Shares

40. The ISS Report found that 42% of the Dutch listed companies it sampled had multiple voting shares in issue.¹⁷⁴
41. In the Netherlands, the number of votes per share is determined by its nominal value. The Dutch Civil Code states that if a company's authorised share capital is divided into shares of an unequal nominal amount, the number of votes that may be cast by each shareholder is equal to the total nominal amount of the shares held divided by the nominal amount of the smallest share issued by the company. Fractional votes do not count.¹⁷⁵
42. A company can require a subscriber for its shares to pay the nominal value for one class of its shares and the nominal value plus a share premium for another. This means that subscribers can be asked to pay the same amount for each share class even though each entitles them to a different number of votes per share.
43. For example, a company may divide its authorised capital into "A" shares of a nominal value of EUR100 and "B" shares with a nominal value of EUR1,000. The shares of EUR100 give the right to one vote per share and the shares of EUR1,000 give the right to 10 votes per share. The company can require subscribers to pay EUR100 plus a EUR900 share premium for the "A" shares and only the nominal value of EUR1,000 for the "B" shares. In this way the subscription price for both share classes is EUR1,000 even though the "B" shares entitle the holder to 10 times the votes. The "A" shares can be offered to the public and "B" shares to the controller.¹⁷⁶

Limited/Non-voting Shares

44. Under the Dutch Civil Code every shareholder of a Dutch listed company has the right to at least one vote, so it is not possible for a company to issue limited or non-voting shares.¹⁷⁷

Enhanced or Exclusive Director Election Rights

45. The ISS Report found that 11% of the Dutch listed companies it sampled had priority shares. We found that the articles of four of 99 domestic companies with equity listed on Amsterdam Stock Exchange (NYSE Euronext - Amsterdam) (4%) contained provisions giving priority shareholders enhanced or exclusive director election rights. Examples of companies with priority shares in issue include Heineken Holding N.V. (a brewery company) and Akzo Nobel N.V. (a paints and chemicals company).

¹⁷⁴ ISS Report, page 26.

¹⁷⁵ Dutch Civil Code, Article 2:118(3).

¹⁷⁶ Exhibit C (Part II) to the ISS Report, page 113.

¹⁷⁷ Dutch Civil Code, Article 2:118(1).

Spain

Multiple Voting Shares

46. Multiple voting shares are not available to listed companies in Spain. Company law prohibits the creation of shares that may distort the proportionality between voting rights and the par value (i.e. the equity interest) of the shares.¹⁷⁸

Limited/Non-voting Shares

47. Non-voting shares without preferential rights to dividends are not permitted.¹⁷⁹ However, a company's articles can limit the number of votes a shareholder is entitled to cast in respect of a specific resolution.

Enhanced or Exclusive Director Election Rights

48. The granting of enhanced or exclusive director election rights, through structures such as priority shares, is not permitted as they would break the proportionality requirement of Spanish company law described above.¹⁸⁰

Sweden

Multiple Voting Shares

49. We found that 122 of 262 companies listed on NASDAQ OMX Stockholm (47%) have classes of "A" shares or "B" shares, or both, listed¹⁸¹. The ISS Report found that only one of the nine (11%) recently listed companies it sampled had issued such shares. A comparative legal study attached to the report states that it is now fairly unusual for newly listed Swedish companies to have multiple voting shares in issue.¹⁸²
50. Swedish company law sets out an "equality principle" which requires all shares to carry equal rights in a company.¹⁸³ This is subject to the provisions of the company's articles, which may provide for different classes of shares with different voting rights.¹⁸⁴ However, no share may carry voting rights more than 10 times greater than the voting rights of any other share.¹⁸⁵ All of the companies with multiple voting shares reviewed by the ISS Report made use of the maximum 10 to one voting ratio allowed.¹⁸⁶
51. In 2007 and 2009 a group of 24 Swedish and international investment groups sent letters to the Swedish Industry and Commerce Stock Exchange Committee¹⁸⁷ highlighting the criticism that shares with different voting rights can be used as a

¹⁷⁸ Spanish Corporate Enterprises Act 2010, Title IV, Chapter II, Section 96(2).

¹⁷⁹ Spanish Corporate Enterprises Act 2010, Title IV, Chapter II, Section 99.

¹⁸⁰ Exhibit C (Part I) to the ISS Report, page 210.

¹⁸¹ NASDAQ OMX – Nordic website as at 22 August 2014.

¹⁸² Exhibit C (Part II) to the ISS Report, page 233.

¹⁸³ Swedish Companies Act, Chapter 4, Section 1.

¹⁸⁴ Swedish Companies Act, Chapter 4, Sections 2-3.

¹⁸⁵ Swedish Companies Act, Chapter 4, Section 5.

¹⁸⁶ ISS Report, pages 120-121.

¹⁸⁷ The Swedish Corporate Governance Board took over the duties of the Industry and Commerce Stock Exchange Committee in 2010.

defence against takeovers, one stating that “*influence ought to be proportionate with the risk capital invested in the company*”.¹⁸⁸

52. In reaction, the Swedish stock exchange (NASDAQ OMX – Stockholm), in July 2012, implemented revised takeover rules to support the equal treatment of all classes of shareholders, regardless of the different rights attaching to each share class.¹⁸⁹ In summary, the takeover rules require that:
- (a) where an offeree company has different classes of shares, the same form of consideration must be offered for all classes (e.g. an offeror may not offer shares to one class of shareholders and cash to another);
 - (b) if the different classes of shares carry different economic rights (e.g. ordinary shares and preference shares), the offeror may offer each class of shareholders consideration that differs in value, so long as the difference is not unreasonable; and
 - (c) if different classes of shares carry different voting rights, the offeror must offer consideration of the same value for all classes of shares. However, if all classes of shares are listed and their listed prices differ, the offeror may apply to the Swedish Securities Council¹⁹⁰ for permission to offer consideration of a different value for each class.

Limited/Non-voting Ordinary Shares

53. The Swedish Companies Act does not explicitly allow or prohibit non-voting shares. However, the legal study conducted for the ISS Report states that the 10 to one voting ratio cap limit in law means they are not permitted.¹⁹¹

Enhanced or Exclusive Director Election Rights

54. Priority shares are possible under Swedish law. A company can provide in its articles that one or more directors can be appointed other than by shareholder election at a general meeting and this appointment right may be attached to a specific class of shares.¹⁹² However, this is very unusual in listed companies. This may be because the general rules for appointing directors of the board under the Swedish Companies Act require more than half of them to be appointed by a majority vote of shareholders.¹⁹³ We did not find any examples of Swedish listed companies with enhanced or exclusive director election rights.

¹⁸⁸ See the *Financial Times* article, “Sweden to outline new takeover rules”, (23 August 2009).

¹⁸⁹ Section II.11 of the Rules concerning Takeover Bids on the Stock Market - NASDAQ OMX Stockholm (dated 1 July 2012).

¹⁹⁰ The Swedish Securities Council is one of three organisations that make up the Association for Generally Accepted Principles in the Securities Market (along with the Swedish Corporate Governance Board and the Swedish Financial Reporting Board). It oversees corporate actions by Swedish listed companies and has the power to issue statements and rulings on points of interpretation and grant dispensations from compliance with the takeover rules.

¹⁹¹ Exhibit C (Part II) to the ISS Report, pages 235-236.

¹⁹² Swedish Companies Act, Chapter 8, Section 8.

¹⁹³ Swedish Companies Act, Chapter 8, Section 47.

UK

Multiple Voting Shares

55. The ISS Report found none of the UK companies it sampled had multiple voting shares in issue.¹⁹⁴ We could also find no examples of UK listed companies with such shares.
56. The “one-share, one-vote” concept is the default position under UK company law, but subject to an opt-out.¹⁹⁵ The UKLA listing rules do not require companies to restrict themselves to one class of shares. However, the listing rule principles require that listed companies treat all holders of the same class of “premium listed” shares that are in the same position, equally in respect of the rights attaching to the shares.¹⁹⁶
57. The “one-share, one-vote” concept has been strongly supported by institutional investors in the UK for many years.¹⁹⁷ Until the mid-1960s, multiple class share structures were fairly prevalent in the UK. However, in the 1960s and 1970s, the proportion of shares in UK companies owned by institutional investors rose dramatically and multiple class share structures began to disappear.¹⁹⁸
58. Following a 2012 consultation, on 16 May 2014, the UKLA introduced the following two principles for “premium” listed shares:
- “Principle 3: All equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote.*
- Principle 4: Where a listed company has more than one class of equity shares admitted to premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company.”*¹⁹⁹
59. The UK listing rules state that the UKLA will have regard to multiple factors to determine proportionality for the purpose of Principle 4, including:
- (a) the extent to which the rights of the classes differ other than their voting rights, for example with regard to dividend rights or entitlement to any surplus capital on winding up;
 - (b) the extent of dispersion and relative liquidity of the classes; and/or
 - (c) the commercial rationale for the difference in the rights.
60. The aim of the UKLA is to prevent the listing of artificial structures designed to allow control to rest with a small group of shareholders. However, it did not wish to prevent

¹⁹⁴ ISS Report, page 125. The ISS Report noted only that BP plc had preference shares in issue with lower voting rights than its OSOV shares.

¹⁹⁵ Section 284 of the UK Companies Act 2006.

¹⁹⁶ UK Listing Rule 7.2.1A, Premium Listing Principle 5.

¹⁹⁷ Wolf-Georg Ringe, “*Deviations from Ownership-Control Proportionality—Economic Protectionism Revisited*”, (2010), page 228.

¹⁹⁸ Wolf-Georg Ringe, “*Deviations from Ownership-Control Proportionality—Economic Protectionism Revisited*”, (2010), pages 226 and 228.

¹⁹⁹ See UK Financial Conduct Authority, CP12/25 “*Enhancing the effectiveness of the Listing Regime and feedback on CP 12/2*”, (October 2012), paragraphs 7.145-7.148.

the use of these share structures where there was a legitimate commercial rationale for them.

61. These new principles only apply to “premium listed” shares. The UKLA consulted on a two-year transitional period for the small number of existing premium listed companies with structures inconsistent with the new principles.²⁰⁰

Limited/Non-voting Shares

62. In the UK, companies may issue non-voting shares but this is regarded as an unusual and controversial practice, particularly if they are issued to the public whilst OSOV shares are held solely by incumbent controllers. This is because, in this circumstance, the controllers can be the only shareholders with voting power at general meetings.
63. Non-voting shares are generally shunned by institutional investors but have been traditionally favoured by companies with a substantial family shareholding. We found four UK listed examples, Daily Mail and General Trust plc²⁰¹ (listed in 1932), the Hansa Trust plc (listed in 1951), Schroders plc (listed in 1959) and Dee Valley Group plc (listed in 2002)²⁰². Most companies that had non-voting shares cancelled them in the 1990s.²⁰³

Enhanced or Exclusive Director Election Rights

64. In the UK, it is theoretically possible to create priority shares through provisions in a company’s articles that give holders of a particular class of securities special voting rights or veto powers in particular circumstances. However, this would be against market practice and “*Institutional Investor pressure would make the issues of these shares practically impossible.*”²⁰⁴ We are not aware of any UK incorporated listed company that has granted enhanced or exclusive director election rights to shareholders.

²⁰⁰ See UK Financial Conduct Authority, FCA CP13/15 “*Enhancing the effectiveness of the Listing Regime: feedback to CP12/25 and further consultation on related issues*”, (November 2013), paragraphs 9.2 to 9.4. The UKLA stated that only a small number of issuers (about 10) had shares classes or structures that would not meet the proposed new requirements.

²⁰¹ As at 30 September 2013, The Viscount Rothermere, the chairman of Daily Mail and General Trust plc, had a beneficial interest in 17,738,163 of the company’s 19,886,472 OSOV ordinary shares (89.1%) and 68,570,093 of the company’s 373,687,330 non-voting ordinary shares (17.4%). Source: Daily Mail and General Trust plc, Annual Report 2013, pages 67 and 152. This means, as at 30 September 2013, The Viscount Rothermere could exercise 89.2% of the voting power in the company by holding only 21.9% of the company’s total issued share capital.

²⁰² Source: FCA website – “Official List” and London Stock Exchange website – “List of All Companies”.

²⁰³ OECD Report, page 19.

²⁰⁴ Exhibit C (Part II) to the ISS Report, page 272.

Asia Pacific

Australia

Multiple Voting Shares

65. The Australian Corporations Act adopts a presumption of voting equality²⁰⁵ (i.e. “one-share, one-vote”) but also confers on companies the power to determine the rights and restrictions attaching to shares.²⁰⁶
66. Stricter rules on voting equality apply to Australian listed companies. ASX listing rules state that a company may have only one class of ordinary shares (unless the ASX approves the terms of an additional class) and, for a vote by poll, each ordinary shareholder must be entitled to one vote per fully paid security.²⁰⁷
67. One Australian listed and incorporated company (News Corporation²⁰⁸) sought to introduce multiple voting shares in 1993. The company put a proposal to the ASX for the introduction of a new class of shares bearing 25 votes per share. This proposal was widely condemned as an entrenchment and anti-takeover device, which would erode general shareholder rights.²⁰⁹ In light of this criticism, the company re-considered its proposal and, in 1994, issued limited-voting preference shares instead.²¹⁰
68. In December 1993, the Federal Attorney General established an expert panel to examine the ability of listed companies to issue multiple voting shares.²¹¹ The expert panel recommended that the ASX rules should continue to apply the “one-share, one-vote” concept and ASX agreed with this recommendation.²¹²

Limited/Non-voting Shares

69. The ASX listing rules prohibit a listed company from issuing ordinary shares that have limited or no voting rights, unless ASX approves otherwise (see this Appendix, paragraph 66).²¹³ As mentioned above, ASX consented to the issue of limited-voting

²⁰⁵ Australian Corporations Act 2001, section 250E.

²⁰⁶ Australian Corporations Act, sections 124, 254A and 254B(1) provide that a company may determine the terms on which its shares are issued and the rights or restrictions attaching to the shares.

²⁰⁷ ASX rules 6.2 and 6.9.

²⁰⁸ News Corporation subsequently re-domiciled in Delaware and moved its primary listing to NYSE.

²⁰⁹ Exhibit C (Part II) to the ISS Report, page 381.

²¹⁰ Business Spectator, “*Risk without rights*”, (2 January 2008).

²¹¹ Report by the Expert Panel of Inquiry into Desirability of Super Voting Shares for Listed Companies “*Corporations Law: Super Voting Shares*”, (January 1994).

²¹² Exhibit C (Part II) to the ISS Report, page 381.

²¹³ ASX, “*Guidance Note 3 Cooperatives and Mutual Business Entities*” (September 2001). The Note discusses the circumstances in which it may exercise that discretion to allow WVR structures in the case of co-operatives and mutual business entities. This does not limit ASX’s capacity to grant waivers to allow WVR structures in other cases. The ASX has granted such waivers from time to time, although this has generally been for technical reasons rather than to facilitate a mechanism that enables shareholders to obtain voting power that is disproportionate to their economic interest. The Note contemplates that ASX may grant waivers to allow special voting rights in respect of some matters, as well as enhanced or exclusive director election rights or priority shares – for example, the reference in paragraph 34 of the Note to founder shares having special rights in relation to changes to the company’s articles/constitution and takeover matters.

preference shares of News Corporation in 1994. This company re-domiciled to Delaware and moved its primary listing to NYSE in 2004, maintaining a secondary listing on ASX and the LSE. Through a scheme of arrangement, holders of its existing limited-voting preference shares received non-voting preference shares that were intended to (and did) lose their rights to a preferential dividend from 2008 onwards and therefore became holders of non-voting ordinary shares in the company.²¹⁴

70. In response to stakeholder requests, ASX published a paper in December 2007 to consult the market on a proposal to allow non-voting ordinary shares.²¹⁵ Market participants expressed strong concerns in their responses to the consultation paper and ASX has yet to publish conclusions to the paper.

Enhanced or Exclusive Director Election Rights

71. ASX has granted waivers from compliance with “one-share, one-vote” to enable external managers of listed infrastructure funds to hold special voting shares that enable the managers to elect a majority of directors to their particular infrastructure fund's board, in limited situations where there is a stapled entity structure.²¹⁶

Mainland China

Multiple Voting Shares

72. Whilst Article 127 of the Companies Law of the People's Republic of China provides legal ground for companies incorporated in Mainland China to issue different types of shares, companies are prohibited from issuing multiple voting shares. The “Guide to the Articles of Association of Listed Companies (Revised in 2006)”, published by the CSRC, states that companies' articles must include a provision that each share with voting rights held shall be entitled to one vote (Article 78).

Limited/Non-voting shares

73. Limited voting shares and non-voting shares without preferential rights to dividends cannot be issued by listed companies incorporated in Mainland China for the reasons set out immediately above.

Enhanced or Exclusive Director Election Rights

74. Shareholders have the power to elect or replace directors and supervisors under Article 100 of the Companies Law of the People's Republic of China and Article 40 of the “Guide to the Articles of Association of Listed Companies”. A company is free to set out in its articles details of how to nominate directors or supervisors and the nomination procedures, provided that these do not deviate from Article 100 of the Companies

²¹⁴ News Corporation, “*Information Memorandum in relation to a proposal to “re-incorporate” in the United States and to acquire from Murdoch family interests their shareholding in Queensland Press Pty Limited*”, (15 September 2004), page A-4 (see Exhibit B to SEC Form 6-K/A filed on 15 September 2004).

²¹⁵ ASX, “*Non-Voting Ordinary Shares: ASX Public Consultation*”, (14 December 2007).

²¹⁶ ASX, “*Non-Voting Ordinary Shares: ASX Public Consultation*”, (14 December 2007), paragraph 2.5.

Law.²¹⁷ We are not aware of any Mainland Chinese listed company that grants special board nomination or appointment rights to particular persons in its articles.

Japan

Multiple Voting Shares

75. In Japan, the TSE listing rules do not allow a listed company to have multiple voting shares.

Limited/Non-voting Shares

76. A Japanese listed company's articles may state that the shares of a certain class have limited or no voting rights.²¹⁸ However, the number of such shares may not exceed one-half of the total number of issued shares of the company.²¹⁹ The TSE listing rules state that shares without voting rights can be listed on its main market.²²⁰ However, we found no examples of such shares.

Enhanced or Exclusive Director Election Rights

77. In Japan, the Companies Act allows priority shares to be issued that give special rights on the appointment of directors. However, TSE rules prohibit a company from issuing such a share class after it has listed.

Korea

Multiple Voting Shares

78. Korea company law does not allow a stock company to issue multiple voting shares.²²¹

Limited/Non-voting Shares

79. In 2012, Korea company law was amended to allow a stock company to issue non-voting shares and shares with limited voting rights that may be exercised only for certain matters but not others (e.g. amendment of the articles of incorporation, appointment or removal of directors, merger or business transfer).²²²
80. Non-voting and limited voting shares must not exceed 25% of the total issued and outstanding shares of the stock company. Certain exceptions from this limit are permitted for non-voting shares issued under the authority of a Presidential Decree.²²³

²¹⁷ Article 82 of the *“Guide to the Articles of Association of Listed Companies (Revised in 2006)”*.

²¹⁸ Japan Companies Act, Article 108(2)(iii).

²¹⁹ Japan Companies Act, Article 115.

²²⁰ TSE rules, Main Markets, Criteria for Listing, Formal Requirements (Domestic Stocks), paragraph 11 “Classes of stock”.

²²¹ Korean Commercial Code, Article 369(1) states that a shareholder shall have one vote for each share.

²²² IFLR, *“South Korea: Fundamental Changes”*, (1 April 2012); Conventus Law, *“Jurisdiction – Korea: Reports and Analysis, Korea – Introduction to Amendments to the Korean Commercial Code”*, (February 2012); Byoung-Ki Lee and Sun-Hee Park, Bae, Kim & Lee LLC, *“Recent Amendments to the Korean Commercial Code”*, (1 November 2012); Shin & Kim, *“Share Classes Under the Amended Korean Code”*, (14 June 2011).

²²³ Korea Financial Investment Services and Capital Markets Act, Article 165-15.

Enhanced or Exclusive Director Election Rights

81. Korea company law does not allow the issue of shares that have superior voting rights or veto power over particular matters.

Singapore

Multiple Voting Shares and Non-voting Shares

82. Under Singapore's existing company law, public companies must comply with the "one-share, one-vote" concept.²²⁴ However, Singapore's listed newspaper companies (e.g. Singapore Press Holdings) are exempted by law (see this Appendix, paragraph 84). SGX issued guidance on 20 September 2011 stating that Singapore does not permit a company to list with a dual-class share structure.²²⁵
83. In October 2012, the MOF announced changes to the Singapore Companies Act to remove the requirement for shares issued by public companies to have one vote per share.²²⁶ MOF stated that SGX and the Monetary Authority of Singapore will separately evaluate whether companies with multiple class share structures should be permitted to list, and whether listed companies should be allowed to issue multiple voting shares and non-voting shares. MOF issued a draft amendment bill for consultation between May and June 2013. They intended to publish a summary of the comments received together with their responses by the last quarter of 2013.²²⁷

Enhanced or Exclusive Director Election Rights

84. The Singapore Newspaper and Printing Presses Act mandates the issue of separate classes of shares with different voting rights by Singapore's listed newspaper companies (e.g. Singapore Press Holdings). Every newspaper company must have two classes of shares, "management shares" and ordinary shares. Management shares must carry 200 votes each on any resolution relating to the appointment or dismissal of a director or any member of the staff of the newspaper company. Management shares cannot be issued or transferred except to citizens of Singapore or corporations granted written approval by the Singapore government. Also, permission to hold management shares can be revoked by the Singapore government.²²⁸ We are aware of no other Singapore listed companies that have enhanced or exclusive director election rights.

²²⁴ Singapore Companies Act, Section 64.

²²⁵ SGX, Regulators Column – "*The Capital Structure of Listed Companies in Singapore*", (20 September 2011).

²²⁶ Singapore Ministry of Finance, "*Review of the Singapore Companies Act – Ministry of Finance's Responses to the Report of the Steering Committee for Review of the Companies Act*", (3 October 2012), paragraphs 70 to 75.

²²⁷ This has not been published as at the date of this paper.

²²⁸ Newspaper and Printing Presses Act (Cap.206), Section 10.

APPENDIX IV: EMPIRICAL STUDIES

Introduction

1. In this appendix, we provide an overview of some of the empirical academic studies that have been carried out on the impact of a dual-class share structure or “DCS”.
2. The key points debated by academics on DCS are:
 - (a) To what extent do private benefits and management entrenchment negatively affect the value and performance of companies with DCS structures?
 - (b) Is any negative impact offset by positive effects of a DCS structure, such as insulation from short-termism, enabling controllers to diversify their wealth and a more flexible capital structure?
 - (c) What is the impact of DCS compared to other control mechanisms such as pyramid structures?²²⁹
3. This section summarises a selection of the empirical academic studies that endeavour to answer these questions. One of the key reasons for the debate between academics is that there are a number of difficulties involved in analysing DCS structures and how they affect different companies. Therefore, before discussing the empirical studies, we first discuss some of these analytical difficulties.

Difficulties in Analysis

4. The root of the difficulty in analysing the impact of a DCS structure is that a company’s performance and shareholder return varies over time. At any particular point in time a company either has a DCS structure or it does not. Accordingly, it is impossible to analyse the actual impact of a DCS structure on a specific company on a truly “like-for-like” basis.
5. Academics have therefore extrapolated conclusions by comparing the performance of different companies at the same time or the same companies at different times, in each case on the basis of whether or not they had a DCS structure. However, such an extrapolation may not identify the true drivers of differences in performance and shareholder return. For example, company A may have been more profitable than company B because company A sells a better product rather than because company B has a DCS structure and company A does not. Similarly, company A may be more profitable in 2005 than in 2007 because it faced less competition in 2005 rather than because of its capital structure.
6. Academics seek to mitigate this risk by looking at large samples of companies on the basis that such factors may be expected to cancel out given a sufficiently large and

²²⁹ If a controlling shareholder owns 51% of a company that in turn owns 51% of a subsidiary, the controlling shareholder achieves control of the subsidiary with an effective equity stake of only 26%. This is known as a pyramid structure and these structures can have multiple layers.

diverse sample. Nonetheless, it remains an issue, and because most companies do not have a DCS structure, in practice the sample sizes are, in some cases, quite small.

7. There is a further sample selection concern that the companies within a sample analysed may not be representative of all companies with a DCS structure. For example, there are likely to be differences between companies whose owners do not have a formal management role and companies where the owners are also the day-to-day managers of the business, since there is more scope in the latter case for management to award themselves excessive remuneration or take personal advantage of opportunities that come to the company. The studies generally assume that companies with a DCS structure are managed by the controllers.²³⁰ Studies try to look at large samples to address this issue, but as noted above, in practice sample sizes are often rather small. The other approach taken by academics is to make adjustments on a case-by-case basis, for example to adjust for DCS structures being more common in a particular industry sector. However, these adjustments are often subject to considerable subjectivity in their application and magnitude.
8. The relative lack of companies with a DCS structure is also partly responsible for another issue: jurisdictional bias. There may be clear differences between the impact of a DCS structure in different jurisdictions. For example, some jurisdictions may have stronger regulations and enforcement that have the effect of reducing the consumption of private benefits. Most of the studies only look at companies in the US and the few studies that look at Asia generally focus on pyramid control structures rather than DCS structures because it is relatively uncommon for companies in Asia to have DCS structures. The impact of and drivers for other structures may well differ from that of DCS structures.
9. A further issue is endogeneity. This is the concern that low valuations and other indicators demonstrating negative performance (or the opposite, depending on your point of view) drive companies to put in place a DCS structure, rather than being a consequence of having a DCS structure. For example, the managers of an underperforming company may have put in place a DCS structure to act as a takeover deterrent so that they can retain their positions (and any private benefits of control), in which case it would be the underperformance that caused the DCS structure rather than the other way round.
10. Endogeneity is a particular issue for studies looking at the impact of a change from a one vote per share structure to a DCS structure or vice versa. It is also relevant to studies looking at post-IPO performance of companies with DCS structures. This is because a DCS structure will often have been put in place for the purposes, or in contemplation, of an IPO. Some studies make case-by-case adjustments to try to address the endogeneity concern, as well as analysing the impact of external shocks on companies. However, as with sampling adjustments, these adjustments are often subject to considerable subjectivity in their application and magnitude.

²³⁰ It is of course still possible for controllers to consume private benefits indirectly (i.e. even if they are not the day to day managers), for example by establishing a board that can be relied on to take decisions in favour of the controller such as not bidding for contracts that the controller plans to bid for.

Empirical Studies

Control has a Value

11. There is general consensus that the ability to control a company has a value over and above the value of any ordinary equity rights held by the controller. Dyck and Zingales (2004)²³¹ estimated the value of control by looking at privately negotiated transfers of 393 controlling blocks of shares in 39 countries. They concluded that control is worth a premium equal to on average 10% to 14% of the equity value of the firm.²³² In a DCS structure, holders of shares with superior voting rights are able to exert control with a smaller equity investment than holders of shares with ordinary voting rights. This feature should, all other things being equal, make shares with superior voting rights more valuable than shares with ordinary voting rights.²³³
12. This conclusion appears to be supported by the empirical studies. Smart, Thirumalaib and Zutter (2007)²³⁴ looked at 253 IPOs of US companies with a DCS structure against just over 2,000 companies with a “one–share, one–vote” structure from 1990 to 1998. They found that the listed shares (with inferior voting rights) of DCS structure companies tended to be priced at a discount to shares in non-DCS structure companies. For the five years following an IPO, the median discount represented an 18 % difference in the P/E ratio.²³⁵ In addition, 37 of the companies within the study unified a DCS structure into a “one–share, one–vote” structure and the study found that the average rise in the stock price of such companies post-unification led to a narrowing of the discount to between one-third to one-fifth of the original valuation gap.
13. Masulis, Wang and Xie (2008)²³⁶ looked at 457 US companies from 1995 to 2002 with two classes of listed stock. The average discount between the two classes, after adjusting for differences in the cash flow rights of the stock, was 3.6% and the median 2.4%. Similarly, in the few examples of DCS listed in Hong Kong (see main paper, paragraphs 83 and 85), the shares with the ordinary voting rights on average traded at a slight discount to the shares with the superior voting rights, after adjusting for any differences in the cash flow rights of the shares.
14. Pajuste (2005)²³⁷ looked at 493 companies in seven European countries (Denmark, Finland, Germany, Italy, Norway, Sweden and Switzerland), 108 of which had unified a DCS structure from 1996 to 2002. The study found that companies that had unified a

²³¹ Alexander Dyck and Luigi Zingales, “*Private Benefits of Control: An International Comparison*”, (April 2004).

²³² Although there is considerable variation between countries, the highest premium being 65% and Hong Kong having one of the lowest premiums at approximately 3%.

²³³ Although generally when a WVR structure is collapsed through takeover (see Bauguess, Slovin and Sushka (2011) at footnotes 253 and 257 below) or share consolidation (such as the various Hong Kong listed companies that formerly had dual classes of share and now have only one class of shares), all shareholders receive the same amount for their shares (subject to differences in cash flow rights) regardless of the voting rights attached.

²³⁴ Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter, “*What’s in a vote? The short- and long-run impact of dual-class equity on IPO firm values*”, (July 2007).

²³⁵ They also conducted further analysis seeking to remove potential biases such as industry concentration and endogenous issues, and still found a statistically significant discount for WVR structure companies.

²³⁶ Ronald W. Masulis, Cong Wang and Fei Xie, “*Agency Problems at Dual-Class Companies*”, (June 2008).

²³⁷ Anete Pajuste, “*Determinants and Consequences of the Unification of Dual-Class Shares*”, (March 2005).

DCS structure not only had a better industry adjusted market to book value than the companies pre-unification, but were also more highly valued on this measure compared to companies which had a DCS structure throughout the study period.

The Private Benefits of Control

15. The separation of ownership and control gives rise to what is known as the ‘agency problem’. An owner relies on its agent, a manager, to operate the owner’s business, but the managers’ interests may conflict with the owner’s interest that the value of the business be maximised. For example, it is in the interests of the owners to pay the managers the minimum amount necessary for them to manage the business well, whereas it will be in the managers’ interests to maximise their pay and benefits.
16. A more extreme example would be where a profitable opportunity is presented to the company and the managers do not pursue that opportunity for the company but instead offer it to another company controlled by the managers. Assuming that the owners are aware that this is going on, they would be expected to remove the managers and replace them with new ones. This threat acts as a disincentive for bad behaviour by managers. However this is not possible where the managers control the company and can block their own removal. Resources expropriated in this way are known as private benefits since they are only available to the controllers.
17. Private benefits of control can be classified into two types:
 - (a) “monetary” benefits - such as: transacting in the company’s assets for personal benefit, directing opportunities from the company to entities controlled by the manager, excessive salaries, expensive perks (e.g. corporate limousines, private jets etc.), “empire building” - increasing the size but not the value of a company - and investment in “pet projects” that are of interest to the manager but do not increase the company’s value; and
 - (b) “non-monetary” benefits – such as: the self-satisfaction from being the one in control of the enterprise, respect and esteem bestowed by society, political power and reputation.
18. Adams and Ferreira (2008)²³⁸, in a study reviewing a wide range of empirical studies, conclude that evidence on the value of the control premium strongly supports the hypothesis that sizeable private benefits exist, and that controlling shareholders enjoy private benefits at the expense of non-controlling shareholders.
19. In a company with a one vote per share capital structure, the manager-owners must hold a sufficiently large stake to be able to block any attempt to remove them from management.²³⁹ This reduces the incentive to consume private benefits because of the resulting negative impact on the value of the controllers’ own shares if value is extracted from the company, as well as requiring a greater absolute investment to maintain control.

²³⁸ Renée Adams and Daniel Ferreira, “*One Share, One Vote: The Empirical Evidence*”, (December 2007).

²³⁹ Technically generally 50% plus one vote, but de facto this may be possible with a smaller holding and, as explained above, pyramid structures can reduce the effective economic interest even further.

20. However, these disincentives can be reduced by using a DCS structure. For example, the controllers may hold “Class A” shares of HK\$1 carrying 10 votes each and the other owners may hold “Class B” shares of HK\$1 carrying one vote each. In this example, assuming a share capital of HK\$100, the controllers could enjoy a majority of the voting rights with an economic interest of 10%. Therefore, in a company with a DCS structure, there is a greater risk of the controllers consuming private benefits at the expense of minority shareholders.

Entrenchment

21. Entrenchment can perpetuate the extraction of private benefits since the non-controlling owners are powerless to remove management. In addition, even if the managers are honest and do not extract any private benefits, they may not be managing the business in a way that maximises its value and performance, or that otherwise does not correspond with the wishes of the majority of the shareholders (e.g. timing of dividends, entry into major acquisitions and disposals). Accordingly, entrenchment is regarded as a potential negative risk to controlled companies, and as discussed above, a DCS structure tends to make it easier for controllers to retain control.

Evidence of Underperformance and Neutral Performance

22. The argument that entrenchment and private benefits result in underperformance by companies with a DCS structure is generally supported by studies that compare different companies’ performance over time based on whether or not they had a DCS structure and the extent of deviation between the voting and cash flow rights of the shares with superior voting rights. However studies that look specifically at post-IPO performance generally show that a DCS structure has no impact on performance. Despite this, as discussed above, the shares of companies with a DCS structure will generally still trade at a discount to companies without a DCS structure.
23. Gompers, Ishii and Metrick (2008)²⁴⁰ compared approximately 300-500 companies with a DCS structure and approximately 6,000 to 7,000 companies without a DCS structure in the United States from 1995 to 2002. They found that a higher share of managers’ voting rights to cash flow rights tended to result in a lower firm valuation (based on Tobin’s Q)²⁴¹, and that a higher share of managers’ cash flow rights to voting rights tended to result in a higher firm valuation. These results were statistically stronger for companies where managers had voting control but less than 50% of cash flow rights.
24. Masulis, Wang and Xie (2008)²⁴², using the same sample of companies as Gompers, Ishii and Metrick, concluded that a greater share of managers’ voting rights tended to result in lower efficiency in the use of cash resources by a company, higher CEO

²⁴⁰ Paul A. Gompers, Joy L. Ishii and Andrew Metrick, “*Extreme Governance: An Analysis of Dual-Class Companies in the United States*”, (May 2008).

²⁴¹ Tobin’s Q is the ratio between the market value of a company’s stock and its equity book value. It is a measure of the value the market ascribes to a company. For the purposes of the empirical studies reviewed, Tobin’s Q is adjusted for differences between industries – for example high tech companies may have comparatively high Tobin’s Q because of the intellectual property rights created by them which are not reflected on the companies’ balance sheets at market value.

²⁴² Ronald W. Masulis, Cong Wang and Fei Xie, “*Agency Problems at Dual-Class Companies*”, (June 2008).

remuneration (a potential measure of private benefits), and less successful acquisitions and returns on capital expenditure.

25. Li, Ortiz-Molina and Zhao (2007)²⁴³, looking at a sample of 614 US companies with a DCS structure and 8,360 US companies without a DCS structure, from 1995 to 2002, found that institutional investor ownership of companies with a DCS structure was substantially lower than companies without a DCS structure.²⁴⁴ As well as having a potentially negative impact on the share price of such companies through reduced investment demand, they also noted that this may restrict their access to equity capital.²⁴⁵
26. Smart, Thirumalaib and Zutter (2007)²⁴⁶ (in the study referred to in this Appendix, paragraph 12, on companies that did an IPO with a DCS structure) tried to identify the reasons for the discount applied by the market to listed inferior voting class shares of companies with a DCS structure. They found that the level of discount reflected the stock returns (i.e. share price changes and distributions) earned by holders of DCS structure companies compared to non-DCS structure companies but that the underlying operating performance of DCS structure and non-DCS structure companies was broadly the same.²⁴⁷ They suggested that the discount therefore reflected the risk of entrenchment of management and presented data on the performance of companies before and after CEO changes to support this hypothesis.
27. Holmén²⁴⁸, in a 2011 working paper, analysed 208 non-financial Swedish companies from 1985 to 2005, focussing on the impact of the lifting of a ban on foreign ownership in 1993. The study found that pre-1993, companies with a DCS structure were not subject to a discount compared to companies with a “one–share, one–vote” structure, but that from 1993, an average discount of 12% (based on Tobin’s Q) applied to companies with a DCS structure. The study did not find evidence that this was driven

²⁴³ Kai Li, Hernan Ortiz-Molina and Xinlei Zhao, “Do Voting Rights Affect Institutional Investment Decisions? Evidence from Dual-Class Firms”, November 2007.

²⁴⁴ The paper by Li, Ortiz-Molina and Zhao (see footnote 243) is a good example of the extent to which adjustments, as described in paragraphs 7 and 8 above, affect the result of studies. Based on the aggregate unadjusted data, they found that institutional investors invested 3.24% more in companies with a dual class structure compared to companies with a single-class structure. However, after making a number of adjustments for control variables, their findings were reversed, concluding that institutional investors invested 3.6% less in companies with a dual class structure. This represented 11% of the holdings of institutional shareholders based on the sample used (since institutional ownership represented 33% of total market holdings). The direction of this result is supported by their other findings, leading them to make the conclusion referred to above.

²⁴⁵ Li, Ortiz-Molina and Zhao (see footnote 243) also looked at 79 companies in the sample that moved from a WVR structure to a “one–share, one–vote” structure and found that institutional investor ownership rose.

²⁴⁶ Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter, “What’s in a vote? The short- and long-run impact of dual-class equity on IPO firm values”, (July 2007).

²⁴⁷ There are two other studies on this topic worth mentioning: the most recent, “Dual Class Companies: Do Inferior Voting Shares Make Inferior Investments?” by Judith Swisher (2006), looking at 72 companies that did an IPO in the United States from 1990 to 2003 with a dual class structure found no significant difference in the three year post-IPO performance of companies with a dual class structure compared to a “one-share, one–vote” structure. However an older study, “The effect of consolidated control on firm performance: The case of dual-class IPOs” by Ekkehart Böhmer, Gary C. Sanger, and Sanjay B. Varshney (1996), which analysed 98 dual-class IPOs from 1984 to 1988, found that companies that did an IPO with a dual-class structure outperformed companies that did an IPO with a “one–share, one–vote” structure over a three year period post-IPO.

²⁴⁸ Martin Holmén, “Foreign Investors and Dual Class Shares”, (February 2011).

by differences in operating performance, a more aggressive use of the DCS structure or greater extraction of private benefits. It concluded that the discount was as a result of foreign investors putting a discount on the shares of companies with a DCS structure independent of actual expropriation. This is similar to the risk discount postulated by Smart, Thirumalaib and Zutter per the previous paragraph.

28. Pajuste (2005)²⁴⁹ (in the study referred to in this Appendix, paragraph 14) made similar findings in the context of a study of companies that unified a DCS structure. The study found that while companies that had unified a DCS structure had a better industry adjusted market to book value than both the companies themselves pre-unification and other companies that had a DCS structure throughout the study period, this was not supported by higher sales growth, once adjusted for growth prospects, or other operating performance measures. The study suggested that the higher firm values arose as a result of unified companies issuing more new equity, making more acquisitions and having higher industry growth opportunities post-unification, which is supported by a reduced cost of equity financing in a “one–share, one–vote” structure.
29. Bebchuk (2013)²⁵⁰ considers the empirical evidence of other studies on the impact of activist investor interventions on companies listed in the United States and concludes that activist investor interventions generally have a positive impact on a company. He reasoned from this that measures, including DCS structures, which entrench management and prevent activist investor interventions (or at least enable management to ignore them), have a negative impact on companies. In a separate study Bebchuk, together with Brav and Jiang (2013)²⁵¹ found evidence that such interventions are followed by improvements in operating performance over a five-year period.
30. Lemmon and Lins (2003)²⁵² analysed the impact of the Asian Financial Crisis on 800 companies controlled through pyramid structures in eight East Asian countries. We have included this study notwithstanding that it does not directly relate to DCS because it considers the impact of an external shock, so is less prone to endogeneity issues (see this Appendix, paragraph 9). Lemmon and Lins found that companies in which the management group had a relatively high level of control compared to their economic interest through a pyramid structure underperformed the market by approximately 20% following the Asian Financial Crisis.

Potential Positive Consequences of a DCS structure

31. Although the risks of entrenchment and private benefits are well understood, some academics have argued that they are outweighed by positive consequences of having a DCS structure. In particular, while entrenchment is detrimental for investors if a company is performing badly as a result of poor management, many argue that a degree of management entrenchment is good for a company since it insulates management

²⁴⁹ Anete Pajuste, “*Determinants and Consequences of the Unification of Dual-Class Shares*”, (March 2005).

²⁵⁰ Lucian A. Bebchuk, “*The Myth that Insulating Boards Serves Long-term Value*”, (September 2013).

²⁵¹ Lucian A. Bebchuk, Alon Brav and Wei Jian, “*The Long-term Effects of Hedge Fund Activism*”, (July 2013).

²⁵² Michael L. Lemmon and Karl V. Lins, “*Ownership Structures, Corporate Governance, and Firm Value: Evidence from the East Asian Financial Crisis*”, (August 2003).

from potential pressure from shareholders to generate short term returns that are not in the company's long term interests.

32. Some other potential advantages of having a DCS structure derive from the controllers' ability to diversify their wealth through the use of a DCS structure. It is suggested that this may benefit a company. Firstly, through greater capital structure flexibility, as there is less scope for a controller's control stake to be diluted (e.g. through the issue of further OSOV shares to raise funds). Secondly, through reduced propensity to "empire build" (i.e. embark on vanity projects of questionable shareholder value), as controllers are able to use their own money to invest in entities outside of the company-group. Finally, through greater willingness to make investments and take more risky positive net value projects, as controllers are no longer solely reliant on their holdings in a company for their wealth.²⁵³
33. There is also empirical support²⁵⁴ for the argument it is possible to reduce the incidence and magnitude of private benefits by regulation and other steps. Dyck and Zingales (2004) (see this Appendix, paragraph 11) found that the control premium (which they argue is an indicator of the level of private benefits associated with control) tends to be smaller in jurisdictions with (among other things) better protection of minority investors, better tax enforcement, better accounting disclosure rules, better quality law enforcement and more media pressure. A reduction in the risk of controllers consuming private benefits may shift the balance of using a DCS structure from a negative impact to a positive impact.

Evidence of Outperformance

34. There is support for the position that a DCS structure results in the outperformance of a company in empirical studies of existing listed companies moving from a one-share, one-vote structure to a DCS structure.²⁵⁵ It is worth noting however that the sample sizes of these studies are relatively small compared to the studies looking at companies with and without a DCS structure. In addition, such studies are, by their nature, more likely to be influenced by endogenous factors (see this Appendix, paragraph 9) because

²⁵³ Scott W. Bauguess, Myron B. Slovin, and Marie E. Sushka, "Large shareholder diversification, corporate risk taking, and the benefits of changing to differential voting rights", (October 2011).

²⁵⁴ There is also theoretical support for this argument - Thomas J. Chemmanur and Yawen Jiao, in "Dual class IPOs: A theoretical analysis", concluded that shareholder value would be maximised by placing a limit is set on the maximum ratio of votes between superior and inferior voting shares and having regulations focused on seeking to prevent management from extracting private benefits of control.

²⁵⁵ Although there is no support in the studies looking at changing from a WVR structure to a "one-share, one-vote" structure. Beni Lauterbach and Yishay Yafeh in "Long Term Changes in Voting Power and Control Structure following the Unification of Dual Class Shares", (April 2009), studied 80 Israeli companies that moved from a WVR structure to a "one-share, one-vote" structure in the 1990s and compare these against companies that retained a WVR structure until the 2000s. They found no significant improvement (or decline) in the performance of companies moving to a "one-share, one-vote" structure, although they note that this may in part be because the controlling shareholders were generally able to remain controlling shareholders throughout the period notwithstanding the change in capital structure. Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter in "What's in a vote? The short- and long-run impact of dual-class equity on IPO firm values" (July 2007) found that 37 US companies that unified a WVR structure to a "one-share, one-vote" structure experienced a positive stock price reaction which narrowed the discount that applied to the WVR structure companies at and post IPO compared to non-WVR structure companies to between one fifth and one third.

in each case there would have been a trigger for making the change to a DCS structure. These factors may make the results less reliable.

35. Dimitrov and Jain (2006)²⁵⁶ compared 178 companies in the US that adopted a DCS structure from 1978 to 1998 against the wider market. Most of these companies already had a controlling shareholder before they adopted a DCS structure. They found that their stock market returns were approximately 5% higher than companies without a DCS structure for the first year post-announcement of the adoption of a DCS structure and approximately 23% higher four years after the announcement, albeit with the latter being at a less robust degree of statistical significance.
36. They found the post-announcement performance was even more pronounced and statistically significant where the change to a DCS structure was accompanied or shortly followed by an equity issuance. Dimitrov and Jain also found that following the announcement of a DCS structure, a companies' revenue and assets tended to rise faster than companies without a DCS structure, although there was no significant difference in profitability levels. They also found that when the adoption of a DCS structure was in conjunction with or shortly followed by an equity raising, operating income rose faster than non-DCS structure companies. Among other things, this study supports the argument that a DCS structure may benefit a company through giving it greater capital structure flexibility.
37. Bauguess, Slovin and Sushka (2011)²⁵⁷ looked at 142 companies in the US that adopted a DCS structure from 1978 to 1998. They found that where those companies (69) were the subject of a takeover, their shareholders obtained a higher average takeover premium than companies with a one-share, one-vote structure. They also found that following the adoption of a DCS structure, there tended to be no decline in operating performance and that where, following adoption of a DCS structure, the controlling shareholder sold down or was diluted, operating performance increased. In addition, there tended to be greater capital expenditure following adoption of a DCS structure. They hypothesise that this is a result of the controlling shareholders being able to diversify their wealth out of the company. This makes them more willing to make investments and take more risky positive net value projects at the company level.

Concluding Observations

38. We have set out below some concluding remarks by way of observation on the empirical studies discussed in this section. We would stress that these are solely the views of the Exchange.
39. It seems that investors generally apply a discount to shares with inferior voting rights in a DCS structure and that this is to reflect the risks of consumption of private benefits, underperformance and management entrenchment. However, there is a lack of

²⁵⁶ Valentin Dimitrov and Prem C. Jain, "*Recapitalization of One Class of Common Stock into Dual-class: Growth and Long-run Stock Returns*", (2004).

²⁵⁷ Scott W. Bauguess, Myron B. Slovin and Marie E. Sushka, "*Large shareholder diversification, corporate risk taking, and the benefits of changing to differential voting rights*", (October 2011).

consensus as to whether those risks actually result in a negative impact on a company's performance.

40. This lack of consensus is in part due to the differing approaches taken to analysing the impact of a DCS structure. There is some support in studies comparing different companies with and without DCS structures for the conclusion that DCS structures have a negative effect on performance, but this conclusion is not supported by studies looking at the performance of listed companies in the period immediately following their IPO (which generally show a neutral effect), studies of companies that have unified a DCS structure (which generally show a neutral effect) or studies looking at the impact of existing listed companies moving to a DCS structure (which generally show a positive effect). There is also generally considerable variation between studies using the same approach.
41. The results of all of these studies must be viewed in the context of the significant difficulties involved in conducting an analysis of the impact of DCS, which casts doubt on the reliability of their conclusions and may explain the divergence in views. In particular, endogeneity (see this Appendix, paragraph 9) is a major concern and the studies that support the hypothesis that DCS have a positive impact or no impact are more prone to endogenous factors.
42. Finally, some studies provide evidence that laws and regulations can limit the negative impact of DCSs. Dyck and Zingales (2004) (see this Appendix, paragraph 33) estimated that the control premium tends to be smaller in jurisdictions with better protection of investors, better tax enforcement and more media pressure. This is perhaps not surprising as measures such as connected transaction rules are designed to reduce the scope for the extraction of certain private benefits.

APPENDIX V: US LEGAL & REGULATORY CHARACTERISTICS

Class Action Law Suits

1. The US has adopted a procedure known as a "class action", which enables the claims of a number of persons against the same defendant to be determined in a single court action. In a class action, a representative plaintiff sues on behalf of himself and all the other persons ("the class") who have a claim in respect of the same (or a similar) alleged wrong, and whose claims raise the same questions of law or fact. The aggregate claims of the class may be substantial enough to justify the potential costs.
2. In the US, private plaintiffs can initiate a class action lawsuit for violation of federal securities laws. This means that both the SEC and private individuals can take action to enforce securities laws in response to any managerial misbehavior that may take place in a company with a WVR structure. Private litigation is more common than SEC enforcement action. Between 1997 and 31 December 2012, an average of 193 such class action lawsuits were filed a year in the US.²⁵⁸ A 2007 US study on the legal penalties for financial misrepresentation found that "*for the United States at least, private and public enforcement activities both are important in the control of managerial opportunism.*"²⁵⁹
3. Hong Kong does not have a class action regime. In November 2009, the Law Reform Commission of Hong Kong published a consultation paper seeking views on introducing such a regime. In May 2012, the Commission published a report proposing that a class action mechanism should be adopted. "Securities cases" was one of the types of cases identified by the report as being possibly suitable for class action proceedings.²⁶⁰ The Department of Justice has established a cross-sector working group to study and consider the proposals of the report.²⁶¹

Private Actions in Hong Kong

4. Minority shareholders of a company listed on the Exchange can bring private actions regarding the listed company in Hong Kong courts, by petitioning the Court for unfair prejudice remedies or by bringing a derivative action. For the former, a member of a company (including a non-Hong Kong incorporated listed company) can petition the Court for an appropriate order on the grounds that affairs of the company are being or have been carried out in a manner which is unfairly prejudicial to the interests of all or some of the members. In a derivative action a member of a company can, with leave of

²⁵⁸ Cornerstone Research, "*Securities Class Action Filings – 2012 Year in Review*", page 3.

²⁵⁹ Johnathan M. Karpoff, D. Scott Lee and Gerald S. Martin, "*The Legal Penalties for Financial Misrepresentation*", (2007), page 4.

²⁶⁰ The Law Commission of Hong Kong, "*Report – Class Actions, (May 2012)*", Annex I, page 275.

²⁶¹ The Law Reform Commission of Hong Kong's Annual Report on Implementation to LegCo 2014 website states that the first six meetings of the Working Group were held in February, May, and July and November of 2013, and February and May of 2014. In addition, a sub-committee to the Working Group has been formed to assist the Working Group on technical issues that might arise during its deliberations. The sub-committee held its first meeting in April 2014. The Government will map out the way forward in light of the recommendations to be made by the Working Group.

the Court, bring an action on behalf of the company for misconduct committed against the company by another (e.g. a director).²⁶² Both of these types of action have statutory backing.²⁶³

5. These private actions require considerable cost, time and effort to bring and so, practically, they are available only to the most tenacious and wealthy shareholders. A large listed company or its controlling shareholder would normally have far greater financial and legal resources to take or defend any legal action. Also, the costs of a private action are not shared among other shareholders and so those who do not participate in the action may “free ride” on any benefits that result. In a derivative action, damages awarded by the Court are attributable to the company, not the minority shareholder bringing the action. Also, minority shareholders are typically unable to access information from the company easily or in full to commence a proper action. For these reasons, for listed companies, such private actions are rare²⁶⁴.

US Shareholder Litigation

6. In the US, shareholder litigation (both class actions and derivative actions) is relatively common for a number of reasons, including:
 - (a) US shareholders are able to retain counsel on a contingency fee basis and a company is required to pay the shareholders’ legal fees in a derivative action if the lawsuit is successful;
 - (b) The availability of class action lawsuits allow minority shareholders to pursue their claims even though the amount of compensation sought, when taken individually, would not be sufficient to justify the expense of a lawsuit as is often the case with minority shareholder claims; and
 - (c) The availability of punitive damages and broad discovery capabilities in the US also encourage private litigation by shareholders.

²⁶² An action taken by shareholders on behalf of a company against third parties (usually directors). Directors have contractual and fiduciary obligations to a company. A company has contractual obligations to shareholders. However, there is no direct contractual relationship between directors and shareholders. If directors wrong the company and, by doing so, damage shareholders’ interests, it is for the company, not the shareholders, to take action. The company may not be willing to do so because it is controlled by the directors.

²⁶³ Section 214 of the SFO (unfair prejudice), sections 723 to 727 of the Companies Ordinance (Cap 622) (unfair prejudice), and sections s731 to s738 of the Companies Ordinance (Cap 622) (derivative action).

²⁶⁴ Gordon Jones, “*Corporate Governance and Compliance in Hong Kong*”, (2012), ISBN: 978-988-8146-23-9, Chapter 19, pages 451 to 477. Mr Jones notes: “*The cases invoking the statutory derivative action have been overwhelmingly used by private companies while those regarding inspections and injunctions hardly at all.*”

APPENDIX VI: IPO ELIGIBILITY REQUIREMENTS COMPARISON – HONG KONG VS. US EXCHANGES

	HONG KONG		UNITED STATES		
Minimum Criteria	Main Board	GEM	NYSE (Domestic Issue ²⁶⁵)	NASDAQ (Global Select Market ²⁶⁶)	NASDAQ (Global Market)
Trading Record	Three financial years	Two financial years	Earnings Test Three financial years Valuation/Revenue/Cash Flow Test Three financial years Valuation/Revenue Test One financial year Assets and Equity Test None	Earnings Standard Three financial years Capitalization with Cash Flow Standard Three financial years Capitalization with Revenue Standard One financial year Assets with Equity Standard None	Income Standard None Equity Standard Two financial years Market Value Standard None Total Assets/Revenue Standard None

²⁶⁵ A Foreign Private Issuer (as defined by rule 405 of Regulation C under the Securities Act) may elect to qualify for listing either under NYSE’s Alternate Listing Standards for Foreign Private Issuers or its criteria for US domestic listings. US domestic issuer standards are shown here as they are less stringent. Tests shown are for listing in connection with an IPO.

²⁶⁶ NASDAQ operates three distinct markets: The Nasdaq Global Select Market (“NGSM”), the Nasdaq Global Market (“NGM”), and the Nasdaq Capital Market (“NCM”). The NGSM has the most stringent requirements and the NCM the least stringent. Eight of the twelve NASDAQ listed Mainland Chinese companies shown in Appendix II are listed on the NGSM, the remaining four are listed on the NGM.

	HONG KONG		UNITED STATES		
Minimum Criteria	Main Board	GEM	NYSE (Domestic Issue ²⁶⁵)	NASDAQ (Global Select Market ²⁶⁶)	NASDAQ (Global Market)
Financial Standards	<p>Profit Test</p> <p>Market cap \geqHK\$200m (US\$25.8m) + Profit \geqHK\$20m (US\$2.58m) for the most recent financial year + Profit \geqHK\$30m (US\$3.87m) in aggregate for two preceding financial years.</p> <p>OR</p> <p>Market Cap/Revenue/Cash Flow Test</p> <p>Market cap \geqHK\$2bn (US\$260m) + Revenue \geqHK\$500m (US\$64.51m) for most recent audited financial year + Aggregate positive cash flow \geqHK\$100m (US\$12.9m) for three financial years.</p>	<p>Cash Flow Test</p> <p>Market cap \geqHK\$100m (US\$12.9m) + Aggregate positive cash flow \geqHK\$20m (US\$2.58m) for the two preceding financial years.</p>	<p>Earnings Test</p> <p>Aggregate pre-tax earnings \geqUS\$10m for the last three financial years + \geqUS\$2m in each of the last two financial years + positive amounts in all three years</p> <p>OR</p> <p>Aggregate pre-tax earnings \geqUS\$12m for the last three financial years + \geqUS\$5m in the most recent financial year + \geqUS\$2m in the next most recent financial year</p> <p>OR</p> <p>Valuation/Revenue/Cash Flow Test</p> <p>\geqUS\$500m market cap + \geqUS\$100m revenues during the most recent 12 month period + \geqUS\$25m aggregate cash flows for the last three financial years with positive amounts in all three years.</p> <p>OR</p>	<p>Earnings Standard</p> <p>Aggregate pre-tax earnings of \geqUS\$11m in last three financial years + \geqUS\$2.2m in each of the the last two financial years + positive amounts in all three years</p> <p>OR</p> <p>Capitalization with Cash Flow Standard</p> <p>Average \geqUS\$550m market cap over prior 12 months +</p> <p>Aggregate cash flows of \geqUS\$27.5m over last three financial years with positive amounts in each year +</p> <p>Revenue of \geqUS\$110m in last financial year</p> <p>OR</p>	<p>Income Standard</p> <p>Aggregate pre-tax earnings of \geqUS\$1m (in last financial year or in two of last three) + Stockholders' equity \geqUS\$15m</p> <p>OR</p> <p>Equity Standard</p> <p>Stockholders' equity \geqUS\$30m</p> <p>OR</p> <p>Market Value Standard</p> <p>Market value of listed securities \geqUS\$75m</p> <p>OR</p> <p>Total Assets/Revenue Standard</p> <p>Total assets \geqUS\$75m Total revenue \geqUS\$75m (in last financial year or in two of last three)</p>

	HONG KONG		UNITED STATES		
Minimum Criteria	Main Board	GEM	NYSE (Domestic Issue ²⁶⁵)	NASDAQ (Global Select Market ²⁶⁶)	NASDAQ (Global Market)
	<p>OR</p> <p>Market Cap/Revenue Test</p> <p>Market cap ≥HK\$4bn (US\$520m) +</p> <p>Revenue ≥HK\$500m (US\$64.52m) for most recent audited financial year</p>		<p>Pure Valuation/Revenue Test</p> <p>≥US\$750m in market cap +</p> <p>≥US\$75m in revenues during the most recent financial year.</p> <p>OR</p> <p>Assets and Equity Test</p> <p>≥US\$150m in market cap +</p> <p>≥US\$75m in total assets +</p> <p>≥US\$50m in stockholders' equity</p>	<p>Capitalization with Revenue Standard</p> <p>Average ≥US\$850m market cap over prior 12 months +</p> <p>Revenue of ≥US\$90m in last financial year</p> <p>OR</p> <p>Assets with Equity Standard</p> <p>≥US\$160m market cap +</p> <p>Total assets of ≥US\$80m +</p> <p>Stockholders' equity of ≥US\$55m</p>	
Distribution	Minimum 300 shareholders	Minimum 100 shareholders	400 holders of 100 shares or more + 1.1m publicly held shares	≥450 holders of 100 shares OR ≥2,200 total holders + 1.25m publicly held shares	400 holders of 100 shares or more + 1.1m publicly held shares

	HONG KONG		UNITED STATES		
Minimum Criteria	Main Board	GEM	NYSE (Domestic Issue ²⁶⁵)	NASDAQ (Global Select Market ²⁶⁶)	NASDAQ (Global Market)
Market Value of Publicly Held Shares	≥HK\$50m (US\$6.45m)	≥HK\$30m (US\$3.87m)	≥US\$40m	≥US\$110m (or ≥US\$100m if the company has stockholders' equity of at least ≥US\$110m)	Income Standard ≥US\$8m Equity Standard ≥US\$18m Market Value Standard ≥US\$20m Total Assets/Revenue Standard ≥US\$20m
Minimum Bid Price	No Listing Rule requirement.	No Listing Rule requirement.	≥US\$4	≥US\$4	≥US\$4

**APPENDIX VII: US COMPANIES WITH DUAL-CLASS SHARE STRUCTURES –
TOP 25 BY MARKET CAPITALISATION**

BIC Industry Group	Company	Business Description	IPO Year	Market Cap. (US\$m)
Internet	Google	Internet search engine	2004	\$374,415
	Facebook	Social networking platform	2012	138,820
	LinkedIn	Social networking platform	2011	25,891
	Groupon	E-commerce	2011	7,860
	Zulily	E-commerce	2013	5,129
	Yelp	Internet B2C platform	2012	4,846
	Zillow	Internet based real-estate marketplace	2011	3,210
Software	VMware	Virtualization infrastructure solutions provider	2007	38,608
	Workday	Management software developer	2012	14,536
	Tableau Software	Computer software company	2013	4,077
	Veeva Systems	Cloud-based software solutions provider	2013	4,000
	SS&C Technologies Holdings	Financial services software provider	2010	3,759
Commercial Services	MasterCard	Payment services provider	2006	100,571
	Vantiv	Payment services provider	2012	6,329

BIC Industry Group	Company	Business Description	IPO Year	Market Cap. (US\$m)
Retail	Dick's Sporting Goods	Sports and fitness retailer	2002	7,308
	DSW	Footwear and accessories specialty retailer	2005	3,877
Diversified Financial Services	Visa	Payment services provider	2008	141,756
Apparel	Under Armour	Sports clothing and accessories company	2005	9,222
Lodging	Hyatt Hotels	Hotel group	2009	7,744
Cosmetics/Personal Care	Coty	Fragrance and cosmetics manufacturer	2013	5,860
Aerospace/Defence	Spirit Aerosystems Holdings	Commercial aerostructures OEM	2006	4,930
Food	WhiteWave Foods	Plant-based foods and beverages retailer	2012	3,978
Entertainment	Dolby Laboratories	Audio system provider in entertainment industry	2005	3,929
Advertising	Clear Channel Outdoor Holdings	Outdoor advertising provider	2005	3,636
Transportation	Swift Transportation Company	Transportation services provider	2010	3,124
TOTAL				927,416

US IPOs of US companies with issued share capital that includes a dual-class share structure that went public since 2001. Excludes investment vehicles, limited partnerships and limited liability companies. Source: Bloomberg and company filings. Market data as at 31 December 2013.

APPENDIX VIII: PRIVACY POLICY STATEMENT

Privacy Policy Statement

Hong Kong Exchanges and Clearing Limited and from time to time, its subsidiaries, affiliated companies controlling it or under common control with it and its joint ventures (each such entity, from time to time, being "HKEx", "we", "us" or an "affiliate" for the purposes of this Privacy Policy Statement as appropriate) recognises its responsibilities in relation to the collection, holding, processing, use and/or transfer of personal data under the Personal Data (Privacy) Ordinance (Cap. 486) ("PDPO"). Personal data will be collected only for lawful and relevant purposes and all practicable steps will be taken to ensure that personal data held by HKEx is accurate. HKEx will use your personal data in accordance with this Privacy Policy Statement.

We regularly review this Privacy Policy Statement and may from time to time revise it or add specific instructions, policies and terms. Where any changes to this Privacy Policy Statement are material, we will notify you using the contact details you have provided us with and, as required by the PDPO, give you the opportunity to opt out of these changes by means notified to you at that time. Otherwise, in relation to personal data supplied to us through the HKEx website, continued use by you of the HKEx website shall be deemed to be your acceptance of and consent to this Privacy Policy Statement.

If you have any questions about this Privacy Policy Statement or how we use your personal data, please contact us through one of the communication channels below.

HKEx will take all practicable steps to ensure the security of the personal data and to avoid unauthorised or accidental access, erasure or other use. This includes physical, technical and procedural security methods, where appropriate, to ensure that the personal data may only be accessed by authorised personnel.

Please note that if you do not provide us with your personal data (or relevant personal data relating to persons appointed by you to act on your behalf) we may not be able to provide the information, products or services you have asked for or process your request.

Purpose

From time to time we may collect your personal data such as your name, mailing address, telephone number, email address and login name for the following purposes:

1. to process your applications, subscriptions and registration for our products and services;
2. to perform or discharge the functions of HKEx and any company of which HKEx is the recognised exchange controller (as defined in the Securities and Futures Ordinance (Cap. 571));
3. to provide you with our products and services and administer your account in relation to such products and services;
4. to conduct research and statistical analysis; and
5. other purposes directly relating to any of the above.

Direct marketing

Except to the extent you have already opted out or in future opt out, we may also use your name, mailing address, telephone number and email address to send promotional materials to you and conduct direct marketing activities in relation to our financial services and information services, and related financial services and information services offered by our affiliates.

If you do not wish to receive any promotional and direct marketing materials from HKEx or do not wish to receive particular types of promotional and direct marketing materials or do not wish to receive such materials through any particular means of communication, please contact us through one of the communication channels below.

Identity Card Number

We may also collect your identity card number and process this as required under applicable law or regulation, as required by any regulator having authority over us and, subject to the PDPO, for the purpose of identifying you where it is reasonable for your identity card number to be used for this purpose.

Transfers of personal data for direct marketing purposes

Except to the extent you have already opted out or in future opt out, we may transfer your name, mailing address, telephone number and email address to our affiliates for the purpose of enabling our affiliates to send promotional materials to you and conduct direct marketing activities in relation to their financial services and information services.

Other transfers of personal data

For one or more of the purposes specified above, the personal data may be:

1. transferred to our affiliates and made available to appropriate persons in our affiliates, in Hong Kong or elsewhere and in this regard you consent to the transfer of your data outside of Hong Kong; and
2. supplied to any agent, contractor or third party who provides administrative or other services to HKEx and/or any of our affiliates in Hong Kong or elsewhere.

How we use cookies

If you access our information or services through the HKEx website, you should be aware that cookies are used. Cookies are data files stored on your browser. The HKEx website automatically installs and uses cookies on your browser when you access it. Two kinds of cookies are used on the HKEx website:

Session Cookies: temporary cookies that only remain in your browser until the time you leave the HKEx website, which are used to obtain and store configuration information and administer the HKEx website, including carrying information from one page to another as you browse the site so as to, for example, avoid you having to re-enter information on each page that you visit. Session cookies are also used to compile anonymous statistics about the use of the HKEx website.

Persistent Cookies: cookies that remain in your browser for a longer period of time for the purpose of compiling anonymous statistics about the use of the HKEx website or to track and record user preferences.

The cookies used in connection with the HKEx website do not contain personal data. You may refuse to accept cookies on your browser by modifying the settings in your browser or internet security software. However, if you do so you may not be able to utilise or activate certain functions available on the HKEx website.

Compliance with laws and regulations

You agree that HKEx and its affiliates may be required to retain, process and/or disclose your personal data in order to comply with applicable laws and regulations, or in order to comply with a court order, subpoena or other legal process, or to comply with a request by a government authority, law enforcement agency or similar body (whether situated in Hong Kong or elsewhere). You also agree that HKEx and its affiliates may need to disclose your personal data in order to enforce any agreement with you, protect our rights, property or safety, or the rights, property or safety of our affiliates and employees.

Corporate reorganisation

As HKEx continues to develop its business, we may reorganise our group structure, undergo a change of control or business combination. In these circumstances it may be the case that your personal data is transferred to a third party who will continue to operate our business or a similar service under either this Privacy Policy Statement or a different privacy policy statement which will be notified to you. Such a third party may be located, and use of your personal data may be made, outside of Hong Kong in connection with such acquisition or reorganisation.

Access and correction of personal data

Under the PDPO, you have the right to ascertain whether HKEx holds your personal data, to obtain a copy of the data, and to correct any data that is inaccurate. You may also request HKEx to inform you of the type of personal data held by it. All data access requests shall be made using the form prescribed by the Privacy Commissioner for Personal Data ("**Privacy Commissioner**") which may be found on the official website of the Office of the Privacy Commissioner.

Requests for access and correction or for information regarding policies and practices and kinds of data held by HKEx should be addressed in writing and sent by post to us (see contact details below).

A reasonable fee may be charged to offset HKEx's administrative and actual costs incurred in complying with your data access requests.

Termination or cancellation

Should your account with us be cancelled or terminated at any time, we shall cease processing your personal data as soon as reasonably practicable following such cancellation or termination, provided that we may keep copies of your data as is reasonably required for archival purposes, for use in relation to any actual or potential dispute, for the purpose of compliance with applicable laws and regulations and for the purpose of enforcing any agreement we have with you, for protecting our rights, property or safety, or the rights, property or safety of our affiliates and employees.

Contact us

By Post:

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