

Second Class Investors

**The use and abuse
of subordinated
shares in Canada**

April 2004



Shareholder Association
for Research and Education

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THE SHAREHOLDER ASSOCIATION FOR RESEARCH AND EDUCATION is a national not-for-profit organization helping pension funds build investment practices that protect the interests of plan beneficiaries and contribute to a just and healthy society. SHARE works with institutional investors to promote socially, economically, and environmentally responsible investment practices through research, education and advocacy.

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COMPANIES RAISING CAPITAL IN EQUITY MARKETS CAN USE VARIOUS MECHANISMS THAT allow a founder or controlling shareholder to avoid dilution of control that normally accompanies the issuance of shares. The issuance of different classes of shares that have different voting rights is one of these methods. There are many variations but in all cases, some classes of shares carry fewer votes or have less power than other classes.

For companies issuing stock in Canada, there are no legal prohibitions on dual-class share structures. Neither does the Toronto Stock Exchange impose any injunctions. The Ontario Securities Commission has established some rules to protect holders of subordinated shares. In the United States, the New York Stock Exchange prohibited dual-class structures for U.S. companies in 1994.

In Canada, dual-class share structures are a fact of life: between 20 and 25 percent of companies listed on the TSX use some form of restricted or subordinated voting. In the United States, dual-class share mechanisms are far less common. Companies that use restricted voting include some of Canada's best known firms.

Companies adopt dual-class structures for a number of reasons. Chief among them is the desire to preserve control. Controlling shareholders argue that they can best run the company and build long-term value. Companies in sectors where Canadian ownership rules are in place say dual-class structures allow them to meet government regulations on foreign ownership.

Investors have other views. Dual-class structures deprive some shareholders of rights and controls over the company and separate economic ownership from control. The existence of a dual-class structure does not imply poor governance, but where problems arise, ordinary investors have difficulty pushing for change. These structures entrench management, even when a company is not performing well. As well, the ability of controlling shareholders to use dual-class share structures to elect compliant boards of directors breaks a critical link in the corporate governance chain.

A number of companies have recently abandoned dual-class structures and it may be that, for various reasons, including increasing investor opposition, they are falling out of favour.

SHARE has proposed recommendations to the Toronto Stock Exchange and Canadian securities regulators that would prohibit new dual class share structures on the Toronto Stock Exchange and give companies with existing structures five years to fall in line. Limited dual class structures would be permitted for firms on the TSX Venture Exchange. Without an outright ban, SHARE has recommended a number of changes to empower holders of subordinated shares.

Introduction

DUAL-CLASS SHARE STRUCTURES, WHICH ARE SOMETIMES REFERRED TO AS SUBORDINATED voting share structures, have been an issue of discussion in Canada for many years. But the issue has taken on renewed prominence in recent years in response to a number of corporate scandals and controversies, in Canada, the United States and around the world. These scandals have led to a widespread focus on issues of good corporate governance. In Canada, for example, shareholder rights groups and trade union pension funds have engaged corporations on governance issues and more than 20 leading institutional investors with a combined \$400 billion in assets under management have joined together to form the Canadian Coalition for Good Governance. Dual-class or subordinated voting shares are one of the factors being examined for their effect on governance.

This paper will examine the issues raised by dual-class share structures. It will look at their prevalence in Canada and their concentration in certain sectors. It will examine the reasons why companies choose them, and it will examine the reasons why institutional investors and other advocates of sound corporate governance oppose them.

This paper has been prepared by the Shareholder Association for Research and Education (SHARE), a national not-for-profit organization that works with pension plan trustees, administrators and members to develop and implement sound investment practices that respond to the needs of plan members and beneficiaries. SHARE appreciates the assistance of Bill Mackenzie of Fairvest, Glenn Cooper of eResearch, and Chris Robinson of the Finance Doctors for their guidance and help. However, the views and recommendations expressed are solely those of SHARE.

Dual-Class Shares: The Setting

2.1 Defining Terms

Companies raising capital in equity markets can use various mechanisms and structures that allow a founder or controlling shareholder to avoid the dilution of control that would normally accompany the issuance of shares. These mechanisms must be distinguished from cases in which a company, group or single shareholder owns a majority interest or a sufficiently large plurality of the common shares to enable control.

Ownership pyramids are one way to achieve minority control, normally with a tightly held or privately held company at the top of the pyramid that holds ever-smaller control blocks as one descends down a pyramid of publicly listed firms. As Randall Morck noted in 1996: “Tax-free inter-corporate dividends invite pyramids in Canada.”¹ Another control method involves cross-ownership among listed companies. These structures are by their nature opaque and for that reason are often shunned by Canadian investors. They are more common in parts of Europe and in East Asia.

The third method of enabling control that is not tied to direct equity participation involves the issuance of different classes of shares that have different voting rights. There is a wide range of variations on this theme. Table 1 below illustrates the case at Magna Inc. where founder Frank Stronach controls the firm. A dual-class structure can be created at the time of the company’s Initial Public Offering (IPO) or can be put in place later through a reorganization or recapitalization. Some superior classes allow multiple votes per share. These multiples can vary widely (see Table 2). In other cases, the superior class carries only a single vote per share while the subordinated shares are non-voting. In some cases, the control share class provides greater powers to elect directors to the board. There are as many differences as there are companies and lawyers that advise them. In order to provide some incentives for investors to buy subordinated shares that provide little or no control, the company will sometimes provide greater dividends to holders of the subordinated shares. When the superior-class shares do trade, they often trade at a premium over the

subordinated voting shares. Table 6 shows the Magna premiums. This premium indicates that investors are willing to pay more for the control these shares offer. The premiums can vary widely by country. (See Table 5). Morck suggests that this premium varies because the legal systems in different countries provide differing opportunities for control groups to appropriate corporate benefits for themselves. “Is control worth more in Italy because the scope for theft by dominant shareholders is broader there,” he asks.² Morck’s question will be explored in greater detail in Section 4.

The shares that provide control are sometimes unlisted. In other cases, control shares are listed but trade is naturally illiquid given the desire of the control group to maintain its position. In all cases, however, what distinguishes this method of maintaining control over a publicly listed company is that some classes of shares carry fewer votes or have less power than other classes. In this, they are subordinate to other share classes.

Given a strong desire to avoid dilution of control, some companies use a combination of methods to solidify control. For example, Conrad Black effects control of Hollinger International through Hollinger

Inc., and ultimately through privately held Ravelston Corp., using both subordinated shares of Hollinger International and a pyramid structure. Hollinger International lists its Class A share on the New York Stock Exchange (NYSE). The Class B shares are unlisted. Using the two classes allows Hollinger Inc. to hold 30.3% of the equity in Hollinger International with 72.7% of the voting interest.³ Hollinger has raised the issue of abandoning its dual-class share structure.⁴

It must be noted in the interests of clarity that some companies have multiple classes of shares where one class is not subordinated to another class with respect to voting, but may have different rights attached to the different classes of shares. Stelco Inc. is one example: Series A and Series B shares have equal powers. Given this reality, which is rare, some observers believe it best to use the term “subordinated voting structures.” Such an argument may have merit. However, because the term “dual-class” is so widely used, in Canada and elsewhere, this paper will use it for the sake of consistency.⁵

Table 1

Dual-Class Shares at Work: The Magna Case

Class A Subordinate: MGa.TO

Listed, 1 vote per share

Equal share with Class B in dividends

Issued: Dec 31 2002: 94,477,224

Class B: MGb.TO

Listed, 500 votes per share

Can be converted into Class A.

Issued: Dec 31 2002: 1,096,509

Conditions: In event of consolidation or other changes, the other class will also be changed to maintain the relative position of each class.

Both classes voting separately have the right to approve any investment in an unrelated investment in the event that investment, together with all other unrelated investments, exceeds 20% of Magna’s equity.

Legalities

2.2.1 The Canadian Rulebook

For companies issuing stock in Canada, there are no legal prohibitions on dual-class share structures. Neither does the Toronto Stock Exchange impose any injunctions. The only restriction, by the Ontario Securities Commission (OSC), establishes the rights of holders of subordinated stock to receive the same information received by those holding superior classes, and the right to attend shareholders' meetings. Reorganizations or reclassifications of common shares into restricted voting shares must have the approval of the majority of the minority shareholders. The TSX demands that issuers provide "coat-tail" protection to holders of subordinated shares that would allow them to participate equally in any "control premium" that might be offered to the controlling shareholder in a public tender offer. The coat-tail protection was imposed in 1987 but only for new listings.⁶ As well, the OSC requires issuers of subordinated stock to clearly identify the shares as having restricted voting rights. Such labelling rules, reconfirmed in 1999, indicate that the OSC has not changed its position on dual-class shares since chairman Peter Dey was quoted in 1984 as saying that investors "should invest with your feet. Walk away from what you don't like."⁷

In the mid-1980s, there had been a flurry of regulatory activity that seemed for a very short time to undermine the foundations of dual-class shares. On May 15, 1984, the Canadian Department of Insurance ruled that because restricted voting shares were not common shares, they were not eligible for pension fund investments. That would have severely limited the appetite for dual-class shares but, a week later, the rule was revoked.⁸

2.2.2 The U.S. Rulebook

Restricted voting shares in the United States are much rarer than they are in Canada (as will be discussed in more detail below) in part because of the regulatory framework.

The NYSE banned dual-class shares in the 1920s, although Ford Motor Company was exempted. The ban lasted until the late 1980s when several large companies threatened to pull their listings if they could not list dual classes of common shares.⁹ The NYSE considered re-imposing a ban on subordinated voting stock in the early 1990s. Investor representatives, including Fairvest Corporation's predecessor, Allenvest Group, made submissions to the NYSE at that time pointing out the problems encountered with these structures in Canada and calling for a total ban. The ban on subordinated voting stock was subsequently re-imposed on U.S. companies in 1994, however existing structures are permitted subject to safeguards.

The Exchange's Listed Company Manual states, pursuant to SEC Rule 19c-4:

Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance. Examples of such corporate action or issuance include, but are not limited to, the adoption of timed phased voting plans, the adoption of capped voting rights plans, the issuance of supervoting stock, or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer.

This rule does not prohibit new dual class capital IPOs, nor does it prohibit the initial listing of companies with existing dual class shares listed elsewhere. Most other jurisdictions around the world seem to have few restrictions on issuing dual-class stock.

2.3 More Common Than Not

Whether dual-class share structures promote or hinder good governance, they are a fact of life in Canadian equities. In recent years, between 20 and 25 percent of companies listed on the TSX have used some form of restricted or subordinated voting.

Dual-class shares were not always so popular. In 1975, only 5 percent of companies listed on the Toronto Stock Exchange used them. By 1987, their frequency had grown to more than 15%, according to a paper by Randall Morck in the Spring 1996 issue of the *Canadian Investment Review*.¹⁰ A 1996 study by Burgundy Asset Management revealed that from Dec. 31 1987 to Dec. 31 1995, 29.2 percent of the 413 companies listed in the Stock Guide database had dual class shares.¹¹ A paper by Randall Morck and colleagues, *The Rise and Fall of the Widely Held Firm in Canada*, suggests that the rise of pyramidal control (which would include dual-class firms) of Canadian corporations in the latter decades of the 20th century is related to the removal of the inheritance tax in 1972. This, the article says, encouraged families to seek perpetual control of their corporate assets. As well, the authors hypothesize that an increase in state involvement and intervention in the economy in the same period made rent-seeking more profitable and thus encouraged the growth of tightly held firms.¹²

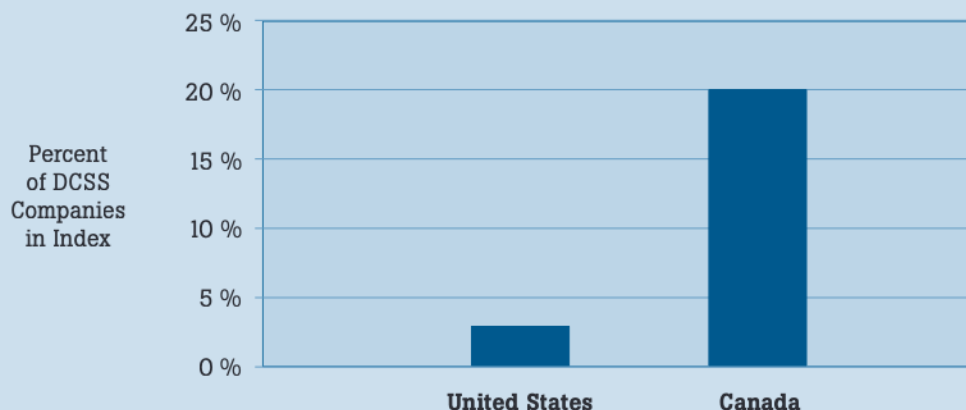
A 2003 study by the *Globe and Mail's* Report on Business of the 207 companies on the S&P/TSX Index showed that more than a quarter of the firms had some form of special voting rights that conferred control without equivalent equity participation.¹³

Using the MSH function on Bloomberg in May 2003 showed that 21.7% of companies in the S&P/TSX used subordinated voting (See Figure 1).

In the United States, as Figure 1 indicates, dual-class share mechanisms are far less common.

Figure 1

Dual-Class Prevalence in Canada and the U.S.



Source: S&P 500; Canada: S&P/TSX

Companies that use restricted voting to protect the position of a minority controlling shareholder are hardly relegated to the margins of Corporate Canada. They include some of the country's best known, and best regarded, firms. Their number includes Quebecor Inc., Four Seasons Hotels Inc. Canadian Tire Corp., Magna International Inc., Torstar Corp., Onex Corp., Power Corp., Rogers Communications Inc., Shaw Communications Inc., Bombardier Inc., Molson Inc., and Jean Coutu Group Inc.

An examination of which companies use dual-class shares (see Table 4 for the full list as of May 2003.) shows that they are largely concentrated in communications, media and entertainment. Of the 48 companies, 11, or 22.9% are in that sector, including such sector leaders as Quebecor, Torstar, CanWest, and Rogers. A number of others are in consumer products, food services and retail.

The defining characteristic is that most are associated with a founding shareholder such as Frank Stronach at Magna, Gerald Schwartz at Onex, the Bombardiers at Bombardier, the Péladeau family at Quebecor, or the Sobeys family at Empire. The fact that such names continue to have the prominence they do may be largely because of their use of dual-class shares.

Although there are far fewer dual-class structures in the United States, there are some similarities with Canada. Subordinated voting is associated with companies in the communications, media and entertainment sectors. Dow Jones, New York Times Co., Comcast and Viacom use subordinated share structures. Although few, there also companies associated with famous founders like Milton Hershey (Hershey Foods Corp.) Adolph Coors, the Wrigley family, and, of course, Ford Motor, controlled by the Ford family through

unlisted Class B shares. Ford's dual-class share structure is the reason, says Bob Casey, an historian at the Henry Ford Museum, "why Ford is still run by Fords and ... Dodge is not run by Dodges."¹⁴

Elsewhere, dual-class structures are relatively common. In Europe, they are regularly found in Germany and Nordic countries. Ericsson, for instance, has two classes, A and B. A-class shares carry 1,000 times as many votes as the B shares.¹⁵ Sweden's Wallenberg group, which controls Ericsson with 40 percent of the votes and less than 4 percent of the equity, also controls appliance maker Electrolux with about 95 percent of the votes but less than 7 percent of the equity.¹⁶

Table 2

The Separation of Equity and Power⁶³

Company	Ratio: Voting Power to Equity
Sceptre Investment Counsel Ltd. ⁶⁴	1,508
Onex Corp.	964
Magna International Inc.	66
Teck Cominco Ltd.	28
Corus Entertainment Corp.	23
Shaw Communications Inc.	20
Astral Media Inc.	15
CCL Industries Inc.	14
Cable Satisfaction Intl. Inc.	9
Cogeco Inc.	9

What's the Attraction?

3.1 Being There

Control. It's not always the reason given for adopting dual-class share structures but keeping control of a company while raising public equity is the fundamental driver. Some companies admit it. "The controlling shareholder intends to remain the controlling shareholder and therefore the dual classes of shares will remain," said Paul Tellier, the CEO of Bombardier Inc.¹⁷ Tellier arrived at Bombardier with a mandate to reform the Company, including its governance practices. He quickly found out that good governance at Bombardier does not include elimination of dual-class shares. The Bombardier family has 17.5 percent of the equity in the firm but thanks to Class A shares that carry 10 votes each, the Bombardiers have 59.7 percent of the votes.¹⁸ Tellier said there had been a perception that the company would end its dual-class structure but "Bombardier is not about to change that." Just in case there was any remaining doubt, company chairman Laurent Beaudoin told the 2003 annual meeting that, "The Bombardier family is and intends to remain the corporation's major shareholder."¹⁹ Beaudoin is the son-in-law of company founder Joseph-Armand Bombardier.

The Bombardier family is so attached to the idea of keeping control of the namesake company that it rejected a proposal for long-term financial backing from the Ontario Teachers' Pension Plan Board. In 2003, Teachers was willing to invest more than \$1 billion in Bombardier, which needed the money. But the investment carried a caveat: Bombardier would have to give up its dual-class shares. Bombardier said no.²⁰ It also rejected offers from other institutional investors who made the same demand. It finally ended up selling \$1.2 billion of its subordinated shares at a price that was just above the 52-week low. Holders of the second-class shares suffered a dilution, the company in effect paid a higher price for new capital than it should have, but Bombardier remains in Bombardier hands.

3.2 The Case of Press Barons

Groups that own newspapers or broadcasting enterprises have a special reason for wanting to keep control. They want to ensure that their view of the world will be properly reflected in the media outlets that they control. That's the case with the Schulzbergers at the *New York Times* and the Bancrofts at Dow Jones, which publishes the *Wall Street Journal* and *Barron's*. In Canada, Conrad Black at Hollinger, the Aspers at CanWest Global and the founders of the *Toronto Star* have particular world views that they believe deserve promotion and protection.

Black's January 2004 attempt, blocked in a Delaware court and currently under appeal, to sell control of his papers to the Barclay twins, illustrates the point. Hollinger publishes the *Daily Telegraph*, considered the voice of English conservatism; the Barclays are known for their support of Conservative causes in Britain and had promised that they would not change the paper's political leanings. The twins have since withdrawn their bid.

Table 3

Quebecor Inc. | Dual-Class IPO Waiting in the Wings

THE EXPECTED DECISION BY MONTREAL-BASED QUEBECOR INC. to launch an Initial Public Offering for Quebecor Media Inc. with a dual-class structure has renewed debate over the issue.

Pierre Karl Péladeau, chief executive of holding company Quebecor Inc. has said that Quebecor Media will likely use dual-class shares because of foreign ownership limits in the broadcasting and cable industries.²⁹ The IPO was expected before the summer of 2004 but as of the end of March had not been officially announced.

Dual-class share schemes are not required by the federal government. But Péladeau and Quebecor are well-acquainted with the benefits of subordinated and superior-voting shares. The family of founder Pierre Péladeau uses subordinated voting at Quebecor Inc. to maintain control over the printing, media and cable giant. Through Les Placements Péladeau Inc., the family has 22.3 percent of the equity but 64.7 percent of the votes. Each Class A share carries 10 votes compared to a single vote for each Class B certificate. Placements Péladeau held 74.3 percent of all Class A shares as of March 14, 2003, giving the family 174.7 million votes against only 41.1 million votes from the total class of B shares.³⁰ The Class A shares also have more voting power to elect directors. Of the nine-member board, six are elected by the Class A shares. The share structure pre-dates the company's entry into the broadcasting and cable business that came with the \$5.4-billion purchase of Groupe Videotron. Quebecor uses a similar dual-class share scheme at Quebecor World, one of the world's largest printing companies. Quebecor holds 99.8 percent of the multi-voting shares and controls 84.6 percent of the votes with 35.6 percent of the equity.³¹

The intended IPO has drawn fire from both the Canadian Labour Congress and the AFL-CIO, which have called on Quebecor to abandon plans for the dual-class IPO. "We believe it is imperative that a Quebecor Media offering respect shareholder investment through a single class stock structure," CLC President Ken Georgetti and AFL-CIO Secretary-Treasurer Richard Trumka wrote in a joint letter.³²

The Caisse de depot et placement du Québec currently holds a 45% stake in Quebecor Media.

At CanWest, which publishes the *National Post*, the Global television network, and most of the country's big-city newspapers, the Aspers have ruled that their local newspapers must run editorials written in its Winnipeg head offices. In 2002, then-chairman Israel Asper told the annual meeting that "on national and international key issues, we should have one, not 14, editorial positions."²¹ Asper died in 2003; his family maintains control with 89 percent of the votes but just 45 percent of the equity. Put another way, shareholders with the subordinated shares have contributed a majority of the equity—55 percent—but have just 11 percent of the votes.²²

3.3 Founder Knows Best

Most controlling shareholders would never admit that keeping the founder at the helm or the family name on the letterhead is a matter of ego. They argue that they can best run the company, that their vision created the firm and is necessary for its continued success. They argue that having management aligned with a controlling shareholder allows the company to build long-term value without worrying about short-term financial success. At FirstService Corp., Jay Hennick, the founder, president and CEO, says getting rid of the company's dual-class share structure would threaten the company's long-term growth. The FirstService website underlines how important Hennick thinks he is to the company: "Jay's vision and stewardship over the last decade has led to consistently attractive growth rates and an extremely well-managed organization operated by senior managers who are partners in the businesses they run. It goes without saying that Jay understands and identifies with entrepreneurs and has successfully partnered with dozens of them to realize their potential, while at the same time providing an opportunity for the shareholders of FirstService to invest in this success!"²³

At the Washington Post Company, the Graham family's Class A shares don't carry super-voting rights but do allow the family to elect 70 percent of the board. As a result, CFO Jay Morse says the company is insulated from meeting short-term financial expectations; it does not provide forecasts of quarterly earnings. "We have a narrow base of shareholders who understand how we invest their money," he says.²⁴ At Molson Inc., chief executive Dan O'Neill said at the time of the 2003 annual meeting that it was "very comforting" to have shareholders with such a large influence in the company. "To me, it's a positive and not a weakness to have that kind of share structure." Molson has performed very well with a controlling shareholder, he said. The Molson family controls 66 percent of the multiple voting B shares with about 12 percent of total equity. It's the same at Onex where Donald Lewtas, the firm's managing director, says that, "Our track record has been achieved because of the controlling shareholder."

Some companies explicitly underline the importance of the founder or particular executives when they set rules for dual-class shares that eliminate subordinated voting when those controlling rainmakers leave the firm. The multiple voting shares at Onex, for instance, will lose their special rights if Schwartz no longer owns them, or when Schwartz and his immediate family have reduced their holdings of the subordinated shares to less than five million shares. At Sherritt International Corp., the multiple-voting shares held by chairman Ian Delaney had a life of 10 years and would have expired if Delaney had left the firm earlier. In December 2003, Sherritt abolished its dual-class share structure. Delaney received compensation for giving up his shares that had given him the right to appoint the majority of directors, a right the company said he never exercised.²⁵

3.4 No Takeovers Here

Companies that use dual-class shares frequently note that they can concentrate on building value for the firm without worrying about takeovers. The existence of a large control block, especially one that is unlisted or where a single shareholder owns most of the control shares, makes it difficult to mount a hostile takeover for a firm. Given the difficulty, it would also increase the premium that would have to be paid to assume control. Coat-tail provisions required by the TSX, as noted above, permit holders of subordinated shares to participate in any takeover premium, with the exception of a private agreement transaction where the change in control involves no more than five selling shareholders and a price premium of no more than 15%.

For Onex, dual-class shares are defended as a way of keeping raiders from getting their hands on some of the company's assets, such as contract-manufacturer Celestica Inc.

WIC Western International Communications Ltd. was a broadcasting company that is now defunct, its parts sold in 2000 to CanWest, Shaw and Rogers. But in the 1990s, it became the focus of controversy over the issue of its dual-class share scheme. Company founder Frank Griffiths Sr. wanted superior and subordinated shares because he had been involved in a bitter takeover battle with Torstar Corp. and did not want to go through the same experience again. When Griffiths died in 1994, his wife Emily sold all her superior and subordinated voting shares. Her class-A shares, representing 61 percent of the company's equity, sold at a premium of \$22 a share over the subordinated shares that she sold at the same time. The company did have a coat-tail provision that would have allowed shareholders of the subordinated stock to share in the premium. But because the class-A shares were sold to different parties, Griffiths was able to skirt the coat-tail and keep the premium for herself.²⁶

A European Union review of corporate takeover rules led to a recommendation to end dual-class share structures. "There is in practice no reason why companies which were family controlled, but not family-owned, should enjoy special privileges," said Klaus-Heiner Lehne, the European Parliament's takeover rapporteur.²⁷

3.5 Canadians in Control

The federal government puts limits on the level of foreign ownership of companies in various regulated sectors, including telecommunications, broadcasting, and airlines. Companies in these sectors often say they create dual-class structures in order to avoid running afoul of foreign-ownership restrictions. For companies in these regulated sectors, it is a popular excuse because it absolves the owners of responsibility and makes it seem as if they have set up such structures only to meet Canadian government requirements. "It's not a personal thing that hangs on with me until the end of time," says Michael MacMillan, the CEO of Alliance Atlantis Communications Inc. "Each year the board has to review this and say, are these rules still in place and is it still necessary for us to have this dual-class structure." The government, however, does not mandate dual-class structures. It only demands that companies respect the limits; it doesn't prescribe methods for doing so. Bell Canada Enterprises, for example, has to follow similar Canadian ownership rules but manages with a single-class share structure. It monitors how much stock non-Canadians own and has the authority to force the sale of shares by foreigners if the limit is breached. Foreign ownership is nowhere near the threshold and monitoring ownership data is not an onerous task, says Nick Kaminaris, BCE's director of communications.²⁸

So What's the Problem?

4.1 Where the Opposition Comes From

It is obvious from the preceding section that the people who use dual-class share structures to control their companies think highly of them, and have a variety of arguments to support them. But the fact that these controlling shareholders find them profitable does not mean that investors in their companies are equally approving.

Given the premium that is generally applied to superior-class shares and the fact that, in some cases, subordinated shares receive a greater dividend as an incentive to buy them, it is evident that investors in general are suspicious of subordinated voting schemes.

Goldcorp Inc. is a case in point. In 2000, the Company ended its dual-class structure when it merged with CSA Management Inc. Company chairman Robert McEwen said he decided to give up voting control to make Goldcorp more attractive to American investors. Before the change, McEwen said trading on the NYSE used to make up about 5 percent of daily volume. Afterward, NYSE trading represented more than half of daily trading volume with an average of 1.5 million shares a day changing hands, compared with about 1.1 million in Toronto.³³

Large institutional investors are at the forefront of demanding changes in dual-class structures. First, given the size of their holdings, they have a substantial interest in the companies they invest in. As a result, they are more likely to press for changes when they find things they do not like. Second, they have a fiduciary responsibility to their beneficiaries and unit holders, whether members of pension plans they administer or investors in the mutual funds or investment pools that they manage. Finally, the size of their holdings gives them more clout than retail investors. They press for change because they are more likely to be listened to. Proxy voting guidelines of the Canada Pension Plan Investment Board, Ontario Teachers' Pension Plan, Ontario Municipal Employees' Retirement System (OMERS), and the British Columbia Investment Management Corporation all support single class share structures, as do the Shareholder Association for Research and Education Model Proxy Voting Guidelines. The Canadian Coalition on Good Governance, formed by 23 of Canada's leading institutional investors with a combined \$400 billion in assets, is also opposed to dual class share structures.

Opposition has increased for two reasons.

When few Canadian companies had dual-class structures, it was easier to ignore them. Investors could indeed vote with their feet and put their money into companies with single-class structures. As dual-class companies have become more pervasive, now representing more than 20 percent of listed companies on the TSX, it is harder to put together a portfolio that does not include companies with subordinated share mechanisms. This is acutely the case with institutional investors who manage funds that mirror the TSX index and its sub-indices. It would be impossible to run an index fund that did not include a Rogers Communications or a Torstar or a Magna. Magna, for instance, represents 1.6 percent of the TSX60 and 85 percent of the auto equipment class. “There isn’t a choice,” said one fund manager interviewed for this paper. Investors also find it difficult to avoid companies with dual-class shares because of Canadian foreign investment limits. Currently, at least 70% of the assets of Canadian tax exempt funds such as RRSPs and pensions are subject must be invested in Canadian securities in order to remain tax exempt. This limitation narrows the investment options for funds, leading them to choose dual-class share structure companies in order to maintain adequate diversity.

Table 4

Canadian Companies with Dual-Class Share Structures (May 2003)⁶⁵

Ticker Symbol	Company	Ticker Symbol	Company
AGF/B	AGF Management Ltd	FSH	Four Seasons Hotels Inc
ATD/B	Alimentation Couche Tard Inc	GIL/A	Gildan Activewear Inc ⁶⁶
AAC/B	Alliance Atlantis Communications Inc	TCL/A	GTC Transcontinental Inc
ACM/A	Astral Media Inc	IFP/A	International Forest Products
ACO/X	Atco Ltd	PJC/A	Jean Coutu Group Inc
BBD/B	Bombardier Inc	MG/A	Magna International Inc
CTR/A	Canadian Tire Corp	MRU/A	Metro Inc
CU	Canadian Utilities Ltd	MOL/A	Molson Inc
CGS/S	CanWest Global Communications Corp	OCX	Onex Corp
CAO/A	Cara Operations Ltd	POW	Power Corp Of Canada
CCL/B	CCL Industries	QBR/B	Quebecor Inc
CLS	Celestica Inc	IQW	Quebecor World Inc
GIB/A	CGI Group Inc	RCI/B	Rogers Communications Inc
FLY/A	CHC Helicopter Corp	RCM/B	Rogers Wireless Communications Inc
CCA	Cogeco Cable Inc	RYG	Royal Group Technologies Ltd
COB/A	Coolbrands International Inc	SJR/B	Shaw Communications Inc
CJR/B	Corus Entertainment Inc	SCL/A	ShawCor Ltd
DEC/A	Decoma International Inc	ST/A	St Lawrence Cement Group Inc
DII/B	Dorel Industries	TEK/B	Teck Cominco Ltd
DBC/A	Dundee Bancorp Inc	TSM/A	Tesma International Inc
EMP/A	Empire Co Ltd	TS/B	Torstar Corp
EXE/A	Extencicare Inc	TVA/B	TVA Group Inc
FFH	Fairfax Financial Holdings Ltd	VH	Van Houtte Inc
FSV	FirstService Corp	WCS/A	Wescast Industries Inc

Second, corporate malfeasance in recent years has generated an increased demand for sound corporate governance. Scandals like those at Hollinger, Cinar Corp., Enron et al in the United States, and Parmalat in Italy have prompted investors to put a greater premium on transparency and accountability. This increased attention can be seen in the decision by Standard and Poor's to create a separate unit that will evaluate corporate governance as a risk factor. As Michael Wilson, the chairman of the Canadian Coalition for Corporate Governance, put it in a February 2004 speech to the Association of Chartered Certified Accountants:

It's clear that investors and analysts large and small are beginning to use governance measurements as a criterion for investment and, on a risk avoidance basis alone, why would you put your client's money into a company with anything less than excellent governance practices when those practices could bring that company onto the front pages and you onto the carpet in terms of your investors?³⁴

While there is no evidence to date linking a greater propensity for corporate malfeasance amongst companies with dual class share arrangements, these structures have received greater scrutiny as a consequence of the broader investor concern over the impact of governance practices on financial returns and the health of financial markets generally.

The specific reasons why investors are demanding an end to dual-class shares will be explored in more detail below.

4.2 Fairness and Simplicity

Dual-class structures are by their very nature unfair to investors who put their money in the subordinated class. In the political realm, revolutions have been fought over the notion that all citizens should be treated equally. Why should Frank Stronach get 500 votes for every one of his shares while another investor gets one vote? If founding shareholders argue, as they do, that they should have greater voting power because their vision and drive has created the company, is it fair that their greater power should last in perpetuity? And is it for founding shareholders to decide when their vision is no longer creating value? Founding shareholders have freely made a decision to take their companies public. No one has forced them. In return for raising capital on the public markets, the public receives an equivalent amount of control. At Thomson Corporation and George Weston Ltd., for example, family control is maintained with a single class of shares. That is the way it is supposed to work, but dual-class shares overturn the equation, allowing founders to have their cake and eat it too. Controlling shareholders might be better off running private companies, as Peter White, the co-chief operating officer at Black-controlled Hollinger Inc. said recently. "Perhaps in the long run their best option is to become private, with the minority shareholders being bought out at a good and fair price."³⁵

The Ontario Teachers' Pension Plan, one of many large institutional investors that oppose dual-class shares, notes that they "create a 'second-class' of shares in every sense of the term. Such proposals allocate voting rights in a manner that is not consistent with economic ownership, thus depriving some shareholders of certain rights and controls. Dual classifications with unequal voting rights violate the principle of 'one share, one vote,' leading to the possibility that the company may take actions or fail to take actions without the support of a true majority of shareholders."³⁶

The existence of a dual-class structure does not imply poor governance, but where problems are present, the concern for investors is over recourse. When investors are confronted with problems at a company with a single-class structure, they can more successfully push for change.

Transparency is a key factor in good governance. Decisions must be made openly. The ownership structure, management and operations of the company should be clear to all investors. But many dual-class structures, especially those where the superior shares are unlisted, may make a corporation more opaque, not transparent. Pyramidal control added to subordinated voting makes ownership and control even more obscure.

4.3 Empowerment or Entrenchment: The Right to Under-Perform

Controlling shareholders contend that their superior voting rights allow them to concentrate on building long-term value. Ignoring the presumption that controlling shareholders are interested in building long-term value while other investors are not, dual-class share structures insulate them from challenge. Given a natural tendency to oppose change, accentuated in the case of successful entrepreneurs who too often think that their way is the only winning way, this can deprive a company of opportunities that it might otherwise have been able to take advantage of if control was more democratic.

More importantly, it entrenches them. Even when a company is not performing well, they are under no obligation to listen, and cannot be removed by the board or by shareholders. The protection that dual-share structures offer means that the ultimate weapon against corporate incompetence—the hostile take-over—has limited effect. Burgundy Asset Management Ltd., which opposes subordinated voting mechanisms, has noted that: “There is no better incentive to economic efficiency for a publicly traded corporation than the free market in the company’s common equity. As the economic history of the past 20 years has shown, underperforming companies whose management is not entrenched by control blocks or multiple voting stock are routinely bought up and made efficient by new management and ownership groups. ... Subordinated voting and non-voting arrangements ... enable underperforming managements to remain in control, and may contribute to sluggish economic performance.”³⁷

Controlling shareholders complain that subordinated shareholders criticize dual-class structures only when the company isn’t performing well. “When the company is doing well, no one questions the [multiple-voting structure],” says Onex’ Lewtas.³⁸ But surely shareholders in a company that is under-performing have the right to criticize the way the company is being run, and to expect that their criticisms will be heard.

There is no clear-cut proof that dual-class companies either out-perform the market, as their controlling shareholders suggest would be the case, or that they under-perform. But while

Table 5

Premiums for Superior Voting Shares by Country⁶⁸

Country	Premium (%)
United States	5.4
Sweden	6.7
Britain	13.3
Switzerland	20
Canada	23.3
Israel	45.5
Italy	82

the facts appear to be somewhat contradictory,³⁹ some evidence does suggest that companies with subordinated voting offer poorer returns than their single-class cousins. Burgundy Asset Management looked at the performance of 121 dual-class companies over an eight-year period ending Dec. 31, 1995 and compared them with the returns of single-class firms. The annualized compound return for single-class firms was 2.5 percent against 1.8 percent for dual-class companies. Burgundy then redid the numbers for the five-year period ending Dec. 31, 1995 to remove any influence from the 1987 market crash. Again, companies with single-class structures outperformed their dual-class counterparts, 8.6 percent against 8.1 percent.⁴⁰ “We should point out these differences are not immaterial. (Just ask any market manager who underperformed a benchmark by 0.7 percent over eight years—if you can find one still in business.)”⁴¹

Another study reported in the Canadian Investment Review in 1997 found that companies adopting dual-class structures perform significantly worse than their peers in the first year after reclassification and improve only slightly in the following two years. The authors of the study note that, “Clearly, the dual-class

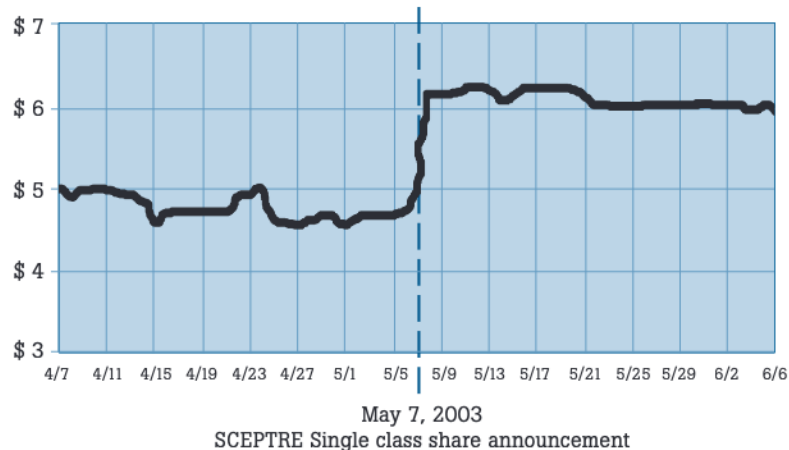
reclassification has been a disappointing experience for shareholders in these firms.”⁴²

A final example comes from the investment services industry, where dual-class investment management companies still exist despite the fact that the industry opposes them in other companies. In 2003, Sceptre Investment Counsel Ltd. abandoned its superior shares that had given CEO Rick Knowles and his managers control with less than 20 percent of the equity. Sceptre’s shares gained 7.4 percent the day of the announcement and had risen 32 percent after five trading sessions. Almost a year later (March 2004) the stock is 16 percent off its 52-week high, and 57 percent above the 52-week low. Sceptre’s experience was also mirrored by other companies that got rid of dual-class shares last year. Sherritt, Home Capital Group Inc., Sino-Forest Corp., and Gildan Activewear Inc. all saw share prices rise after their announcements.⁴³

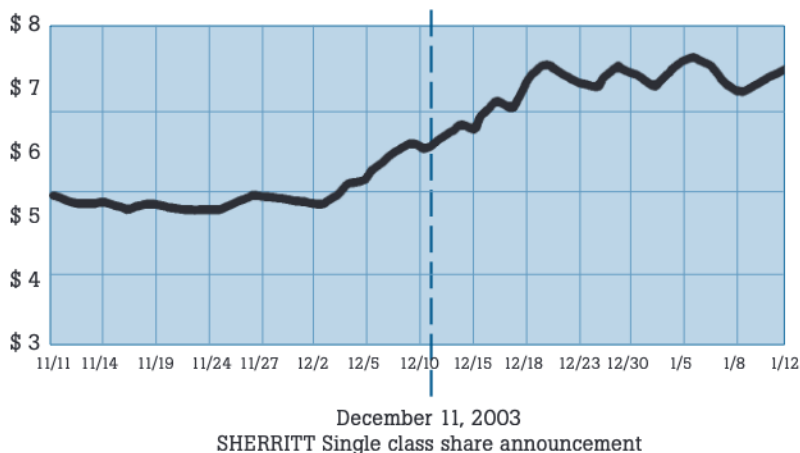
Figure 2

Single Class Share Announcements

SCEPTRE



SHERRITT



4.4 Public Control, Private Benefits

Other than the thrill of control, what's in it for controlling shareholders? Substantial evidence, theoretical and empirical, suggests that dual-class structures allow shareholders to privately appropriate benefits due the corporation. Recall the decision of the Bombardier family to accept, on behalf of the company higher capital costs as the price of maintaining their control. Dual-class structures have a tendency to exact higher agency costs.⁴⁴ "The agency costs associated with CMS firms [controlling-minority shareholders, i.e. holders of superior-class shares] increase very rapidly as the fraction of equity cash flow rights held by CMS controllers declines."⁴⁵ In other words, the less equity and the more power that controlling shareholders have, the more likely their interests will diverge from that of ordinary shareholders. Randall Morck is more succinct about this tendency: "Dominant shareholders sometimes steal from other shareholders. They can direct corporate wealth towards themselves via non-arm's length transactions with other companies they control. They can skew corporate decisions to satisfy their psychological, political or economic needs."⁴⁶

A famous example of this tendency comes from Germany and involves the case of Hohner AG, a world-leader in harmonica production, based in the small town of Trossingen in the state of Baden-Württemberg. The Company donated lavishly to politicians and other local institutions. Between 1949 and 1961, Hohner AG made 11.7 million DM in social and philanthropic donations, against aggregate dividend payments in the same period of 7.2 million DM. In 1957, the Company celebrated its 100th anniversary in style, with heavy praise for the Hohner family. More than 1,000 guests from 33 countries attended the festivities, which lasted three working days. The postscript is that Hohner avoided liquidation in 1986 when its banks wrote off 10.6 DM in debt. As a result, the family's voting power was diluted from 60 to 30 percent.⁴⁷

There are, of course, examples of allegations of private expropriation of benefits closer to home. Conrad Black's Hollinger paid US\$8 million to buy the papers of Franklin Roosevelt at the same time Black was

writing a biography of the former U.S. president. Black's activities at Hollinger International are the subject of various lawsuits and investigations. One shareholder suit claims that Black and other executives "looted" the company of as much as US\$300 million. Black denies wrong-doing and has launched his own counter-suits.⁴⁸

At Magna, one analyst has been quoted as saying that Stronach runs the company "very much like a private firm."⁴⁹ Although Magna is an auto parts firm, and has been a very successful one, Stronach has tried at various times to take the company he controls in other directions. A big fan of the ponies, Stronach had Magna buy the Santa Anita racetrack near Los Angeles in 1998 for US\$126 million. He put \$750,000 into a soccer team in Austria, where he was born. He founded an Austrian sports

Table 6
Premiums for Magna Subordinated and Multiple-Voting Shares⁶⁷

Period	High	Low
Class A: Subordinated		
1 st Q 2002	118.75	94.50
2 nd Q	122.00	98.17
3 rd Q	104.60	85.52
4 th Q	91.54	78.67
Class B: Superior		
1 st Q	125.00	93.00
2 nd Q	123.00	96.00
3 rd Q	105.00	90.00
4 th Q	95.00	83.00

channel and planned a \$1 billion amusement park in Vienna. “Shareholders were pretty ticked off when he started buying race tracks,” says Bill Mackenzie of Fairvest. “But there was nothing you could do.”⁵⁰ Stronach finally spun off the non-auto parts into a separate company in 2000.

Compensation is one way for controlling shareholders with pliant boards to take home benefits that many argue should remain with their companies. Again, Stronach figures large. In 2002, he made \$52 million in consulting fees, plus \$6 million from stock options. That was more than the combined pay of the five CEOs at the big banks. Magna stock had fallen 30% in the previous year.⁵¹ In May 2003, the Ontario Teachers’ Pension Plan withheld its votes for Magna’s board because of Stronach’s compensation package. The move failed because of Stronach’s voting power that easily overpowered the Teachers’ holding of 1.7 million shares.⁵² Thanks to Magna’s dual-class structure, Stronach has largely remained unbowed and in charge. Faced with complaints about his pay, he insisted he was worth more than he was being paid. As journalist Berman commented: “Stronach may be wrong-headed but he’s also the boss.”⁵³

Compensation is also an issue at Shaw Communications where the Shaw family uses a dual-share structure that gives it 20 times the voting power that it would ordinarily have if the family owned only common stock. And there’s a clear difference between the way that executive chairman J.R. Shaw calculates his bonus and the way bonuses are set for top managers. Bonuses for managers are based on Shaw’s bottom line. But the chairman has a separate contract that determines his package as a flat percentage of operating profit. So while Shaw lost \$288-million in 2002, Shaw took home a \$6.3-million bonus.⁵⁴

4.4.1 Go Where the Money Is

Academic research suggests that controlling shareholders are more likely to try to appropriate corporate benefits for their private use when there are monopoly profits at stake. Burgundy uses this argument as an explanation why dual-class firms have been concentrated in sectors such as communications and consumer products, while resource and cyclical sectors are dominated by companies with single-class share structures.

Until recently, in areas like broadcasting, a small number of companies were licensed to import American programs and sell them for oligopoly profits into the Canadian market. The old system of tariffs and duties allowed Canadian retailers to charge higher prices to Canadian consumers ... Canadian breweries were protected by requirements for in-province brewing ...

The point is that if you owned a TV station or a retail chain or a brewery, it could be a licence to print money. If you went public in order to acquire other TV stations or breweries, it was a good idea to protect control through a DCSS [dual-class share structure].⁵⁵

Although dual-class firms are relatively rare in the United States, that’s not the case in the cable industry. All but three of the 25 largest publicly listed cable companies had dual-class share schemes. Companies receive a government-mandated monopoly to provide cable service in a particular franchise area (as is, more or less, the case in Canada). Until recently, with the rise of small-dish satellite services, there was no competition. Companies were assured monopoly profits. When they needed to invest in improved infrastructure, they could raise low-cost capital on the equity markets, protected from losing control of their cash cows by subordinated voting.⁵⁶

Intriguingly, a subsidiary argument, and an additional explanation why dual-class companies are so concentrated in the broadcasting and cable industries, relates to the takeover protection conferred by subordinated voting. Once government regulators provide a broadcast licence, they are unlikely to revoke the licence unless there has been egregious behaviour on the part of the licensee. The only way to obtain an existing licence, therefore, is to take over a company that already has one. The potential of an open season on licensed firms, with its consequent advantage to minority shareholders, gives them every incentive to protect themselves, and what better way to do so than through dual-class shares.

4.5 Boards—The Missing Link

The Harvard Business Review has noted that when management, directors and shareholders “work well together as a system, they provide a powerful set of checks and balances. But when pieces of the system are missing or not functioning well, the system as a whole can become dangerously unbalanced.”⁵⁷ Dual-class share structures and the ability of controlling shareholders to elect the boards of their choice break that critical link in the corporate governance chain. It seems to be a safe assumption that controlling shareholders, having accumulated power through multiple-voting shares would use that power to elect compliant boards. Why amass the power and then allow an independent board to check it? That’s an assumption, but it seems to be borne out by a survey by the Conference Board of Canada of 205 Canadian companies. Boards of widely held companies had a wider range of responsibilities than companies with concentrated ownership. As well, 93 percent of widely held companies complied with guidelines on unrelated directors. That was the case for only 69 percent of companies with a major shareholder.⁵⁸

SHARE Model Proxy Voting Guidelines

3.5.1 Unequal voting shares and dual classes of stock

Common stock traditionally carries one vote per share. Dual class stock structures with subordinate or unequal voting shares contain a class of common stock with inferior voting rights or no voting rights. This stock usually pays a higher dividend and can be transferred more easily than shares with full voting rights, making them attractive to some investors. This structure allows management to maintain control of the corporation by keeping the shares with full voting rights. [The fund] is opposed to dual class share structures for several reasons. First, they violate the principle of one share, one vote, making it possible for the company to act without the support of a true majority of shareholders. Second, when dual classes of stock are initiated, they are likely to dilute the voting power of shares already issued. Third, dual class share structures make it possible for a few investors to gain or keep control of the corporation, which is not in the best interests of the majority of shareholders.

[The fund] will vote against the creation or issuance of shares that do not have full voting rights. It will vote for the replacement of dual class shares with common stock carrying one vote per share, unless circumstances make this contrary to the long term interests of the majority of shareholders. In cases where a dual class structure is already established, [the fund] will support proposals for a mandatory review of the stock structure and reapproval by shareholders every five years.

SHARE Model Proxy Voting Guidelines, 2004, <http://www.share.ca/files/pdfs/2004%20Revised%20Guidelines.pdf>

In a 2001 examination of corporate boards by Canadian Business and a 2002 review by the Globe and Mail, dual-class companies stood out when it came to boards that did not meet governance criteria.⁵⁹ Alliance Atlantis, Quebecor and CanWest Global, all dual-class companies, had either family members on the board or directors who work as consultants for the company. Bombardier, another dual-class company, has two Bombardiers and two in-laws on the board, plus a few former Liberal politicians and the son-in-law of then prime minister Jean Chrétien. Bombardier also had related directors on its audit and compensation committees. At Magna, says Fairvest's Mackenzie, "it's Frank Stronach's board."

The Canadian Coalition for Good Governance says Canadian companies should have strong and independent boards that represent the interests of shareholders. It suggests that at least 50 percent of directors be independent of management. Best practices call for two-thirds of the board to be independent. Meeting that target, and the goal of sound governance that it represents, means that either dual-class shares, or board independence, will have to go. It's difficult to have both.

Has the Bloom Faded?

THE NUMBER OF DUAL-CLASS COMPANIES ROSE DRAMATICALLY IN CANADA IN THE FINAL decades of the 20th century. In 1975, only 5 percent of companies had subordinated voting mechanisms. By 2003, that had risen to about a quarter of the firms listed on the S&P/TSX index.

Given the data for 2003, it may be too soon to say that dual-class share structures have reached their high water mark, yet it may turn out that this is indeed the case. Although some new companies, such as Quebecor Media, may opt for new dual-class structures, it seems certain that opposition will continue to grow along with the renewed emphasis on corporate governance. An amendment to the Canada Business Corporations Act in November 2001 has made it easier for institutional investors to launch concerted efforts against dual-class share structures in federally incorporated companies. This will increase the pressure on companies to act. And as respect for best practices in governance increases in the boardrooms, those in Canada's business class who ignore this trend may well start to find themselves treated as outcasts by their colleagues. Demand for changes in the boardroom to provide more independence for corporate boards will also undermine the ability of controlling shareholders to use dual-class voting to elect pliant boards.

There may also be a judicial trend that could help, on its own terms and in terms of the provision, and costs, of liability insurance for directors. The trend appears to support the existence of a fiduciary obligation to shareholders as well as the company. Although the general obligation has been to the company as the nexus of contracts, the courts have said time and again that each case will be determined on its facts and that the classes of fiduciary relationships are not closed. If this trend raises liability issues for directors who support the interests of the controlling shareholder against the interests of holders of common equity, directors may begin to balk, and insurance premiums for directors' liability at dual-class companies could rise.

A number of companies chose to abandon dual-class structures in 2003. That trend continued into 2004 with the announcement by MDC Partners Inc. that it would give up its dual-share scheme. Miles Nadal had controlled a 44.9 percent stake in the company with only 20.2 percent of the equity. "The decision to convert my multiple-voting shares into single-voting shares is an important incremental step in my commitment to the highest standards of corporate governance," he said.⁶⁰ In the United States, shareholders of Readers' Digest Association and Fairchild Semiconductor International both approved the elimination of dual class share structures.

One indication that dual-class share structures are falling out of favour with Canadian investors is that companies with such schemes are disproportionately represented among companies on the S&P/TSX index with low Price/Earnings (P/E) ratios. This may point to the fact that investors are increasingly wary of putting their money into such vehicles. As reported in the Corporate Governance Review published by Fairvest Corporation, the list published on Jan. 30 by the Globe and Mail of the 20 companies with the lowest P/E ratios on the S&P/TSX Composite Index contained nine dual-class companies—45 percent. Over the last year, Fairvest reported that between 35 and 55 percent of the companies on the list have had dual-class shares.⁶¹

5.1 Investor Recommendations For Change

There are many calls for an outright end to dual-class share schemes. One effect of the campaign against them is that while controlling shareholders are hardly in a stampede to abandon subordinated voting, institutional investors believe that their activity has discouraged companies from adopting new dual-class arrangements.

As a compromise short of a total ban, Burgundy Asset Investment Management has recommended that securities regulators move to:

- Abolish non-voting stock entirely,
- Limit multiple voting shares to no more than 10 votes a share,
- Impose a sunset clause with a vote after 10 years or on the death or retirement of the CEO,
- Treat all shareholders equally in the event of a takeover bid.

The Canadian Coalition for Good Governance has called for clear labelling of dual-class shares to identify issues that have multiple votes, limited votes, or no votes at all.

Fairvest Corporation has long prescribed the following minimums for dual class capital structures:

- A three year sunset provision - the structure must receive subordinate class approval to continue at least every three years
- *any* transfer of super-voting shares that effects a change in control requires subordinate class approval
- The subordinate share class can nominate and elect a limited number of directors

5.2 IPOs: A Special Case?

Companies going to market with IPOs might well argue that they have a special case to make. In such companies, the founders argue that they need some protection from takeovers and an ability to concentrate on long-term growth rather than short-term results. There is also an argument that a firm that is growing quickly has a large need for capital that diminishes the likelihood that a controlling shareholder will appropriate private benefits. There is an obvious attraction for multiple-class IPOs. Even in the United States, more than 7 percent of companies go public with dual-class share structures.⁶²

Even if there is a special case, the argument of perpetuating control without proportionate equity participation forever is difficult to make given the risks of entrenchment and incentives for poor corporate governance discussed above. In cases where a founder can make a convincing case, a dual-class structure could be adopted for a limited period of time. As an alternative, protections can be put in place through voting agreements that do not require dual-class shares.

Conclusions & Recommendations

DUAL-CLASS SHARES, WHATEVER THE CLAIMS THAT CONTROLLING SHAREHOLDERS MAY MAKE in favour of them, raise the risks of poor performance, private expropriation of benefits and poor corporate governance. It is also a red herring to blame foreign ownership limits imposed by the government given that there are companies with single-class structures that fall under similar rules. Despite the prevalence of dual-class structures in Canada, there may be signs that they are falling out of favour, among investors and the people who run Canadian companies. Dual-class share structures promote the practice of poor corporate governance, violate the standard that participation in a public company should be related to equity participation, and deserve no significant place in modern and well-run capital markets. Their end would not be mourned.

Based on the foregoing discussion, it is time for Canadian securities regulators and stock exchanges to take steps to address the effects of dual class share structures on Canadian equity markets.

Accordingly, SHARE recommends that the Toronto Stock Exchange and Canadian securities regulators adopt the following ten recommendations. In each case, currently listed companies would be allowed a two year implementation grace period or longer, where indicated:

Recommendation 1: Prohibit new dual class share structures on the Toronto Stock Exchange. Require a three-year sunset provision for companies with existing structures. Dual class share structures would be permitted for firms listed on the TSX Venture Exchange subject to the conditions in the recommendations below.

Recommendation 2: Abolish non-voting common stock.

Recommendation 3: For companies listed on the TSX Venture Exchange, require subordinate class approval for the continuation of dual-class share structures at least every three years.

Recommendation 4: Permit subordinate class shareholders to directly elect a portion of the Board of Directors.

Recommendation 5: Limit voting strength of multiple voting shares to a total of 51% of total outstanding votes and to no more than 10 votes per share.

Recommendation 6: In the event of a takeover bid, treat all shareholders equally (one share, one vote) or, alternatively, require subordinate class approval for any transfer of super-voting shares that effects a change in control.

Recommendation 7: Clearly label dual class shares and exchange ticker symbols to identify issues that have multiple votes, limited votes, or no votes at all. 

Notes

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“Restricted voting shares” means restricted shares that carry a right to vote subject to a restriction on the number or percentage of shares that may be voted by a person, a company or any combination of persons and companies, except to the extent the restriction or limit is permitted or prescribed by statute and is applicable only to persons or companies that are not citizens or residents of Canada or that are otherwise considered as a result of any law applicable to the issuer to be non-Canadians;
The Rule can be found at: www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/56-501r_19991029.html
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