Dalhousie Journal of Legal Studies

Volume 21 Article 7

1-1-2012

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Introduction

The publicly traded corporation has long been a source of legal debate and controversy. In the 21st century, however, a combination of highly publicized corporate scandals and financial improprieties has centered the debate surrounding publicly traded companies on the topic of corporate governance. Corporate governance refers to the framework by which business corporations are managed and controlled,[1] and each corporation has its own unique internal characteristics and organization that impact the way it is governed. One such aspect is a corporation's equity ownership structure that sets out the types of shares to be issued to the public, and the rights, responsibilities, and degrees of control that each share confers on its respective owner. This paper focuses on the contentious topic of dual class share structures in Canada.

At their core, dual class share structures refer to a particular corporate equity structure in which different classes of common shares are issued, each with distinct voting and control rights.[2] While organizations like the Shareholder Association for Research and Education ("SHARE")[3] and institutional investors like the Ontario

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[1] Thomas Clarke, *International Corporate Governance: A Comparative Approach* (Oxon: Routledge, 2007) at 2.
[2] Dual class shares may include non-voting shares, restricted voting, and subordinate voting shares.
[3] Second Class Investors, *The Use and Abuse of Subordinated Shares in Canada* (April 2004), at 5, online: SHARE: Shareholder Association for Research and Education <www.share.ca/files/Second_Class_Investors_1.pdf> [*SHARE*].

Teacher's Pension Plan ("OTPP")[4] have argued that dual class share structures reduce non-controlling shareholder wealth and ought to be banned from Canadian public stock exchanges, the evidence for this claim is less than conclusive.[5] Others, particularly financial analysts, have argued that in some instances dual class firms have exhibited better stock market performances than even the widest held firms. This paper aims to examine both the favourable and unfavourable characteristics of dual class share structures, and argue that these equity arrangements create a precarious controlling-minority structure ("CMS")[6] that increases agency costs and financial risks to non-controlling shareholders.

Part I of this paper provides an overview of the general structure of public corporations and how dual class firms fundamentally differ from other forms. In addition, a brief review of the history of dual class share structures in Canada is provided as well as their current relevance in Canadian capital markets. Part II examines the arguments supporting dual class firms and the potential economic benefits they can yield for society as a whole. While it is acknowledged that some examples suggest that dual class firms are an effective corporate governance structure, it is argued that these tend to be the exception rather than the rule. Part III examines, through the use of two models, how dual class share structures increase the agency costs and financial risks to non-controlling shareholders. Specifically, it is argued that as a controlling minority shareholder's equity in the firm decreases, agency costs for non-controlling shareholders tend to rise at a rapid rate. Part IV

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[4] Ontario Teacher's Pension Plan, *Shareholder Rights Issues: 4.2 Dual Class Share Structures*, online: Ontario Teacher's Pension Plan < http://www.otpp.com/wps/wcm/connect/otpp_en/home>.

[5] John L. Teall, *Governance and the Market for Corporate Control* (Oxon: Routledge, 2007) at 46. "The wealth impact of dual class recapitalizations is not clear. For example, Partch (1987) finds no evidence of shareholder wealth reductions resulting from dual class recapitalizations. However, after expanding the data set of Partch from 44 firms to 94 and including recapitalizations from 1984 to 1987, Jarrell and Poulsen (1988) found that shareholders experience significant negative abnormal returns from dual class recapitalizations."

[6] Lucian Arye Bebchuk, Reinier Kraakman, & George G. Triantis, "Stock Pyramids, Cross Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash Flow Rights" in Randall K. Morck, ed, *Concentrated Corporate Ownership* (Chicago: The University of Chicago Press, 2000) at 295.

demonstrates how these increased agency costs and financial risks occur. Particularly, it is argued that CMSs erode the traditional internal and external monitoring mechanisms that serve as effective monitoring and disciplinary mechanisms in more dispersed ownership structures.[7] Part V considers the current regulatory regime surrounding dual class firms and argues that these limited provisions, specifically the 1987 coat-tail provision, are largely inadequate to manage the enhanced risks and agency costs that CMSs pose to non-controlling shareholders. However, rather than espousing the positions of SHARE and OTPP, Part VI of this paper proposes that the benefits of dual class firms be harnessed under a more appropriate regulatory regime that better mitigates the risks they pose to non-controlling shareholders. In particular, it is argued that the provincial implementation of a mandatory voting cap restriction is a practical step towards improving the regulation of dual class firms and minimizing the added agency costs they pose to non-controlling shareholders. Part VII concludes this argument.

I. Background

To properly understand these issues, it is important to examine the basic governance structure of a traditional public corporation and how it differs from CMSs, as well as why dual class firms are a relevant issue in Canadian capital markets. Public corporations, in an effort to raise capital and expand, issue ownership shares to the general public.[8] Investors, both individual and institutional, contribute financial capital to the firm in the hopes of realizing a profit through the appreciation of the firm's shares and the distribution of dividends. Shareholders elect and delegate decision-making rights to a board of directors who, in turn, appoint corporate managers responsible for the firm's day-to-day operations.[9] The managers are accountable to the board of directors, and the directors are accountable to the shareholders. This separation of ownership from control gives rise to the principal-agent problem, which was

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[7] Dispersed ownership structures refer to firms in which no single shareholder owns enough shares to exercise complete control over the company.

[8] Tara Gry, "Dual Class Share Structures and Best Practices in Corporate Governance" *Library of Parliament* (18 August 2005) at 2, online: Parliamentary Information and research Service <http://www2.parl.gc.ca/Content/LOP/ResearchPublications/prb0526-e.htm>.

[9] *Ibid*.

famously described by Adolf Berle and Gardiner Means in their book, *The Modern Corporation and Private Property*.[10] Michael Jensen and William Meckling further developed this concept in the 1970s in their piece *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*. According to Jensen and Meckling, directors and managers, acting as agents, often have greater access to corporate information and wield more direct control over the firm and, as a result, can use their positions to act in their own self-interests rather than those of the shareholders or principals.[11] The costs borne by shareholders of managerial and directorial indiscretion and the resources required to monitor such actions are referred to as agency costs. As a result of the risks that the agency problem poses to shareholders, various laws and corporate governance mechanisms have been implemented. Examples include the legal requirement that directors have a fiduciary duty to act in the best interests of the corporation,[12] the granting of ownership positions in the firm to management to better align their interests with those of shareholders, and a host of financial disclosure and reporting requirements.[13] Perhaps the most important corporate governance mechanism for influencing management behaviour and protecting shareholder interests is a shareholder's right to vote. The right to vote permits shareholders to elect the board of directors, to vote on corporate policy changes, and, in some instances, to approve executive compensation arrangements and appointments.[14] Most corporations issue shares that each yield one vote. Under this equity arrangement, voting rights are proportionate to the amount of equity held in the firm, and thus the more equity invested, the more influence an investor has on the decisions of the corporation. However, the effectiveness of an investor's right to vote, which in theory is intended to offer all shareholders a degree of control and influence on the board, is largely restricted in corporations employing a dual class equity structure.

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[10] David Millon, "Theories of the Corporation" (1990) Duke LJ 201 at 214.
[11] *Ibid* at 230.
[12] John A. Willes & John H. Willes, *Contemporary Canadian Business Law: Principles and Cases*, 8th ed (Toronto: McGraw-Hill Ryerson, 2006) at 322.
[13] Gry, *supra* note 8.
[14] *Ibid*.

In a dual class share structure, there are two classes of equity securities—superior and inferior voting shares.[15] The number of votes that each share wields differs according to its class. In some cases, superior shares carry multiple votes while inferior shares carry only one. In other instances, superior shares carry one vote while the inferior shares are non-voting. It is important to note that both forms of subordinated shares are permitted to trade on the Toronto Stock Exchange ("TSX"), Canada's largest stock market.[16] Instead of the traditional management-shareholder agency relationship described above and characteristic of more dispersed ownership structures, these arrangements give rise to a unique agency relationship between controlling minority shareholder(s) and non-controlling shareholders.

Distinct from a situation where an individual or group owns a large share position and, in turn, an equal number of votes, dual class share structures manipulate the typical one share to one vote ratio and allow voting rights to exceed cash flow rights.[17] These equity structures can be created at the time of a company's initial public offering ("IPO") or can be implemented later through a recapitalization or reorganization.[18] By creating multiple classes of shares, founder(s) of corporations often keep the higher voting stocks for themselves, decrease their equity in the firm, and sell the non or reduced voting stock to the public in order to raise the necessary capital. According to Professor Paul Halpern of the Rotman School of Management at the University of Toronto, "without the dual class structure, a firm that has significant growth opportunities would have to issue voting equity with a resulting loss in control to the founder(s)."[19] Another motivation for the issuance of two distinct classes of shares, according to Halpern, is to permit the founder(s) of the company to reduce their equity investment in the firm in an effort to diversify their own personal portfolios.[20] Professors Lucian Bebchuk, Reinier Kraakman, and George Triantis of Harvard Law

[15] Paul J.N. Halpern, "Systemic Perspectives on Corporate Governance Systems" in Stephen S. Cohen & Gavin Boyd, eds, *Corporate Governance and Globalization: Long Range Planning Issues* (Northampton: Edward Elgar Publishing Inc., 2000) at 32.
[16] Gry, *supra* note 8 at 3.
[17] Cash flow rights refer to claims that a shareholder has on the cash payouts of the firm.
[18] *SHARE*, *supra* note 3 at 7.
[19] Halpern, *supra* note 15.
[20] *Ibid*.

School argue that this pattern of ownership creates an unstable "controlling-minority structure because it permits a shareholder to control a firm while holding only a fraction of its equity."[21] It is these structures, which increase agency costs for non-controlling shareholders and expose them to potentially exploitative behaviour on behalf of the controlling minority shareholder, that are a fairly common feature of Canadian capital markets.

The use of dual class shares as a corporate financing mechanism in Canada is largely rooted in mid-19th century changes to corporate statutes. Professors Stephanie Ben-Ishai and Poonam Puri of Osgoode Hall Law School attribute much of these changes to the shifting economic values of that period.[22] Particularly, they claim that the encouragement of the private initiative led to changes in corporate legislation that "increasingly allowed corporations to vary the one vote per share allocation through their by-laws or articles of incorporation."[23] For example, the *Ontario Joint Stock Companies' Letters Patent Act* of 1874 stated that "at all general meetings of a corporation every shareholder was entitled to as many votes as he owned shares in the company, unless expressly provided otherwise by letters patent or by-laws of the corporation."[24] However, despite legislation permitting the issuance of all types of dual class shares between 1874 and 1953,[25] their popularity in Canada did not firmly take hold until the late 1970s.[26]

In 1975, only 5 per cent of companies listed on the TSX used some form of dual class share structure.[27] However, by 1987 this number had grown to more than 15 per cent.[28] According to a study conducted by Burgundy Asset Management between December 31, 1987 and December 31, 1995, 29.2 per cent of the 413 companies listed on the TSX had a dual class share structure.[29] Randall Morck, Jarislowsky Distinguished Professor of Finance at the University of

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[21] Bebchuk, *supra* note 6.
[22] Stephanie Ben-Ishai & Poonam Puri, "Dual Class Shares in Canada: A Historical Analysis" (2006) 29 Dalhousie LJ 117 at 121.
[23] *Ibid.*
[24] *Ibid* at 122.
[25] *Ibid.*
[26] *SHARE*, *supra* note 3 at 10.
[27] *Ibid.*
[28] *Ibid.*
[29] *Ibid.*

Alberta, argues that the rise of pyramidal control (which encompasses dual class share structures) during the final decades of the 20th century is, in part, related to the elimination of the *Inheritance Tax* in 1972.[30] With shares held by estates being treated as sales or deemed dispositions upon death for the purposes of income tax, Morck claims that families were encouraged to maintain perpetual control of their corporate interests so as to transfer assets to their progeny in a virtually costless manner.[31]

While increasing investor opposition (particularly from institutional investors) suggests that the use of dual class share structures in Canada may be in decline, an estimated 25 per cent of corporations listed on the TSX still maintain some form of dual class shares.[32] Included in these statistics are some of Canada's largest and most renowned firms, such as Four Seasons Hotels Inc., Rogers Communications Inc., Bombardier Inc., Telus Corp., and Quebecor.[33] Typically, a founder or their family maintains control in each of these corporations by means of a superior voting class of shares. For instance, the Bombardier family has only 17.5 per cent of the equity invested in the firm, but due to its superior voting Class A shares that each wield 10 votes, the family controls 59.7 per cent of the firm's total outstanding votes.[34] A more extreme example is the Stronach family of Magna International Inc., who, until recently, controlled 66 per cent of the firm's votes with only 0.6 per cent of Magna's total equity.[35] With controlling minority shareholders owning very little of the firm's total equity, the potential exists for these individuals and their families to exert their control in an attempt to extract greater financial returns and private benefits. Such benefits may include exclusive use of company resources and assets, excessive compensation packages, and other non-pecuniary items like prestige and status.

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[30] Randall Morck et al, "The Rise and Fall of the Widely Held Firm: A History of Canadian Corporate Ownership" in *A History of Corporate Governance around the World: Family Business Groups to Professional Managers* (Chicago: University of Chicago Press, November 2005) 65 at 145.
[31] *Ibid.*
[32] Gry, *supra* note 8 at 4.
[33] *SHARE*, *supra* note 3 at 11.
[34] *Ibid* at 12.
[35] S. Khalil & M. Magnan, "Dual-Class Shares: Governance, Risks, and Rewards" (2007, May/June), at 2, online: Ivey Business Journal <http://www.iveybusinessjournal.com/article.asp?intArticle_ID=693>.

Furthermore, dual class share structures pose a very real concern in Canadian capital markets, particularly for Canadian retail investors. As recent statistics indicate, 46 per cent of the Canadian population owns shares in publicly traded companies.[36] The primary objective of many of these investors is to fund their future financial plans and retirement. Dual class share structures, however, do not align with the goals of many investors because this type of structure tends to enhance, rather than mitigate, financial risk. The byproduct of dual class share structures is to effectively shift the burden of financial risk towards the non-controlling shareholders while simultaneously insulating controlling minority shareholders from loss. However, despite the enhanced risks that CMSs pose to non-controlling shareholders, it is important to recognize that dual class structures are not entirely negative. The next part of this paper will consider the arguments in favour of dual class share structures as well as some of the benefits they can produce for investors and society as a whole.

II. Dual Class Shares: Not All Bad

There is some agreement between both proponents and critics of CMSs that without the availability of dual class equity arrangements, founders and entrepreneurs would be reluctant to take their firms public due to the resulting loss in control. It is argued that this will lead to a curtailment in the growth of new and emerging companies who will either choose to remain private or seek less flexible forms of financial capital, such as debt financing.[37] As a result, the potential exists for reductions in innovation, investment returns, job creation, and overall economic growth in Canada.

In addition, some proponents of dual class share structures argue that such arrangements are largely the result of the limits that the federal government imposes on the level of foreign ownership of Canadian companies.[38] For instance, under section 26(1) of the federal *Broadcasting Act*, which provides the Governor in Council the discretion to issue binding directions to the Canadian Radio-television and Telecommunications Commission ("CRTC"), the

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[36] Gry, *supra* note 8 at 2.
[37] *Ibid* at 5.
[38] *SHARE*, *supra* note 3 at 15.

issuance and granting of broadcasting licenses has been prohibited to governments other than the Government of Canada and to persons who are not Canadian citizens or "eligible Canadian corporations".[39] Similarly, the *Telecommunications Act* and the *Insurance Companies Act*, stipulate that foreign ownership limits of companies within these industries may not exceed 20 per cent and 25 per cent, respectively.[40] In accordance with these legislated limits, proponents of dual class share structures maintain that such equity arrangements can serve as an effective mechanism for the protection of Canadian ownership interests in industries traditionally considered economically or culturally sensitive.[41] In pursuit of protecting national interests, Canadian controlling minority shareholders can maintain control of firms in these particular industries while still raising financial capital on a global scale as "many foreign investors have happily bought into structures of this sort."[42] It is notable, however, that the Canadian government does not require dual class structures nor does it even recommend such measures in the furtherance of this policy goal.[43] Rather, the federal government simply requires companies to respect their related ownership limits. For example, Bell Canada Enterprises is required to maintain strict foreign ownership limits but does so with a single class of shares.[44] Once a foreign investor has surpassed this ownership threshold, Bell Canada has the authority to force the sale of those shares in excess of that limit in order to comply with its legislated limits.[45]

Lastly, proponents of dual class share structures also tout the efficiencies of such equity arrangements by quoting powerful

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[39] Stikeman Elliott LLP, *Broadcasting and Telecommunications: Section Q of Stikeman Elliott's Doing Business in Canada*, online: Stikeman Elliott LLP <http://www.stikeman.com/images/core/Q_Broadcasting_and_Telecommunications.pdf>. See also *Broadcasting Act*, SC 1991, c 11, s 26(1).
[40] See *Telecommunications Act*, SC 1993, c 38, s 16(3)-(4). See also *Insurance Companies Act*, SC 1991, c 47, s 619; *Investment Limits (Foreign Companies) Regulations*, SOR/92-274, s 4.
[41] Barry Reiter, "Dual Class Shares: Not the Enemy" *Lexpert* (7 October 2010) at 1, online: Bennett Jones LLP <http://bennettjones.com/ProjectFolder/Templates/Publications/PublicationDetail.aspx?id=112752>.
[42] *Ibid*.
[43] *SHARE*, *supra* note 3 at 15.
[44] *Ibid*.
[45] *Ibid*.

corporate examples like Google Inc., Warren Buffett's Berkshire Hathaway Inc., the Blackstone Group, and Mastercard.[46] In support of these examples, it is argued that dual class share structures provide the controlling minority shareholder with an entrenched and protected position from corporate takeovers that allows other shareholders to benefit from the long term value of the founder's vision and entrepreneurial spirit.[47] However, while it is undeniable that *some* of the best performing and managed companies in Canada and the world employ dual class share structures, this does not detract from the fact that such firms enhance potential agency costs and financial risks to non-controlling minority shareholders. These increased agency costs and concerns are best exemplified through a look at the models and research conducted by Professors Bebchuk, Kraakman, and Triantis.

III. Increased Agency Costs to Non-Controlling Shareholders

Based on the findings of their research, Bebchuk, Kraakman and Triantis primarily argue that as cash flow rights or equity ownership of the controlling shareholder declines, the agency costs to non-controlling shareholders tend to rise at an alarming rate.[48] They examine this trend in two specific instances: project choice and decisions on scope.

Project choice refers to a controller's decision amongst various investment options. The authors argue that in choosing between two distinct projects, a controlling minority shareholder will typically choose the project that produces the greatest personal return. For instance, projects A and B will each yield a total value composed of cash flows available to all shareholders, and private benefits available only to the firm's controlling minority shareholder (project = cash flows + private benefits).[49] In choosing between these projects, the authors argue that, depending on the amount of equity the controlling minority shareholder has invested in the firm, it is possible that he or she may choose not to maximize total value and instead may opt for the choice with the largest private return. Furthermore, the authors assert that as the controller's financial

[46] *Ibid*.
[47] Gry, *supra* note 8 at 5.
[48] Bebchuk, *supra* note 6 at 296.
[49] *Ibid* at 301.

investment in the firm declines, the difference in total value between each project will become less important to the controlling minority shareholder relative to the private benefits they can extract.[50] In this sense, controlling minority shareholders are often in a position in which they can make decisions that maximize their own personal returns. If their cash flow rights are large, they can opt for the project that yields the greatest value to the firm, which increases the value of their equity investment while perhaps still yielding some personal benefits. On the other hand, if their cash flow rights are small, controlling minority shareholders can opt for the project with the largest private benefits while externalizing much of the resulting decline in share price to non-controlling shareholders, thereby increasing overall non-controlling shareholder agency costs.

These same agency costs and wealth diverting activities can occur when a controller decides to expand or contract the scope of a firm's operations. The authors explain that this can occur in two ways. First, assume an asset confers a total value, which, similar to above, is composed of cash flows to the firm and private benefits. If the firm owns this asset, the controlling minority shareholder may refuse to sell it and distribute its proceeds (likely in the form of dividends) to non-controlling shareholders so as to maintain the private benefit. Alternatively, if the firm does not own the asset, the controlling minority shareholder may choose to have the company purchase it (rather than distribute these funds via a dividend to non-controlling shareholders or employ those funds in some use that increases overall firm value) in order to obtain the private benefit that the asset may yield.[51] Consequently, on the basis of these models, it is evident that the potential for private gains can distort the decisions of controlling minority shareholders and may encourage them to utilize the firm as a vehicle for expropriating non-controlling shareholder wealth.

IV.I The Erosion of Internal Monitoring Mechanisms

While it can be argued that firms that issue a single class of equity shares are also plagued by agency costs, an important distinction between single and dual class firms lies in the effectiveness of their

[50] *Ibid* at 302.
[51] *Ibid*.

internal and external monitoring mechanisms. In a single class firm, much of the internal and external governance mechanisms remain intact and effective, especially in highly developed capital markets like Canada. However, in the case of a dual class firm, these internal and external governance mechanisms are largely curtailed and any oversight function they serve in a dispersed ownership structure is effectively eliminated.

As indicated above, a shareholder's right to vote is one of the most important means of ensuring that their interests in the corporation are heard and protected. By electing directors, introducing shareholder proposals, and raising issues concerning corporate performance (often at the Annual General Meeting ("AGM")), shareholders are responsible for monitoring the decisions of the board and managers.[52] In theory, if management is underperforming, directors have the right to remove and replace those managers in the interests of the corporation. Furthermore, if shareholders are dissatisfied with the level of their representation on the board or any major decisions of the directors, they can, at the next AGM, vote to elect new directors.[53] In this sense, shareholders, as an oversight mechanism, serve as an important element in the overall internal governance of a corporation.

However, in a dual class firm, non-controlling shareholders are largely deprived from fulfilling this function as the controlling minority position generally assumes this role. With superior and often absolute voting power, controlling minority shareholders can elect a plurality of the directors, dominate board decisions, and can often run the corporation to further their own interests.[54] For example, according to Robert Bertram, former Executive Vice President of the Ontario Teachers' Pension Plan Board, "there are only two or three people on the Magna board who could be considered independent of Frank Stronach."[55] Though some may argue that a controlling position can act as a more effective

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[52] Erik Banks, *Corporate Governance: Financial Responsibility, Controls and Ethics* (New York: Palgrave MacMillan, 2004) at 282.
[53] Willes, *supra* note 12 at 328-329.
[54] Bernard Simon, "Many Shares, Little Power for Change" *The New York Times* (8 May 2003), <http://www.nytimes.com/2003/05/08/business/many-shares-little-power-for-change.html> [*Simon*].
[55] *Ibid*.

monitoring mechanism than other more dispersed ownership structures (similar to the role that financial institutions serve in the co-determination corporate governance models common in Germany),[56] there is a lack of internal mechanisms that can in turn monitor the controlling minority shareholder. With voting power no longer tied to equity, even large institutional investors cannot monitor or counterbalance the influence, activities, and interests of controlling minority shareholders.

Moreover, in a 1999 study of the ownership structures of the 20 largest firms in the 27 wealthiest economies, Professors Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer find that in 69 per cent of cases,[57] individuals and families that control firms are also involved on the board and management, serving as either the Chairman or Chief Executive Officer ("CEO"), or both.[58] The authors also state that this data does not include those instances where an individual who has married into the family is serving in either a board or management position, as they typically do not have the same last name and therefore were not identified by the study. In Canada, due to the voting influence that controlling minority shareholders typically wield, they can influence decisions on the election and appointment of corporate directors and officers. In many cases, controlling minority shareholders or their family members have and, in some instances, continue to serve as Chairman, CEO, or both. For instance, Peter Munk, founder of Barrick Gold Corporation, who is also the firm's controlling minority shareholder by means of a dual class share structure, has, at times, served as either the Chairman or CEO, or both.[59] In the case of Bombardier Inc., Laurent Beaudoin, who is the son-in-law of company founder Joseph-Armand Bombardier, served as both the firm's Chairman and CEO from 1979 to 1999.[60] Perhaps the most notable example of this

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[56] John W . Cioffi, "Adversarialism versus legalism: Juridification and litigation in corporate governance reform," (2009) 3 Regulation & Governance 235 at 241.
[57] Rafael La Porta is the Nobel Foundation Professor of Finance at the Tuck School of Business at Dartmouth. Florencio Lopez de Silanes is a Professor of business and economics at EDHEC Grande Ecole in France. Andrei Shleifer is a Professor of economics at Harvard University.
[58] Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "Corporate Ownership Around the World" (1999) 54: 2 The Journal of The American Finance Association at 496.
[59] *Ibid*, at Appendix 2.
[60] *SHARE*, *supra* note 3 at 12.

is Conrad Black of the Canadian company Hollinger Inc., which served as the holding company of Hollinger International and a myriad of media and newspaper companies. Black was accused and convicted of expropriating more than $400 million from the firm through his roles as Chairman, CEO, and controlling minority shareholder.[61] Though it would be overly presumptuous to claim that in all instances where controlling minority shareholders are involved in both board and management positions corporate abuses and improprieties will necessarily arise, it is reasonable to suggest that, at the very least, the risk of conflicts of interest are enhanced. Halpern argues that the controlling minority shareholder acting in these roles "maintains the power to include or exclude any shareholder proposals" that are raised at the AGM, and can dictate the majority of corporate decisions regardless of other shareholder approval.[62] Consequently, while controlling minority shareholders may be in an advantaged position to monitor management and directors, the fact that they are often managers and directors themselves largely erodes the internal monitoring function of the board, and increases their propensity for appropriating non-controlling shareholder wealth. In this sense, the fact that controlling minority shareholders are often involved at both the board and management levels increases the potential for conflicts of interest to arise, particularly in "non-arms length" transactions, and ultimately ends up suppressing the internal supervisory function of the board.[63]

IV.II The Erosion of External Monitoring Mechanisms

Though it is evident that in a controlled corporate structure many of the internal monitoring mechanisms are extinguished, there are also external mechanisms that can work to discipline majority equity holders and management. Specifically, the two primary external disciplinary mechanisms are the securities market and the market for

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[61] Frank Ahrens & Peter Slevin, "Conrad Black, 3 Others Indicted: US Says They Looted Parent of Chicago Sun-Times" *The Washington Post* (18 November 2005) at para 11, <http://www.washingtonpost.com/wp-dyn/content/article/2005/11/17/AR2005111700910_pf.html>.

[62] Halpern, *supra* note 15 at 9.

[63] Yvan Allaire, "Dual-Class Shares in Canada: Some Modest Proposals", online: (November 2006) at 6. Social Science Research Network: <http://ssrn.com/abstract=952043> .

corporate control. However, while these mechanisms prove highly effective in cases of dispersed ownership structures and controlled firms where control is achieved through a majority equity stake, the effectiveness of these mechanisms is largely stifled in cases of dual class share structures.

In the securities market, a firm's share value generally serves as an indication of its overall performance. Accordingly, the securities market signals the success of a company by rewarding it with a higher share price, or signals poorer results with a lower share price. In the case of a firm with dispersed ownership, prolonged underperformance will translate into shareholder dissatisfaction. And through investor pressure and voting rights, underperforming directors and management will, in theory, be removed.[64] In a firm with concentrated holdings, where control is achieved through a majority equity position, the securities market can discipline management, directors, and even the controlling shareholder as they must internalize much of the costs experienced by market declines. Consequently, it is in the best interest of the controlling shareholder to pressure management and directors to improve share price and not to engage in any wealth diverting activities. In turn, this will increase the value of the firm and produce a financial benefit for all shareholders. Conversely, the discipline of the securities market is highly ineffective against dual class firms.

The effectiveness of the securities market is further inhibited by the illiquidity of superior voting shares.[65] While inferior voting shares can be bought and sold readily on public stock exchanges, superior shares are often in limited supply and in a lot of cases do not even trade at all.[66] As a consequence, they are less susceptible to market fluctuations and work to protect the value of the controlling minority shareholder's equity. This insulated position from the securities markets can, in turn, lead to a misalignment of interests between the controlling and non-controlling shareholders. For instance, in 2003 the Bombardier family was offered a $1 billion dollar investment from the OTPP in return for giving up its dual class share structure.[67] At the time, the investment would have helped the struggling

[64] Halpern, *supra* note 15 at 27.
[65] Gry, *supra* note 8 at 3.
[66] *Ibid*.
[67] *SHARE*, *supra* note 3 at 12.

company with its highly leveraged balance sheet by allowing it to reduce some of the capital costs associated with its loans.[68] However, the Bombardier family, rather than improving the corporation's financial situation, sought to maintain control of the firm and refused the offer. Subsequently, the firm resorted to issuing $1.2 billion of its subordinated voting shares at a price just above its 52-week trading low.[69] In effect, while the existing holders of the subordinated stock suffered a dilution[70] and the company "paid a higher price for the new capital than it should have…Bombardier was able to remain in Bombardier hands."[71] This example illustrates that the desire of controlling minority shareholders to maintain their position within a firm can work to override the influence that the securities market can have on their decision-making. If, at the time of the OTPP offer, the Bombardier family had a larger equity stake in the firm or, at the very least, if its equity was not so insulated from the securities market, it is more likely that the firm would have made the more rational and cost efficient choice of accepting OTPP's offer. These types of actions and choices are further enhanced by the entrenched and insulated position that controlling minority shareholders have against the market for corporate control.

Generally, the market for corporate control refers to corporate takeover bids and the transfer of ownership and control of publicly traded companies. Primarily facilitated by the securities market, it functions best in instances of firms with highly dispersed ownership.[72] Halpern argues that in such firms underperformance often produces a lower stock price, which in turn attracts potential acquirers who believe they can expand the performance of the firm by either removing management, achieving economies of scale, or increasing market share.[73] In this way, the theoretical threat of replacement encourages management to maximize corporate performance and shareholder returns.

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[68] *Ibid.*
[69] *Ibid.*
[70] Stock dilution occurs when a public corporation issues additional common stock. The additional issuance of stock, notwithstanding other effects, reduces the proportion of existing shareholder positions in the firm and can affect the amount of control they wield over the firm.
[71] *Ibid.*
[72] Halpern, *supra* note 15 at 18.
[73] *Ibid.*

However, as with the securities market, this situation is much different in cases of controlled or dual class firms. Firstly, if controlling minority shareholders make poor corporate decisions and the value of the firm's shares decline, then the market for corporate control will not work to discipline these actions. Though securities markets will produce a lower share price to reflect underperformance, "the lower price is not a signal for a takeover but is just a cost to the non-controlling shareholders."[74] As previously mentioned, this reduction in share value will have a negligible impact on the limited and insulated shareholdings of the controlling minority shareholder, and it is unlikely to affect their ability to continue extracting private benefits. Moreover, even if the share price of the dual class firm declines to the point where there are potential acquirers, the absolute control that the controlling shareholder wields over the firm's votes allows them to effectively quash any attempts to allow the acquisition to proceed.

Secondly, in order for a takeover bid to be successful, the target company's board of directors must determine that it is in the best interests of all shareholders and must approve the sale. Controlling minority shareholders seeking to maintain control will often be disinclined to accept such a bid and relinquish their position. Though Halpern argues that the board may still be deeply concerned with the interests of non-controlling shareholders, he also claims that the board will realize that the superior-voting shareholder has ultimate control and is thus unlikely to counter or oppose his or her interests.[75] According to a report compiled by the United States Securities and Exchange Commission, Conrad Black, through his controlling minority position in Hollinger Inc., routinely appointed the majority of board members who "were unlikely or unwilling to oppose his authority."[76] As such, the controlling minority shareholders' special voting privileges allow them to control or heavily influence the board to prevent a takeover threat and ultimately remain in control of the firm.

Lastly, prior to the TSX's imposition of the non-retroactive coat-tail

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[74] *Ibid*, at 28.
[75] *Ibid* at 29.
[76] Gry, *supra* note 8 at 6.

provision in 1987, controlling minority shareholders could sell their controlling positions at a premium[77] while no equivalent offer or purchase had to be made for the company's inferior voting shares. In this case, the controlling minority shareholder could simply sell control of the firm to a potential acquirer willing to pay such a premium.[78] As such, in the event of a takeover, controlling minority shareholders were (and to a large extent still are) able to extract large financial premiums while excluding the interests of non-controlling shareholders.[79] In addition, in the event that the sale of the controlling position proceeds, the acquirer simply assumes the controlling position in the firm, subjecting non-controlling shareholders to perpetual controlled ownership. This entrenchment of the controlling position in dual class firms adds to the weakened position of non-controlling shareholders and increases their vulnerability to potentially exorbitant agency costs and financial risks.

V. Regulatory Response – Good, but not Good Enough

Despite the concerns and issues surrounding dual class share structures discussed above, Canadian provincial regulators and public stock exchanges have imposed very limited regulations and requirements on these types of equity ownership arrangements. In particular, the Ontario Securities Commission ("OSC") requires holders of inferior voting shares to receive the same information that holders of superior shares are entitled to, and calls for dual class firms to provide inferior voting shareholders with the right to attend shareholder meetings.[80] In addition, the OSC requires that any "reorganizations or reclassifications of common shares into restricted voting shares must have the approval of the majority of the minority shareholders."[81] Perhaps the most significant restriction imposed on dual class share structures in Canada is the previously mentioned

[77] The premium that superior shares carry is a result of the control they grant their holder. As such, controlling minority shareholders are able to sell their shares at a premium due to the control they offer the prospective purchaser.

[78] Allaire, *supra* note 63 at 10.

[79] This relates to the fact that 13 firms currently listed on the TSX are still able to trade absent the coat-tail provision as it was not provided a retroactive status. This is discussed further in Section V.

[80] *SHARE*, *supra* note 3 at 9.

[81] *Ibid.*

provision implemented by the TSX that requires reporting issuers to provide coat-tail protections to non-controlling shareholders.[82] Coat-tail provisions require companies issuing superior voting shares to ensure that any offer made to purchase the firm's superior voting shares must be accompanied by a concurrent offer at the same terms and conditions to the other inferior classes of shareholders.[83] This provision eliminates a key source of private benefits for controlling minority shareholders, namely, "the possibility for a controlling shareholder to sell the control of the company and pocket the large premium that usually comes with control, while all other shareholders would receive no benefit from the transaction."[84]

Several studies conducted on dual class firms in Canada have concluded that as a result of the coat-tail protections, Canadian superior voting shares trade at some of the smallest premiums in the world.[85] According to a study by Brian F. Smith and Ben Amoaka-Adu, Professors of Finance and Economics at Wilfrid Laurier University, the median premium for superior shares of Canadian companies between 1988 and 1992 was 6.37 per cent.[86] Tatiana Nenova, a Harvard Researcher currently at the World Bank, conducted studies on superior share premiums in 2000 and 2003 and estimates that the control premium in Canada ranges between 2 per cent and 4 per cent.[87] Though the data collected largely confirms the conclusion that the coat-tail provision instituted by the TSX has successfully curbed the ability of controlling minority shareholders to extract premiums in the event of a sale, two problems still plague the effectiveness of the coat-tail provision. The first pertains to a loophole in the coat-tail protection that allows controlling minority shareholders to extract a premium when selling their controlling interest. The second refers to the fact that the TSX failed to provide the coat-tail provision with a retroactive status.

Under the first scenario, a controlling minority shareholder may sell their interest in the firm at a premium, so long as the interest is sold

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[82] Willes, *supra* note 12 at 701. "Reporting issuer" refers to a corporation that has issued its shares to the public by way of a prospectus.
[83] *SHARE*, *supra* note 3 at 9.
[84] Allaire, *supra* note 63 at 10.
[85] *Ibid* at 12.
[86] *Ibid*.
[87] *Ibid*.

to multiple parties and each party, on their own, is unable to exercise absolute control.[88] This form of transaction does not trigger the coat-tail provision as control is only achieved through joint and coordinated action. For example, in 1994, after the death of Frank Griffiths Sr., founder of WIC Western International Communications Ltd., his wife, Emily Griffiths, sold all her superior voting shares at a significant premium over the subordinated shares she sold at the same time.[89] Though the company had a coat-tail provision in place that ought to have provided non-controlling shareholders with the option to sell their shares at the same premium, because the sale of the superior shares was to Rogers Communications, Shaw Cable and CanWest Inc., each of which were unable to garner absolute control individually, the coat-tail provision was not triggered.[90] Consequently, by selling her controlling interest to multiple parties, Mrs. Griffiths was able to escape the scope of the coat-tail and earn a premium on her controlling shares with no equivalent offer made to the non-controlling shareholders.

The coat-tail provision's lack of a retroactive status also limits its effectiveness in mitigating against the increased agency costs and risks associated with dual class firms. Consequently, a significant number of companies that listed their superior voting shares prior to 1987 have been able to operate and trade absent a coat-tail provision. Currently, 13 of the 96 dual class firms listed on the TSX are permitted to trade without a coat-tail provision.[91] One of these firms in particular, Magna International Inc., which created its multiple voting class share structure in 1978,[92] has been the recent source of immense controversy and debate.

In March 2010, Frank Stronach was asked by Magna's management if he would be willing to abandon Magna's dual class share structure and, by extension, his controlling minority position in the firm.[93] Following a month of discussions, Magna's management informed

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[88] *Ibid* at 22.
[89] *SHARE*, *supra* note 3 at 15.
[90] *Ibid.*
[91] *Ibid.*
[92] John Tuzyk & Christopher Kozub, "Ontario Court Approves Magna's Plan of Arrangement" *Blakes Bulletin* (25 August 2010), online: Blakes <http://www.blakes.com/english/view.asp?ID=4186>.
[93] *Ibid.*

its board ("the Board") of the potential offer to purchase Stronach's controlling superior Class B shares. The Board subsequently established a special committee of independent directors of Magna to review, consider and negotiate with Stronach over the proposed purchase.[94] The Stronach Trust, which is owned by Stronach and his family and is the actual legal owner of Magna's superior voting Class B shares, agreed that it would "sell its Class B shares to Magna…at a premium of some 1800 per cent over Magna's Class A shares.[95] In addition, Stronach would receive a five-year consulting contract and equity and voting interests in an electric car partnership between Magna and Stronach Trust."[96]

While the Board retained CIBC to conduct the valuation and act as its financial advisor, CIBC was unable to provide a fairness opinion because the dilution associated with the transaction was unprecedented.[97] At the announcement of the proposal, there was much debate among shareholder advisory groups and institutional investors. RiskMetrics Group Inc, a risk advisory firm, advised its clients holding Magna's Class A shares to support the proposal because of the potential future benefits of the one share, one vote structure, including: elimination of the Stronach discount,[98] improved corporate accountability, and the removal of the impediment to future takeover threats.[99] Glass Lewis & Co., a proxy advisor and wholly owned subsidiary of the Ontario Teacher's Pension Plan ("OTPP"), on the other hand, strongly urged its clients to vote against the deal.[100] Particularly, the OTPP "was concerned

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[94]Barry Reiter, "Lessons from Magna" *Lexpert* (September 2010), online: Bennet Jones LLP <
http://www.bennettjones.com/BennettJones/images/Guides/external9646.pdf>.
[95] *Ibid*.
[96] *Ibid*.
[97] A fairness opinion is an evaluation, typically conducted by an investment bank or other professional advisory services firm, which provides an opinion as to whether the proposed transaction is "fair" or adequate." Lucian Arye Bebchuk & Marcel Kahan, "Fairness Opinions: How Fair Are They and What Can be Done about It?" (1989) Duke Law Journal I at 27.
[98] The Stronach discount refers to a general presumption that Magna's Class A shares, prior to its recapitalization, traded at a significant discount due to the fact that control of the company was held solely by Stronach and control could be achieved by simply purchasing his shares, rather than Class A shares. Reiter, *supra* note 95.
[99] *Ibid*.
[100] *Ibid*.

that Stronach was being permitted to extract outrageous premiums from Magna under the guise of normalizing its governance structure."[101] The debates surrounding this proposal continued for several months and eventually culminated in a hearing at the OSC. Though several issues were considered by the OSC, it primarily focused on whether "the proposed transaction was abusive and should the Commission restrain it in the public interest?"[102]

Impeding the arguments of those opposed and seeking to have the transaction barred by the OSC was the fact that Magna did not have a coat-tail provision in place. Moreover, because the deal was not a third party bid to acquire control but rather the company itself effectively paying to release control into the market, the coat-tail would not have applied. According to Professor Edward Waitzer, Former Chair of the OSC, if a coat-tail would have been in place, those opposed to the transaction would have argued that the policy concerns underpinning coat-tail provisions should have been invoked similar to the OSC ruling in *Re Canadian Tire* (1987).[103] In *Re Canadian Tire*, the third party bidder sought to avoid and exploit the corporation's coat-tail provision by purchasing only 49 per cent of the firm's outstanding common voting shares.[104] While the coat-tail was not triggered by the proposed transaction, the OSC intervened and ordered a cease trade order because the deal was "contrived to circumvent the coattail, and thus frustrate the intention of its well-intentioned proponents."[105] In the case of the Magna transaction, the fact that no coat-tail provision was in place limited the ability of those opposed to the transaction to ground such an argument and to urge the OSC to invoke similar reasoning in prohibiting the transaction from proceeding. Ultimately, given the circumstances, the OSC held that Magna's shareholders would best determine the deal's fairness so long as they were provided with adequate disclosure in order to understand their interests and the ramifications

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[101] *Ibid.*
[102] Ontario Securities Commission, *In the Matter of the Securities Act and In the Matter of Magna International Inc and In the Matter of the Stronach Trust*, online: Ontario Securities Commission: OSC Proceedings – Before the Commission <http://www.osc.gov.on.ca/en/Proceedings_rad_20110131_magna.htm>.
[103] Interview of Edward J. Waitzer by Daniel P. Cipollone (10 March 2011) email correspondence.
[104] *Re Canadian Tire Corporation; Re CTC Dealer Holdings Ltd.; Re Billes et al*, 1987 CarswellOnt 128, 35 BLR 56, 10 OSCB 857, at para 170.
[105] *Ibid*, at para 77.

of their decision. On July 23, Magna's Class A shareholders voted 75.3 per cent in favour of the proposal.[106]

The overwhelming shareholder support for the recapitalization can be cast in two distinct lights. On one hand, it may be interpreted as a clear signal that the non-controlling shareholders of Magna were of the opinion that the premium the Stronach Trust was able to extract was reasonable and fair. On the other hand, however, the overwhelming support for the recapitalization may suggest that non-controlling shareholders were dissatisfied with Frank Stronach continuously imposing his will on the firm and, as a result, were willing to pay a premium in order to remove his entrenched position. However, regardless of the reasons supporting the transaction's approval, it is a deal that has remained largely criticized as a gross abuse and exploitation of non-controlling shareholders and Canadian capital markets. According to Anita Anand, a University of Toronto Law Professor and Chair of the OSC's Investor Advisory Panel, the incredibly constrained choice that shareholders were presented with is indicative of "the power of the despot."[107] At the deal's close, it was estimated that Mr. Stronach obtained more than US$863 million from Magna International Inc. for abolishing Stronach Trust's Class B superior voting shares.[108] In addition, given that part of this payout was in the form of 9 million common Class A shares, non-controlling shareholders suffered a stock dilution of approximately 11.4 per cent, a rate considered off the charts by most investment banks, as typical dilutions range between 1 and 4 per cent.[109] For Anand, the Magna recapitalization carries important precedential value and implications for capital markets as a whole. Specifically, she states that "after Magna, the greater the private benefits of control, the higher the premium that will be paid to extricate firms from [their] controlling

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[106] Reiter, *supra* note 95.

[107] Michael McKiernan, "$1-billion Magna Deal's Fairness Scrutinized: Experts Look Into Securities Legal Action Over Dismantled Dual-Class Share System" *Canadian Lawyer Magazine* (21 March, 2011), <http://www.canadianlawyermag.com/$1-billion-magna-deals-fairness-scrutinized.html> [*McKiernan*].

[108] Reiter, *supra* note 95.

[109] Greg Keenan, Jeff Gray, & Andrew Willis, "Stronach, the Fighter, takes the Magna Deal Controversy in Stride" *The Globe and Mail* (18 June, 2010), online: The Globe and Mail < http://www.globeadvisor.com/servlet/ArticleNews/story/gam/20100618/FINALMAGNAOSC18ATL>. Please see Appendix I.

shareholders."[110] Furthermore, in opposition to those who have argued that Magna's non-controlling shareholders were offered the opportunity to vote on the recapitalization, Jeffrey MacIntosh, Toronto Stock Exchange Chair at the University of Toronto Faculty of Law, has argued that "claiming a shareholder vote…says nothing about whether the transaction is fair."[111] Specifically, he maintains that "while Magna ticked all the applicable boxes, the transaction [violated] many of the fundamental underpinnings of contemporary corporate and securities law."[112] Lastly, the OSC, despite approving Magna's recapitalization, recently released the reasons to its decision and characterized several aspects of the deal as "fundamentally flawed."[113]

The coat-tail provision's lack of a retroactive status, therefore, erodes its effectiveness and permits controlling minority shareholders of dual class share structures pre-dating 1987 to extract large premiums in exchange for relinquishing their control. Furthermore, with 13 major dual class firms currently listed on the TSX operating without a coat-tail provision, each of the controlling minority shareholders of these firms could legally sell their controlling interest for a significant premium, without any equivalent offer being made to the non-controlling shareholders of the firm. Thus, while the implementation of the coat-tail provision was an important measure instituted by the TSX to curb the extraction of such premiums, it is a measure that remains susceptible to abuse and exploitation in Canadian capital markets.

VI. Recommendation for Reform

On the basis of the above analysis, it is clear that the equity structure of dual class firms enhances many of the concerns and risks of more traditional corporate ownership models. It is also evident, despite the

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110 McKiernan, *supra* note 108.

111 Barry Critchley, "L'affaire Magna's Lessons" *Financial Post* (17 February 2011), online: <http://www.financialpost.com/opinion/columnists/affaire+Magna+lessons/4298942/story.htm>.

112 *Ibid.*

113 Barry Critchley, "Flawed Magna Deal: OSC" *Financial Post* (4 February 2011), online: Financial Post <http://www.nationalpost.com/related/topics/Flawed+Magna+deal/4221680/story.html>.

efforts of the OSC and TSX, that the current regulatory regime is inadequate to deal with these enhanced governance concerns. However, with dual class firms producing superior returns for their controlling shareholders, whether in the form of private benefits or cash flow, any proposals that work to limit these gains are going to be met with significant opposition and resistance. Thus, in seeking to introduce new mechanisms that improve the governance of these firms, a balance must be struck that improves accountability to non-controlling shareholders without completely alienating the interests of current controlling minority shareholders. It is in this sense that the proposal for introducing a retroactive voting cap provision is endorsed, as it represents a highly practical and effective means of enhancing the overall governance of CMSs.

A voting cap, in its most fundamental sense, involves limiting the ratio of votes between superior and inferior shares. As such, instead of allowing entrepreneurs and founders the freedom to attribute any concentration of voting rights to their particular class of controlling shares, there ought to be retroactive legislated restrictions on these rights. For instance, returning to the case of Magna International Inc., where Frank Stronach's Class B shares carried 500 votes while Class A shares only wielded 1 vote, a legislated cap would prevent such disproportionate voting power and influence.[114] Under the proposed voting cap, superior shares would be restricted to a maximum number of votes, some suggest between 4 and 10 votes, while inferior shares, in most cases, would yield 1.[115] Consequently, in order for controlling minority shareholders to exercise control over a company, they would have to significantly increase their equity in the firm. Though it is not yet certain what specific ratio should be constructed or introduced, what is important is how this proposal will improve the monitoring function of both the securities market and the market for corporate control.

In order for this proposal to yield meaningful improvements in the governance of dual class firms, it is important that it include a retroactive status. Drawing on much of the failure and criticism surrounding the coat-tail provision (most of which is directed at its lack of a retroactive clause) it appears that such a condition would

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[114] Simon, *supra* note 54.
[115] Allaire, *supra* note 63 at 23.

provide important strength and support to the implementation of a voting cap in Canada. With an estimated 25 per cent of companies traded on the TSX utilizing multiple class shares, it is crucial that none of these firms be able to escape the proposed voting cap clause on the basis of non-retroactivity. This is further supported by the previously mentioned fact that at least 13 major dual class companies on the TSX continue to operate unaffected by the coat-tail provision. Thus, by reflecting on the flaws of the coat-tail provision, it is easy to rationalize the inclusion of a retroactive status for the voting cap proposal, as it should ensure that all dual class firms, regardless of their public listing date, comply with the proposed legislated voting restriction. Moreover, by ensuring greater adherence to this restriction, the retroactive clause will simultaneously help to improve the monitoring function of the securities market and the market for corporate control in relation to dual class firms.

In combination with the proposed retroactive voting cap restriction, it is recommended that all Canadian dual class firms be required to eliminate their non-voting equity. In cases where firms currently offer non-voting stock to the public, these shares should be converted such that they yield at least one vote. The rationale supporting this recommendation is two-pronged. Firstly, the elimination of non-voting stock would provide each shareholder, regardless of equity held, a degree of influence on the firm. Though in many cases this influence would be negligible, in the event that non-controlling shareholders were to coordinate their efforts, their ability to vote would serve as a tremendous advantage, especially in challenging proposals or actions by the controlling minority shareholder. Secondly, granting each shareholder a right to vote will eliminate the ability of dual class firms to exercise a potential loophole in the proposed voting cap. For example, if a firm was to adopt the voting cap restriction absent a provision for eliminating non-voting stock, it could, in theory, comply with the cap yet retain a sub-set class of non-voting stock/shareholders. Though the controlling minority shareholder would have fewer votes as a result of the cap, they would still maintain absolute voting power over the class of non-controlling shareholders holding shares with no voting rights. Moreover, the non-voting shareholders would not be able to exercise any influence over the firm. Consequently, by counteracting the voting cap, controlling minority shareholders would still be able to exercise complete control over the firm while other shareholders would wield little to no influence. Thus, in order for the proposed voting cap to be successful, it is essential that dual class firms also eliminate any of their non-voting stock.

While the mechanics of the voting cap and its need for retroactive status are important, greater in significance and more central to this analysis is how these instruments will improve the monitoring and disciplinary functions of the securities market and the market for corporate control. Central to the voting cap proposal is the manipulation of voting rights, which will alter typical CMS ownership arrangements so that they more closely resemble a controlled corporate structure ("CCS") where control is achieved through a majority equity position. By restricting the number of votes that superior shares wield, the voting power exercised by the controlling position is effectively diluted. Though the controlling minority shareholder may still be able to acquire more than 50 per cent of the corporation's total votes, the only means in which to achieve such control is by simultaneously increasing their equity ownership and financial risk in the firm. Consequently, any risk taking, moral hazard, or diversionary activity that may produce a private benefit to the controlling shareholder, which generally results in a lower share price, also produces a significant cost to the equity they hold in the firm. Similar in effect to a CCS, the increased capital invested in the firm forces the controlling minority shareholder to bear more of the costs of their non-wealth maximizing behaviour. Thus, by aligning the controlling minority shareholders interests more closely to the firm's overall value and the interests of other non-controlling shareholders, a voting cap provides a disincentive for them to extract private benefits and in turn mitigates against non-controlling shareholder exploitation and agency costs. It is this important equity requirement for exercising corporate control that will improve the functioning of the securities market in disciplining dual class firms and their controlling shareholders.

Though a voting cap will undeniably improve the monitoring mechanism of the securities market, its imposition will not, however, guarantee the same degree of success in terms of the market for corporate control. The market for corporate control is most efficient when firms are widely held. The presence of a controlling position, whether a controlling minority shareholder or a controlling shareholder who has achieved control through equity, diminishes this monitoring function. However, while a controlling minority shareholder is effectively entrenched and insulated from a takeover threat, a controlling shareholder in a CCS is somewhat more susceptible to takeovers. Thus, a voting cap that allows a CMS to function more like a CCS in takeover situations represents a modest improvement for the overall governance of the corporation and accountability to non-controlling shareholders. Moreover, beyond facilitating a more efficient market for corporate control, the dilution of the controlling minority shareholder's voting power should improve the overall investment appeal of dual class firms and encourage greater institutional ownership and investment, a group that has traditionally opposed such structures. This may render the controlling position more susceptible to proxy contests and takeovers, and may lead to the creation of several large block investment holdings in the firm, similar to the co-determinant German and Japanese governance models.[116] In turn, this may result in greater corporate oversight and a governance system with a broader set of checks and balances, as the interests of each block would be posited against the others.

Moreover, with SHARE working with various pension funds in Canada to help promote greater shareholder activism, the introduction of a voting cap could help to support these important efforts.[117] In turn, this could provide non-controlling shareholders of dual class firms with a superior means in which to raise proposals for change and encourage their participation at annual general meetings. Thus, utilizing a voting cap to dilute the voting concentration of a controlling minority shareholder may work to encourage corporate takeovers, increase institutional investments, correct the power imbalances associated with dual class firms, and generally result in a better corporate governance model that mitigates against the enhanced agency costs and risks to non-controlling shareholders.

VII. Conclusion

While there are some undeniable benefits associated with dual class firms and many, in fact, have produced financial returns similar to, or better than, more dispersed ownership structures, this does not

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[116] Cioffi, *supra* note 56.
[117] *SHARE*, *supra* note 3 at 1, 18.

detract from the fact that these ownership structures significantly augment agency costs and financial risks for non-controlling shareholders. By manipulating typical corporate voting arrangements, dual class firms firmly concentrate control in the hands of a limited number of shareholders, threaten effective corporate governance practices, and violate the ability of non-controlling minority shareholders to effectively influence corporate decision making.

It has been argued that these adverse effects are primarily facilitated by the fact that the structure of dual class firms effectively erodes the traditionally successful internal and external corporate monitoring mechanisms. Though some, albeit limited, regulatory attempts have been made to curb the adverse implications dual class firms can have on non-controlling shareholder interests, these attempts have been largely ineffective in their aim. However, rather than banning these firms from Canadian capital markets, it has been argued that the provincial implementation of a mandatory retroactive voting cap restriction may serve as a practical and effective attempt to harness the benefits associated with dual class firms while mitigating their risks and improving their overall governance.

Particularly noteworthy in Canada is the recent dual class share recapitalization of MI Developments Inc ("MI"), a firm also controlled by Frank Stronach and spun out of Magna International Inc. in 2003.[118] The proposal to eliminate MI Developments' dual class share structure was approved by its shareholders at its AGM on March 29, 2011 and was subsequently approved by the Ontario Superior Court of Justice on June 30.[119] The recapitalization, similar to that in Magna, was made by way of a plan of arrangement under the *Ontario Business Corporations Act*. According to Blair Franklin Capital Partners, which conducted the valuation of MI's recapitalization, the transfer of assets to Stronach upon the cancellation of his controlling superior shares was "outside of the

[118] MI Developments Inc, News Release, "MI Developments Enters in Agreements For Shareholders to Consider Elimination of its Dual Class Share Structure" (31 January 2011) online: <http://www.midevelopments.com/uploads/File/PR/Press-Release-Dated-Feb-1--2011.pdf>.

[119] Borden Ladner Gervais LLP, *MI Developments Eliminates its Dual Class Share Structure*, online: BLG < http://www.blg.com/en/media-centre/Pages/dealSuits_303.aspx>.

range of the consideration paid for comparable transactions relating to the collapse of a dual class share structure."[120] However, despite Blair Franklin's formal valuation of Stronach's Class B superior voting shares of US$50 per share, the final transaction translated into a final per share value somewhere between US$1,610 and US$2,009 for Stronach's controlling interest.[121] Apart from this significant premium for ceding control of the firm, Blair Franklin estimates the resulting dilution to the subordinate Class A shareholders at approximately 31 per cent.[122] This ruling, together with the decision in Magna, underscores the relevance and ongoing concern of dual class share structures in Canada. Furthermore, these cases shed light on the deference that decision makers afford to shareholder approval in such transactions, and presents an important avenue for further research and investigation into the recapitalization of dual class firms in Canada.

Clearly, despite growing opposition, dual class share structures are, and will likely remain, a prominent and contemporary concern in Canadian capital markets. As a result, it is incumbent upon regulatory organizations, academics, legal and investment practitioners, and investors in general, to engage in further research, investigation, and critical debate into dual class share structures and the enhanced risks they pose to non-controlling shareholders. Ultimately, the question that must centre the debate is how the governance of dual class firms in Canada can be improved so as to mitigate their associated risks while still maintaining their inherent efficiencies and benefits.

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[120] *Supra* note 118.
[121] *Ibid.*
[122] *Ibid.*

Appendix I

Date	**Company**	**% Share Dilution**
May 2010	Magna proposal	11.41
May 2006	Extendicare	1.28
March 2006	Canam Group	3.04
Dec. 2005	CoolBrands	0
Sept. 2005	ProMetic Life Sci.	0
March 2005	Diaz Resources	0
Feb. 2004	MDC Partners	0
Feb. 2004	Gildan	0
Dec. 2003	Sherritt	0
Source: Greg Keenan, Jeff Gray & Andrew Willis, "Stronach, the Fighter, takes the Magna Deal Controversy in Stride" *The Globe and Mail* (18 June, 2010), online: The Globe and Mail <http://www.globeadvisor.com/servlet/ArticleNews/story/gam/20100618/FINALMAGNAOSC18ATL>.		