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Why harmonising multiple voting rights for SMEs may be a bad idea[1]

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On 7 December, the European Commission presented the Listing Act package which contains three proposals. These aim to improve and simplify current EU law on listing securities to help small and medium enterprises (SME) make better use of European trading venues. Thus, they are an important and much needed step in the right direction.

The package also contains another proposal for a directive that aims to address differences across Member States' national law on corporate governance and allow shares with multiple voting rights (MVR) for national SMEs that seek admission to an SME growth market. Although MVR shares are well known in many Member States as being not only harmless, but also a very useful tool, this Policy Brief argues that the proposal is an unjustified incursion into national law. It lacks the empirical and logical support necessary for EU harmonisation to proceed. If MVR shares are to spread across the EU, it should rather be by the power of example, and not by the brute force of harmonisation.

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The Listing Act package

Being part of the very important work initiated by the Commission on creating a Capital Markets Union (CMU), the Listing Act package[2] consists of a proposal for a directive and a regulation to make public capital markets in the EU more attractive for companies, as well as facilitate SMEs' access to capital. To achieve this, the proposed regulation contains amendments to the Prospectus Regulation, the Market Abuse Regulation (MAR), and the Markets in Financial Instruments Regulation (MiFIR), whereas the proposed directive would amend the Markets in Financial Instruments Directive (MiFID II). Given that the regulation on admission to trading venues has long been in dire need of revision, these proposals are very welcomed and many of their elements represent good initiatives that deserve attention.

In the Listing Act package there is also a proposal on MVR (i.e. the Proposal) that tries to harmonise national corporate governance structures across Member States regarding the distribution of powers within companies[3]. However, contrary to the above-mentioned amendments which will rectify EU law on securities regulation, the Proposal will interfere with the Member States' right and freedom to design national company law applicable to their own national companies. This significant difference between this and the two other proposals under the Listing Act package makes the case for harmonisation very onerous. More importantly, and as we argue below, the justification to pursue harmonisation in this area is clearly lacking.

The Proposal would make the availability of MVR structures mandatory in all Member States in the case of an SME applying for admission into an SME growth market. Currently, the use of MVR differs considerably across the EU[4]. Some Member States forbid MVR structures for their national companies, opting instead for a 'one share one vote' (OSOV) structure. Others, among them the Nordics, allow MVR structures either fully or within a range of 1-10, considering the issue of shares a decision to be made solely by the company and its investors. There are also those Member States that accept different classes of shares and allow both MVR and non-voting shares[5].

The difference between voluntary cooperation and voluntary interaction

A trading venue is a regulated and authorised facility where securities are traded and includes, among others, multilateral trading facilities (MTFs), organised trading facilities (OTFs) and regulated markets such as stock exchanges. Given the plethora of trading venues registered in the EU, harmonisation efforts that will facilitate the cross-border allocation of capital among companies and investors are necessary. However, there is a difference between the need to harmonise securities regulation in the EU and proposals aiming to harmonise company law (i.e. the regulation of a company's internal

[2] The initiative followed a public consultation from 19 November 2021-25 February 2022 informed, *inter alia*, by Oxera (2020), *Primary and secondary equity markets in the EU*, Study for the European Commission, November.

[3] When a company goes public by issuing shares with an MVR structure, it typically issues two or more classes of shares, for example one to the public and another to insiders. While the publicly-issued shares have limited voting rights, those issued to insiders carry more voting rights, thus allowing the insiders to retain control of the company (i.e. governance) without owning a majority of shares. This corporate structure differs from the one-to-one ratio of votes to shares that might give minority shareholders a voice in the boardroom proportionate to their investment depending on the distribution of shares. See for example Anand, A. (2019), *Shareholder-driven corporate governance*, Oxford University Press.

[4] See for example Table 3.3 of Oxera (2020).

[5] Non-voting shares can be distinguished to those with preference – special cash-flow rights to compensate for the absence of voting rights – like a preferential dividend (higher or guaranteed), and those without preference.

organisation) across Member States. This is because voluntary interaction is different from voluntary cooperation.

Voluntary cooperation, like that found in companies, is permanent and requires permanent agreements among the participating parties. Voluntary interaction, on the other hand, as found in markets for goods or in trading venues for securities, is of a temporary nature, leaving no time for the parties to enact agreements among themselves. Consequently, the character of company law is mostly to enable, using only mandatory regulation to protect parties that are not deemed able to negotiate for themselves, whereas securities regulation is mostly mandatory and entails setting up standard conditions for the interaction that the parties cannot erect themselves.

It is important to keep these differences in mind when making use of the harmonising powers of EU law. While it is reasonable to try and harmonise rules on access to – and conduct on – trading venues, it is an overreach to try and regulate company law simply because some of the securities traded happen to be shares in companies. It also goes against the founding Principle of Subsidiarity enshrined in Article 5 of the Treaty of the EU, to suggest that Member States are not capable of designing a suitable company law for themselves. Additionally, the observable differences between national company law among Member States reflect national traditions found important enough to be maintained. Thus, there is limited room and the need for harmonisation in respect of the internal governance structures of national companies.

The inoffensiveness of MVR

As the example of Nordic company law illustrates, MVR structures can be seen as harmless and have proved useful[6]. This may explain why the Commission looks favourably on MVR structures and it may be difficult to understand why some Member States view them as offensive to the point where they command their companies not to use them[7].

A ban on MVR structures cannot be based on considerations of 'shareholder democracy[8]', which is a misnomer because there is no *demos* in a limited liability company (LLC). The constituent elements in an LLC are not its members, as it is in a partnership, but shares. This means that the position of shareholders is determined by the shares they hold, which depends partly on the rights that each share carries, and the number of shares held.

[6] MVR shares – within clearly defined limits set in the companies' acts – are one of the most frequently used ownership control enhancing mechanisms (CEM), primarily in Sweden, but to some degree also in Denmark and Finland. See for example Eckbo, E., Paone, G. and Urheim, R. (2010), *Efficiency of share-voting systems: Report on Sweden*, Law Working Paper Series in Law, No 173, European Corporate Governance Institute; Gilson, R. (2014), 'The Nordic model of corporate governance: The role of ownership', in Lekvall, P. (ed), *The Nordic corporate governance model*, SNS Förlag, pp. 94-112.

[7] Even when a company and its investors would favour them.

8 Shareholder democracy should preferably refer to the ability of shareholders to influence the policy, governance, functions, and decisions of a company through their votes. It is an important concept in corporate law, and one that underpins the legitimacy of shareholder activism.

Equally, a ban on MVR structures cannot be based on the 'principle of equality' of shares and shareholders[9]. It is the company's obligation to treat shares equally, but only to the extent that these shares offer the same rights (i.e. are of the same class). This is neatly spelled out in Article 85 of the Directive relating to certain aspects of company law, which calls for 'equal treatment of all shareholders', but only when they are 'in the same position'[10]. However, there is nothing contrary to this principle in the fact that a shareholder with two shares can enjoy double the voting rights and dividends compared to a shareholder holding only one share, even in an LLC with an OSOV structure.

Another argument that needs to be clarified is that shareholders enjoying MVR would run the company less efficient than in an OSOV structure. But why should this be true, when MVR concerns voting rights and not financial rights? The latter are tied to the capital investment that their MVR shares represent, which are the same as those of all other shares in the company. Their control may be disproportionate to their financial investment, but their financial reward is not. As a result, shareholders with MVR are just as dependent on the financial success of the company to obtain a return on their investment, as are all other shareholders[11].

The above considerations suggest that Member States should allow MVR structures in their national company law. However, changing the perspective that some Member States have about MVR structures or trying to understand why some of them perceive them negatively goes beyond the scope of this Policy Brief. At the end of the day, Member States are free to maintain the company law that they favour. We simply argue that there are ample reasons for them to reconsider their animosity to MVR. The fact that countries like Germany may now allow MVR structures does not justify harmonisation. On the contrary, it shows that Member States are continuously considering how best

[9] The principle of the equality of shares usually means that all of a company's shares shall be treated equally, if not otherwise stipulated in law. Additionally, this principle reflects the principle of the shareholders' equality, which means that the company may not make decisions or take other measures that can cause a shareholder or another person an undue benefit at the expense of the company or a shareholder of the company. See for example Brudney, V. (1983), 'Equal treatment of shareholders in corporate distributions and reorganizations', *California Law Review*, Vol. 71, No 4, pp. 1072-1133; Cox, J. (1997), 'Equal treatment for shareholders: An essay', *Cardozo Law Review*, Vol. 19, pp.615-635; Pönkä, I. (2016), The principle of equality of shares and shareholders, *Nordisk Tidsskrift for Selskabsret*, No 1, pp. 38-49.

[10] This is similar in company law to the 'principle of legality' known from administrative law. The principle entails that there should be a legal basis for the treatment meted out, which has the effect that those who are in the same position must be treated equally. However, this does not rule out that persons may be treated differently if there is a legal basis for it (e.g. by the different rights afforded by the shares they hold).

[11] A 2007 study conducted on behalf of the European Commission to explore whether so-called control enhancing mechanisms (CEM), including MVR, display detrimental effects to companies' performance, found no empirical evidence. As it was summarised by Commissioner McCreevy, '*The study found that there* is no *economic evidence of a causal link between deviations from the so-called "proportionality principle" and the economic performance of companies'*. Furthermore, it can also be argued that the possession of shares with MVR signifies a long-term commitment to the company. See for example Ventoruzzo, M. (2015), *The disappearing taboo of multiple voting shares: regulatory responses to the migration of Chrysler-Fiat*, Working Paper Series in Law, No 288, European Corporate Governance Institute; Dubois, A. (2019), *Introduction of loyalty shares in the Belgian listed companies, a real game changer?*, Louvain School of Management, Université catholique de Louvain, 2019; Belot, F., Ginglinger, E. and Starks, L. (2019), *Encouraging long-term shareholders: The effects of loyalty shares with double voting rights*, Research Paper No 3475429, Université Paris-Dauphine; Gurrea-Martínez, A. (2021), 'Theory, evidence, and policy on dual-class shares: A country-specific response to a global debate', *European Business Organization Law Review*, Vol. 22, pp. 475-515.

to calibrate their national corporate governance systems and that this can be done on a national level without the need for harmonisation on the EU level[12].

No legal basis for harmonisation

To start with, the Company Law Directive, which codifies EU company law legislation, does not regulate MVR structures. This is for the very reason that MVR structures are tightly interwoven with the corporate governance systems of the individual Member States. Thus, they are unsuitable for harmonisation as that might tear into the fabric of property rights in contravention of the fundamental principle enshrined in Article 345 TFEU[13].

In fact, what makes the harmonisation of corporate governance so difficult is that it concerns the *exercise* of private property rights. Meaning that harmonisation can be contemplated only where there is substantive and irrefutable empirical evidence for any harm springing from this kind of private action. In other words, hard evidence of a direct link between MVR structures and public trading is needed. But this is obviously not the case here.

The Commission's impact assessment (IA) finds that 'The absence of data on the share of firms that used MVR share structures when issuing shares prevents an in-depth analysis'. Even when attempting to use a 'substitute[14]', the conclusion is that 'it would be close to impossible to draw any direct causal links between the existence of a possibility to issue MVR shares and a higher number of IPOs in a given Member State'. This is due to the 'complex nature of a listing decision, which takes into account a wide number of various parameters'. It is obvious, therefore, that the case for harmonisation does not live up to the standard required by the Principle of Subsidiarity.

The main argument put forward by the Commission in favour of harmonisation appears to be the observable differences among the national systems of corporate governance. However, the mere fact that governance systems may vary among Member States is not in itself sufficient to overcome the Principle of Subsidiarity. As it has been argued, national differences in legal regimes across the EU should not be viewed as an obstacle to free enterprise within a single market than are differences of culture, language and geography[15]. The very existence of the Principle of Subsidiarity is testament to this acceptance of diversity.

As the Proposal and the IA illustrate, there is lack of empirical evidence showing that the variation in national company governance systems is sufficiently detrimental to harm the functioning of the EU. It has also been shown that there is no difference between the performance of LLCs with MVR or OSOV structures. Or to put it differently, there is no such thing as a superior corporate governance system in

[12] The system of rules, practices, and processes by which a company is directed and controlled, is intrinsically connected not only with the structure of company law in a given jurisdiction, but also with the national and international markets' organisation, ownership structure, business culture and even social traditions at a national level. See for example the Whiter Paper: Challenges to Swedish corporate governance due to EU -level regulation, produced by the Swedish Corporate Governance Board in 2021.

[13] 'The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.'.

[14] This is the comparison between the number of initial public offerings (IPOs) in the Member States that permit MVR share structures with those that do not permit their use.

[15] See for example the Report of the Reflection Group on the Future of EU Company Law and Hansen, J. L. (2011), *The Report of the Reflection Group on the Future of EU Company Law – As seen from a Nordic perspective*, Working Paper, No 10-15, Nordic & European Company Law, 6 June.

respect of these structures. And if it ever existed, the competitive pressure among companies for investment would probably have made the model dominant a long time ago.

Problems with the substantive law of the Proposal

Besides the lack of any convincing empirical evidence, there is a fundamental and inexplicable inconsistency in the reasoning offered in the Proposal.

The irrelevance of MVR as an instrument of control

The Proposal starts by highlighting the benefits of MVR structures. It explains that such a structure may ensure that SMEs issuing shares will not sacrifice their beneficial influence over the company, and rather that it will enable them to focus on their long-term vision for the company[16]. It also argues that other forms of CEM are less efficient and transparent than MVR. The so-called loyalty shares, for example, which appear to be very popular in some circles, have several drawbacks when compared to MVR[17].

However, the Proposal then continues by explaining that the introduction of MVR would result in other shareholders having less decision-making power relative to their economic investments, and that this could lead to specific problems if not properly mitigated. One of these problems, is, for example, the abuse of power by controlling shareholders, and the extraction of private benefits through related party transactions (RPT)[18]. However, such problems are irrespective of whether a company has an MVR or an OSOV structure[19]. The lack of empirical evidence on the opposite makes the case for harmonisation less appealing[20]. Moreover, problems concerning the abuse of control are already addressed both in Member States' national law and EU law itself[21]. Thus, there is no problem that requires a separate EU response.

[16] Indeed, MVR has the added benefit of ensuring that control over management remains in the hands of one or very few shareholders. This thus avoids the problem of collective action that often renders shareholders in companies with dispersed ownership powerless and unable to discipline management.

[17] As the superior voting rights of loyalty shares accrue by the duration of ownership, it is near impossible for other investors or the general public to keep track of the voting rights available in the company at any given time. This results in reduced transparency about control. As these superior voting rights are lost upon transfer, they are designed to create a lock-in effect that discourage public trading and effectively serve as an anti-takeover device.

[18] Controlling shareholders may abuse their power and extract 'private benefits of control' at the expense of minority shareholders. A few examples include: entering into conflicts-of-interest transactions, misusing corporate resources for personal ends, expropriating corporate opportunities, or building a conglomerate empire. However, concentrated ownership is also associated with benefits and costs. For example, concentrated ownership may reduce agency costs through the increased monitoring of top management. See for example Singal, M. and Singal, V. (2011), 'Concentrated ownership and firm performance: does family control matter?', *Strategic Entrepreneurship Journal*, Vol. 5, Issue 4, pp. 373-396; Choi, A. (2018), 'Concentrated ownership and long-term shareholder value', *Harvard Business Law Review*, Vol. 8, No 1, pp. 53-99; Rose, C. (2019), 'Concentrated ownership', in Marciano, A. and Ramello, G. (eds), *Encyclopedia of Law and Economics*, Springer, pp. 299-304.

[19] In fact, they follow from the very existence of *control*. That is, the possession of votes necessary to determine the outcome of voting at the general meeting of shareholders by any one shareholder or by shareholders acting in concert. Control is not an objective feature of shares, it concerns the relative voting power of shareholders. That is why many Member States that accept MVR structures accept them without any limitation. The problem of abuse of control is a problem that arises whenever one shareholder has more votes than the others. This must be solved by addressing that shareholder's abuse and not the share structure of the company.

[20] The Commission's 2007 study was unsuccessful in exposing any such problems.

[21] See for example the measures combating abuse of RPT in the revised Shareholder Rights Directive (SRD2).

The irrelevance of MVR in respect of sustainability considerations

The Proposal suggests that MVR may result in controlling shareholders blocking certain resolutions, including those aimed at sustainability goals. This argument seems to exist for the simple purpose of making use of the concept of sustainability, which is highly popular among EU legislators. However there is no explanation why a shareholder enjoying MVR would vote against sustainability goals. MVR shareholders, as *all* shareholders, know that the value of their shares reflects the present value of future cashflows (i.e. the long-term financial performance of their company). Therefore, there is no reason why any rational shareholder would block such a decision. On the contrary, experience shows that shareholders are acutely aware of the risks connected with climate change and are anxious that these problems are recognised and dealt with by the companies they invest in[22].

Conclusion

The Commission's recent MVR proposal is a faulty parcel in an otherwise very interesting Listing Act package.

As we have explained in this Policy Brief, there is no valid reason to harmonise national corporate governance structures across Member States. Instead, there are many good reasons not to.

Although many Member States are accustomed to MVR structures and their usefulness, others strongly oppose such structures. If the advantages of MVR are to be spread out more evenly throughout the EU, it should be by the power of example, not the brute power of EU law. Respecting the independent judgement and will of Member States should be paramount and unquestionable.

[22] See for example OECD (2018), *Climate-related financial disclosures and corporate board practices: Taking stock of the TCFD recommendations*, 2018 OECD-Asian Roundtable on Corporate Governance, Securities Commission Malaysia, 7-8 November; Flammer, C., Toffel, M. and Viswanatham, K. (2021), 'Shareholder activism and firms' voluntary disclosure of climate change risks', *Strategic Management*, Vol. 42, Issue 10, pp. 1850-1879; Ilhan, E., Krueger, P., Sautner, Z. and Starks, L. (2023), 'Climate risk disclosure and institutional investors', *Review of Financial Studies*, Forthcoming.

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