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Decades-old Controversy over Dual Class Shares Shows No Signs of Abating

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> "The Commission did agree on the view that in the long term it considers the impact of the use of restricted shares on capital markets is negative and that the efficiency of our capital markets will suffer and will therefore be less attractive to investors and issuers if restricted shares continue as an important device of corporate finance to Canadian issuers. The Commission is hopeful that the destiny of restricted shares in Canadian capital markets can be determined by market participants rather than by the regulators. This will be achieved by increased investor sensitivity to the consequences of purchasing restricted shares and by increased participation by minority shareholders in the corporate reorganizations to create these shares. The Commission encourages all investors to take a more active role in expressing their views on the issue of restricted shares and other capital market issues."

the Ontario Securities Commission in 1984, as part of its explanation for amendments to its policy on restricted shares

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Hardly a day goes by when there is not a controversy somewhere in the world involving a dual class share structure, accompanied by calls by investor advocates and others to ban the structure for public companies once and for all. Canada certainly has had its share of incidents. Canadian Tire (1986) and Magna International (2010) immediately come to mind, but there have been a number of others. Recently, some high-profile companies have revived the public debate in Canada somewhat, either by going public with subordinate voting shares or by proposing amendments to the terms of existing dual class structures to preserve the voting power of multiple voting shares for a longer period than the existing share provisions would permit.

Background

In the early 1980s, Canadian securities regulators requested comments and held public hearings on two separate occasions to review issues relating to dual class shares. In 1981, the Ontario Securities Commission and the Toronto Stock Exchange even imposed temporary moratoriums on the public distribution and listing, respectively, of new participating shares that were not fully voting or which had voting rights that were inferior to those of another class of shares (collectively, “restricted shares”), pending the outcome of the first of the public hearings. While existing restricted shares were not in danger of being delisted, the question of whether new issues would be allowed in the future was under serious consideration.

The OSC and some of the other regulators eventually settled on a regulatory regime that was primarily disclosure-based. The conclusion the regulators reached, somewhat reluctantly as indicated by the quote at the beginning of this article, was that the marketplace should dictate the future of restricted shares, and the main role of the regulators was to ensure that the decisions of the marketplace were premised on full disclosure. Market discipline was also a key consideration underlying the OSC’s 1984 decision to reverse its requirement, imposed earlier that same year, for newly created restricted shares to have effective “coattail” provisions attached to them to prevent their holders from being excluded from a take-over bid for the shares with superior voting rights. The Toronto Stock Exchange enacted its own coattail requirement in 1987.

Most of the dual class share structures established in Canada in the last 30 years have been of the subordinate/multiple voting variety. In many cases, the voting ratios have been such that the voting power of the subordinate voting shareholders has been only symbolic. However, for some companies a sufficient number of subordinate voting shares have been issued for financings or acquisitions over the years so as to dilute the voting power of the multiple voting shareholders to a level that has threatened the control position of the primary holder of those shares. In that circumstance, the company may take the position that the original purposes for establishing the dual class structure – for example, to implement the company’s long-term strategy and maintain its corporate governance culture through the continued leadership of the company’s founder and controlling shareholder – continue to apply.

To address this issue, Four Seasons Hotels Inc., with the approval of the disinterested holders of subordinate voting shares (among other shareholder approvals), amended the terms of its multiple voting shares in 1996 so that the number of votes attaching to each multiple voting share would thereafter vary to the extent necessary to maintain the percentage of voting power held by the multiple voting shares at the time of the amendment. At the same time, the share provisions were also amended so that at the time the number of votes per multiple voting share (renamed “variable multiple voting shares”) would first increase after the amendment, the dividend entitlement on those shares would be permanently decreased, on a per share basis, to 50% of the dividend entitlement on the subordinate voting shares (renamed “limited voting shares”). The continued adjustment of the voting rights of the variable multiple voting shares would be subject to a disinterested ratification vote of the holders of the limited voting shares every three years or if any variable multiple voting shares were transferred out of the existing controlling family shareholder group.

Recent Developments

In June of 2015, Fairfax Financial Holdings Limited announced that a special meeting of its shareholders would be held to vote on an amendment to the company's articles which, similar to the Four Seasons Hotels amendment, would have the effect of maintaining the voting power of the multiple voting shares at its current level of 41.8% of the votes attaching to the multiple and subordinate voting shares combined if the company were to issue additional subordinate voting shares. All of the multiple voting shares are held by a company controlled by Fairfax's founder and chief executive officer. The specific proposal was that the number of votes per multiple voting share would be increased from 10 to 50, subject to the 41.8% maximum voting limit. Several additional measures would accompany the amendment, including, among other things, a disinterested shareholder ratification requirement to continue the amended voting structure in the future under certain conditions relating to increases in the number of outstanding voting shares, equal treatment of subordinate and multiple voting shareholders in the event of the collapse of the dual class structure or change of control, and certain limits on the controlling shareholder's employment remuneration.

The meeting of shareholders to consider the amendment was postponed twice. According to the company's press release announcing the first postponement, its purposes were to "allow more time for the holders of a significant number of shares which have not been voted to vote their shares, and allow Fairfax's management to continue ongoing discussions with shareholders concerning the proposed amendment." The second postponement was due to a change to the proposal, which would now require future disinterested shareholder approval of the amended voting structure under additional circumstances to those provided for in the original proposal. This change came about, according to the company's press release, "in response to discussions with certain significant institutional shareholders of Fairfax, which are designed to provide additional minority shareholder protections. Those shareholders, as well as other significant institutional shareholders, have advised that they now intend to vote in favour of the proposal."

In July of 2015, Alimentation Couche-Tard Inc. announced that at its upcoming annual general and special meeting, shareholders would be asked to approve amendments to the company's articles to change the conditions under which its dual class share structure would automatically terminate. The existing share provisions provided that the 10-vote multiple voting shares would lose their superior voting status when all four of the company's founders, who were all directors at the time of the proposed amendments, reached the age of 65 or when they collectively held less than 50% of the voting rights attached to all of the company's outstanding voting shares, whichever was earlier. Under the amendments, the triggering events for termination of the dual class structure would be changed, including the removal of mandatory termination of the structure upon the attaining of age 65 by all the founders. The information circular for the shareholder meeting disclosed that shareholders were involved in discussions that led to changes to the amendments originally proposed by the founders, including an increase in the number of directors that the holders of the subordinate voting shares would be entitled to elect separately.

The shareholder involvement in the finalization of the Fairfax and Alimentation Couche-Tard proposals could be considered as examples of the type of market-based regulation of dual class share structures preferred by the securities regulators as first expressed in the 1980s. Market forces may also reasonably be regarded as playing a key role in the decisions of a number of companies to collapse their dual class share structures. Apart from disclosure, disinterested shareholder approval and coattails, the regulators and stock exchanges are generally content to let the marketplace determine the fate of dual class shares.

Comment – Dual Class Shares and Shareholder Rights Plans

There is a certain paradox in the views taken by securities regulators on dual class shares and take-over bid defences such as shareholder rights plans. A shareholder rights plan that permits a "just say no" take-over bid defence is intended to prevent a change of control from occurring (subject to a normal "permitted bid" exception) without the consent of the directors, who have fiduciary duties to the company. Most dual class share structures are intended to prevent a change of control from occurring without the consent of one shareholder, or shareholder group, that holds a minority of the equity and has no fiduciary duty to the company. Yet shareholder rights plans are generally unacceptable to securities regulators as a "just say no" take-over defence regardless of the amount of disclosure around them, in contrast to the regulation of dual class share structures.

Proponents of dual class share structures emphasize not only their long-term benefits to certain types of companies but also the desirability of allowing investors the freedom to make their own decisions based on their assessment of the attributes of the securities available in the market, including voting rights. It might reasonably be suggested that similar logic applies to shareholder rights plans which, if in existence at the going public stage or subsequently introduced with disinterested shareholder approval, and with prescribed continuous disclosure, should be permitted to operate within the limits dictated by the marketplace.