Offloading the Burden of Being Public:
An Analysis of Multiple Voting Share Structures

by

Anita Anand
Forthcoming Virginia Law and Business Review

Abstract

Public companies with multiple voting share (MVS) structures have grown in popularity in the United States as evidenced by Google, Alibaba and Fitbit. While MVS allow founders to retain control of their firms, they undermine corporate governance standards. In particular, MVS structures undermine minority shareholders' rights and render these rights meaningless in the face of the proportionately greater economic risk that minority shareholders bear. Some argue that "caveat emptor" applies: shareholders, armed with full disclosure of a firm's capital structure, invest in companies with multiple voting shares at their own risk. But this line of reasoning fails to account for two important aspects of relevant law. First, MVS structures undermine existing accountability mechanisms in corporate law. Second, a securities regime premised on investor protection that equips regulators with the discretionary power to intervene in the public interest calls for further regulation, and perhaps prohibition, of MVS.

---

JR Kimber Chair in Investor Protection and Corporate Governance, University of Toronto; Fellow-in-Residence, C.D. Howe Institute. Email: anita.anand@utoronto.ca. Thanks to the participants of the Stanford-Rotman Governance Day and the University of Toronto Dual Class Shares Roundtable for helpful comments. Thanks also to Michele Dathan, Edward Iacobucci, Hal Jackman, Vijay Jog and Naizam Kanji for discussions on this topic. Thanks to Krupa Kotecha, Andrew Mihalik and Duncan Melville for very helpful research assistance.
1. Introduction

Many large firms have multiple voting share structures (MVS) in which the firm issues two or more classes of shares, one to the public and the other to insiders (typically founders, promoters, management, private investors or board members). The shares that are issued publicly have limited voting rights while the class issued to insiders carries more voting rights, allowing them to control the company. The one-to-one ratio of votes per share prevalent in non-MVS firms does not exist.

MVS allow insiders to retain control despite the fact that they do not retain economic ownership in the firm. In this essay, I argue that MVS undermine corporate governance standards because outside shareholders carry a disproportionate share of the economic risk in the firm relative to their ability to influence the affairs of the corporation, and in some cases are totally unable to affect change in the corporation. In particular, public shareholders in MVS have diminished rights, effectively unable to exercise rights to which they would typically be entitled under corporate law in non-MVS structures including the ability to elect directors, approve financial statements, appoint auditors and affect change through their vote. Their rights are meaningless in the face of

1 While the focus of this essay is on public MVS firms, private firms can also have MVS as long as the structure is specified in the firm’s articles of incorporation. Between 1979 and 1983, the number of MVS companies listed on the Toronto Stock Exchange (TSX) increased from 64 to 130. The current number is about 80. See Matthew Merkley, Multiple Voting Shares: Don’t Call It A Comeback, Blake, Cassels & Graydon LLP (February 9, 2015), http://www.blakes.com/English/Resources/TrendsInsights/Pages/details.aspx?AnnouncementID=78.

2 Henry Hu & Bernard Black, Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications, 14 E. Fin. Mgmt. 663, 666 (2008): “Some of these rights are economic, including dividend, liquidation, and appraisal rights under corporate law. Some rights are not purely monetary, including voting rights, director fiduciary duties, rights to bring suits and inspect corporate records, access to corporate proxy machinery... Some of these rules are based on formal record ownership (even where the record owner passes voting rights to an economic owner); some are based on who holds voting rights. However, persons who have economic ownership but not voting rights are regulated lightly or, often, not at all.”
the proportionately greater economic risk that they bear.

As there are reduced checks on the conflicts of interest that can undermine the ability of directors to discharge their fiduciary duty, MVS raise a larger issue regarding the rights of minority shareholders. Their rights, especially their ex ante rights, are ineffective because of the small percentage of votes that they hold relative to the votes held by the holders of the superior class. If a single person has a majority of a single class of shares, the minority shareholders still have voting rights; it is just that they can be out-voted on any given issue. “Ex ante rights” consist of rights such as the right to elect directors, launch a shareholder proposal or requisition a meeting. These are rights that shareholders have qua shareholders. They are not remedial or “ex post rights,” as is the oppression remedy or the derivative action, for example.

Some may argue that even if minority shareholders’ ex ante rights are meaningless in MVS, they continue to have their ex post rights as well as common law private rights of action. Shareholder remedies, however, are of little use because at the moment when ex post remedies become available the damage has already been done. A bad transaction is unlikely to be unwound ex post and will very likely be reflected in the firm’s (probably declining) share price in any case. As I argue here, MVS undermine corporate governance and so should be further regulated and perhaps prohibited in capital markets. Mandatory coattails are insufficient as a response to the poor governance associated with MVS because coattails do not account for the fact that other forms of change of control (e.g. proxy contests) are possible and indeed are increasing in popularity.

The rationale for this argument against MVS is normative rather than positive. MVS firms, and the holders of the superior voting shares, should not be permitted to enjoy the benefits of being public without taking on the commensurate economic burden. In particular, a primary purpose of going public is to give the corporation the ability to access funding from individuals not associated with the corporation (i.e. from the public at large). It seems unfair to allow corporations - and by extension their shareholders at
the time - to enjoy the benefit of going public without also taking on the corresponding burden of ensuring that the corporation’s public shareholders are protected with adequate governance and accountability mechanisms. This normative argument becomes more important in the face of efficiency costs from MVS manifested in severe agency problems as evidenced in the Magna transaction discussed below.3

This essay is largely a response to those who argue that in purchasing shares in a public firm, investors “purchase at their own risk” based on certain mandated disclosures contained in an often unwieldy prospectus or proxy circular. They become shareholders in full knowledge, or with access to full knowledge, of the corporation’s MVS structure. As Stephen Bainbridge notes:

Public investors who don’t want lesser voting rights stock simply won’t buy it. Those who are willing to purchase it presumably will be compensated by a lower per share price than full voting rights stock would command and/or by a higher dividend rate. In any event, assuming full disclosure, they become shareholders knowing that they will have lower voting rights than the insiders and having accepted as adequate whatever trade-off is offered by the firm in recompense.4

I refer to this line of thinking as the “caveat emptor” argument and respond to it in the following respects. MVS allow agency costs to proliferate and they undermine existing accountability mechanisms in the corporate statute. Furthermore, the jurisdiction of securities regulators is founded on investor protection and the public interest rather than caveat emptor. It therefore demands an examination of MVS structures.

3 Id. at 668 (arguing that the efficiency effects of so-called “decoupling” are minimal).
For these reasons, I argue that MVS should be further regulated, and perhaps prohibited, in capital markets.

The motivation for this essay is twofold. First, MVS are, and have traditionally been, prevalent in Canada, and are growing in prevalence in the U.S. As a historical matter, the NYSE refused to list companies with MVS until 1984 and the SEC adopted rules in 1988 that significantly limited the ability of U.S. corporations to install MVS, which remained in effect until they were struck down by the courts in 1990. Due to a combination of this historical legacy, a relatively restrictive regime governing MVS and vocal investor opposition, just over two percent of companies listed in the U.S. featured some form of MVS in 2005.

But after a brief period of popularity in the 1980s as a takeover defense, MVS have returned to notoriety: more than 13.5 percent of companies listed on U.S. exchanges today have adopted MVS, up from 12 percent a year ago. A number of well-known companies, including Berkshire Hathaway, Alphabet (formerly Google) and Facebook feature MVS. In recent months, FitBit, Box, and a division of Alibaba have gone public with such structures in place, while Cara and Stingray have done the same in Canada. This suggests that investors have an appetite for this type of capital structure. Because

---

5 See Tara Gry, *Dual-Class Share Structures And Best Practices In Corporate Governance*, Parliament of Canada (August 18, 2005), http://www.parl.gc.ca/Content/LOP/ResearchPublications/prb0526-e.htm: "An estimated 20% to 25% of companies listed on the TSX make use of some form of dual-class share structure or special voting rights."


7 Gry, supra note 5: "[I]n the United States, where rules on dual-class shares are much more restrictive and investor opposition is more vocal, just over 2% of companies issue restricted shares."


10 There are currently at least 86 firms listed on the TSX with a MVS structure. The incidence of superior voting shares in TSX
MVS firms have traditionally comprised a notable proportion of the Canadian capital markets, this essay draws upon the Canadian experience to contribute to the policy discussion surrounding MVS in the U.S. necessitated by their renewed popularity.

Second, although MVS companies are currently permitted to list on the NYSE, NASDAQ or AMEX (provided the MVS was in place at the time of the IPO), regulators in other jurisdictions (e.g. Canada, France and Japan) are examining the structure. This suggests that the policy implications of these structures, for both domestic and international jurisdictions, warrant further discussion. This essay aims to contribute to the policy debate, arguing that MVS are detrimental to the interests of outside, particularly minority, shareholders.

Part 2 sets forth my argument regarding the weakening of accountability mechanisms and the corresponding management entrenchment it allows. Part 3 sets forth the rights of minority shareholders in the corporation and explains how MVS exacerbate the already disadvantageous position of these shareholders. Part 4 outlines policy options, the main recommendation being that public corporations should be prohibited from establishing MVS unless a majority of the minority has approved the MVS in a vote that would take place after the IPO. Part 5 concludes.

2. Deconstructing Supposed Advantages of MVS

Historically, Canadian firms (for example, Bombardier, Fairfax and Rogers) issued MVS in order to preserve companies rose from 5% in 1975 to over 15% in 1987. See Gry, supra note 5.

family or founder control while allowing the firm to gain access to capital in public equity markets. Family or founding members would retain voting control while the restricted shares were offered to the public.\footnote{Id. Examples of this practice include some of Canada’s most renowned and largest companies: Bombardier Inc., Magna International Inc., Rogers Communications Inc., Shaw Communications Inc., Alliance Atlantis Communications Inc., Power Corporation, Telus Corporation, Quebecor, and Onex Corp., to name only a few. Both Magna and Telus are examples of previous MVS firms.} This is the most prominent argument in favour of MVS: by localizing control on the founders, they prevent the firm from being easily taken over without the controlling shareholder’s cooperation.\footnote{Henrik Cronqvist & Mattias Nilsson, \textit{Agency Costs of Controlling Minority Shareholders}, (2003) 38 J. Fin. Q. A. 695 (2003); Harry DeAngelo & Linda DeAngelo, \textit{Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock}, 14 J. Fin. Econ. 33 (1985); Clas Bergstrom and Kristian Rydqvist, \textit{Ownership of Equity in Dual-Class Firms}, 14 J. Banking & Fin. 255 (1990).} Indeed, MVS will dissuade potential suitors who would be willing to pay a premium for shares (a boon to all shareholders, except the controlling shareholder) and who may in fact be able to better run the business.

MVS advocates also argue that MVS allow the founders to focus on long-term value creation and motivate them to make firm-specific investments in their own human capital.\footnote{Andrew Hill, \textit{Enrolment Open for an MBA in Murdoch}, Financial Times (July 18, 2011), http://www.ft.com/cms/s/0/2fda9e8e-b176-11e0-9444-00144feab49a.html#axzz2IYIKmzDt} MVS protect the founders from the demands of ordinary shareholders allowing them more freedom to grow the corporation.\footnote{Wen, \textit{supra} note 11.} But, at the same time, MVS insulate management and the board, leaving minority shareholders exposed to decisions that undermine their economic interests. Long-term value creation is not absent in non-MVS structures. In other words, MVS are not necessary for firms to develop and thrive.

Proponents of MVS adopt the caveat emptor argument in defending the structure. They argue that investors are not unfairly treated given the disclosure to which they are entitled, including information about the firm’s...
capital structure. In other words, investors purchase securities with knowledge of the MVS. There is a price at which prospective investors are willing to accept any potential negative firm characteristics, including agency costs, bad corporate governance and so forth. Zingales found that the voting shares commanded an 82 percent premium over non-voting shares in Italy. So while non-voting shares have their drawbacks, there is as a practical matter a price at which the market is willing to accept the drawbacks.\textsuperscript{16}

But MVS deprive shareholders of their ex ante rights and in particular the efficacy of their voting rights. They deprive shareholders of a voice in the corporation’s affairs. MVS are thus unpalatable and should be unacceptable regardless of whether certain investors may wish to purchase MVS. Indeed, there is anecdotally a growing sector of investors who do not purchase MVS as a matter of principle, which is in turn a disadvantage for all shareholders not to mention the MVS firm itself.

Proponents of MVS might respond that if investors find the MVS unappealing from an investment standpoint, they simply need not invest or they can sell their shares. If they do decide to purchase shares in the MVS firm, they can free ride on the monitoring done by the founding/controlling shareholder(s).\textsuperscript{17} Also, shareholders may not hold their securities for the long term whereas founders and managers are more likely to do so and may therefore be better placed to make decisions in the firm’s long-term interest.

Yet these benefits do not necessarily accrue to all shareholders because MVS insulate management, the board and the controlling shareholder. They are detrimental to shareholders because they undermine accountability mechanisms built into the corporate statute, including shareholders’ ability to elect directors.\textsuperscript{18} Shareholders carry the financial risk without the corresponding voting power to alter the board, or


\textsuperscript{18} For example, see Wen, \textit{supra} note 11.
affect change by votes. MVS favour insiders who have fewer checks on self-dealing (e.g. via largely unfettered ability to define executive pay, bonuses and stock option plans).\textsuperscript{19}

In other words, MVS weaken accountability mechanisms especially given that no fiduciary duty is owed as between shareholders. \textsuperscript{20} MVS preclude shareholders from mounting successful challenges to the leadership of a public corporation as well as fundamental changes that it seeks to implement. MVS therefore potentially allow senior officers and directors to shirk their duties and/or divert profits. It is not necessarily the case that they will shirk and divert, but MVS insulate them and make it easier for them to do so. This is perhaps especially troubling in light of recent empirical work indicating that managers actively seek ownership of their corporations in ranges typically associated with entrenchment, which suggests a revealed preference on their part to remain in control.\textsuperscript{21} MVS offer them a built-in measure of entrenchment, but without the economic risk they would bear by purchasing shares themselves.

We turn now to a consideration of the legal rights attributed to minority shareholders and the way in which MVS exacerbate these rights. We then examine the role of the securities regulator in addressing MVS.

3. The Place of Minority Shareholders

The debate about MVS is at root one about the place of minority shareholders in the corporation. This section reviews the legal rights of minority shareholders whether in MVS and non-MVS firms, illuminating the tenuous position in which they may find themselves. Despite remedies available to minority shareholders in MVS, their ex ante rights are weak or non-existent

\textsuperscript{19} Gry, supra note 5.
\textsuperscript{20} Jeffrey G. MacIntosh et al., The Puzzle of Shareholder Fiduciary Duties, 19 C.B.L.J. 86 (1991).
because of the way in which votes are disproportionately distributed.

Corporate law is dominated by a tension between the rights and responsibilities of two stakeholders in the corporation: the board of directors on the one hand and the corporation’s shareholders, particularly the majority shareholders, on the other. The statutory duty to oversee the corporation, and to chart its course while acting in its best interests, rests solely with the board of directors. But the corporate statute also embodies a principle of majority rule, which provides that shareholders, not the board of directors or management, should have recourse in the face of a wrong done to the corporation. For example, the majority, or controlling, shareholders elect the directors and push through fundamental changes, which require a two-thirds approval of shareholders.

Obvious negative implications for minority shareholders can arise in cases where the majority shareholders’ and/or board’s decisions disadvantage the minority shareholders. In such cases, case law has held that shareholders can bring an action if they perceive there to be a “fraud on the minority.” The term “fraud on the minority” refers to an improper exercise of voting power by the majority of shareholders evidenced by the failure to cast votes for the benefit of the

22 See for example the Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 122 [CBCA].
24 They have, in all likelihood, paid a premium over market price of the publicly traded company in exchange for their control block. See also Wayne Mikkelson and Hailu Regassa, Premiums Paid in Block Transactions, 12 Mgrl. & Dec. Econ. 511 (1991).
25 A resolution passed upon such vote of the majority is voidable as in, for example, a resolution for alteration of the articles of association to allow the compulsory purchase of members' shares: In re Tyco International, Ltd., 340 F. Supp. 2d 94 (D.N.H 2004). Fraud on the minority permits a derivative suit when the plaintiff sufficiently pleads that a majority who are in control of a company perpetrated a fraud on the minority of the company: Tomran, Inc. v. Passano, 862 A. 2d 453 (Md. Ct. Spec. App. 2004), aff'd, 891 A. 2d 336. See USLegal, "Fraud on the Minority Law & Legal Definition" (last accessed November 15, 2015), http://definitions.uslegal.com/t/fraud-on-the-minority/.
corporation as a whole. Fraud on the minority often contains an element of misappropriation of company property and allows the minority to launch a derivative suit.

Regardless of whether a firm has MVS, minority shareholders, like other stakeholders, can pursue a civil action in the form of the oppression remedy. Yet recent case law suggests a limited ability of minority shareholders to exercise the oppression remedy. They also have a statutory derivative action, which allows them to apply to the court for leave to bring an action on behalf of the corporation for a wrong to the corporation. They have dissent and appraisal rights that provide them, like all shareholders, with the right to require the corporation to buy back their shares at fair value where they dissent from a shareholder vote that approved a fundamental corporate change. Finally, any shareholder who owns more than five percent of a corporation’s outstanding shares may submit a shareholder proposal to nominate directors to be included in the company’s proxy circular or requisition a meeting to elect directors.

Yet minority shareholders may well hold less than five percent of the firm’s shares. Furthermore, unless the firm provides for cumulative voting in its articles, minority shareholders do not have the ability to nominate and elect a director who will represent their

---

26 USLegal, supra note 25.  
27 CBCA, supra note 22, s. 241. In particular, where a shareholder believes that the affairs of a company have been conducted in an oppressive or unfairly prejudicial manner, he or she can apply to the court for a remedy. The court has broad discretion to make any order it considers appropriate, including: restraining the conduct complained of; appointing directors in place of any of the directors then in office; appointing a receiver or receiver-manager; compensating the aggrieved person; and liquidating and dissolving the company.  
29 CBCA, supra note 22, ss. 239-240. Note that leave is required to bring a derivative action.  
30 Id. at s. 190.  
31 Id. at s. 137.  
32 Id. at s. 143.
interests on the board. The absence of a statutory right in this regard has fuelled the “proxy access” movement whose proponents argue for a shareholder right to not only elect directors, but also exercise a right to nominate directors and have those nominees placed on the same ballot as management nominees. The intended goal of proxy access is to increase the independence and quality of board members while providing shareholders a meaningful say in who becomes a director.

This recitation of shareholder rights and reform proposals suggests that minority shareholders face potential risks and abuses in the corporation. In other words, because the corporate statute is based on the principle of majority rule (and not “minority rule”), minority shareholder interests may remain unprotected notwithstanding the view that the principle of majority rule has become somewhat diluted over time. This is the reality of the controlled corporation. But the existence of MVS exacerbates this already tenuous legal position by removing the ability of minority shareholders to participate in the governance of the corporation as discussed further below.

33 “Cumulative voting” is a process by which each shareholder’s voting power is multiplied by the number of directors to be elected. Canadian corporate law does not allow for cumulative voting but the articles of incorporation of a corporation can provide for it. Minority shareholders are better able to ensure their interests are represented on the board since they are able to allocate all of their votes to one or a small number of directors. It is therefore less likely a majority shareholder will not be able to control all the board seats where cumulative voting is permitted.


35 MacIntosh, supra note 23, at 562 states, “Majority rule has been transformed slowly over time, with increasing concern on the part of courts, legislators, and administrators for the protection of minority shareholders....”
4. Policy Analysis

MVS are permitted in law, perhaps because of the assumption that MVS represent free contracting between investors and the firm, and are therefore acceptable at least within limits. This section suggests that this assumption is misguided. It reviews specific transactions in which minority shareholders have been disadvantaged owing to the MVS structure of the firm in which they have invested. It then turns to consider policy responses by urging securities regulators to consider the potential risks and abuses of MVS.

The case that brought MVS to the fore in Canada was the 1987 Canadian Tire case. In this case, the family (who was also the controlling shareholder) agreed to sell its shares to the bidder, which was simply a holding company that the family established to hold their shares. Ontario Securities Commission staff sought a cease trade order, claiming that while the transaction did not violate any specific provisions of the Securities Act, the family breached obligations owed to the minority shareholders and misled them as to the efficacy of the coattail attached to the minority shares (under the coattail, their shares were supposed to be converted from non-voting to voting shares on a takeover bid). The Commission granted the cease trade order, stopping the transaction because it violated the spirit of the Securities Act.36

Following Canadian Tire, the TSX mandated that any company issuing a class of shares with superior voting rights would have to include a provision that no offer to acquire a class of controlling shares would be valid...

---

36 CTC Dealer Holdings Limited/Canadian Tire Corporation, Limited (1987) 10 O.S.C. Bull. 509 (Can. On.) [Canadian Tire], para. 151: “A transaction such as is proposed here is bound to have an effect on public confidence in the integrity of our capital markets and on public confidence in those who are the controllers of our major corporations. If abusive transactions such as the one in issue here, and this is as grossly abusive a transaction as the Commission has had before it in recent years, are allowed to proceed, confidence in our capital markets will inevitably suffer and individuals will be less willing to place funds in the equity markets. That can only have a deleterious effect on our capital markets and, in that sense, it is in the public interest that this Offer be cease-traded....”
without the acquirer making a concurrent offer on the same terms to the other class of shareholders.\textsuperscript{37} These mandatory coattails are an acknowledgement of the inherent unfairness in MVS structures but do not address all such concerns: offers to acquire shares (i.e. takeover bids) constitute just one of a variety of ways to transfer corporate control. Proxy contests, which proceed by way of director elections, are another way. Coattails do not apply to this type of change of control. The coattail rule is therefore limited in its application and usefulness.\textsuperscript{38}

Another example came in 2010 with the collapse of Magna’s MVS structure - one of the largest sales of control transactions in Canadian history. The transaction involved the purchase by Magna of all of the Class B shares—constituting 0.6 per cent of the equity but 66 per cent of the voting rights—owned by the Stronach Trust, the holding entity of founder Frank Stronach, in exchange for US $300 million and 9 million Class A subordinate voting shares.\textsuperscript{39} The transaction diluted the Class A shareholdings and enabled the Stronach Trust to be paid an 1800 percent premium. The Magna board neither made a recommendation to shareholders nor provided them with a valuation or fairness opinion. The OSC declined to stop the transaction under its public interest power, reasoning that regardless of its own views regarding the fairness of the transaction, the Class A shareholders should decide whether to accept the transaction by a vote, which would be held as part of the statutory arrangement process.\textsuperscript{40}

\textsuperscript{37} In 1987, the TSX mandated that any company issuing a class of shares with superior voting rights would have to include a provision that no offer to acquire a class of controlling shares would be valid without the acquirer making a concurrent offer on the same terms to the other class of shareholders. See Toronto Stock Exchange, \textit{Restricted Securities}, TSX Company Manual (2004), TSX Company Manual, s. 624, http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=299.

\textsuperscript{38} MVS firms listed on the TSX prior to 1987 were “grandfathered.” See Merkley, \textit{supra} note 1.

\textsuperscript{39} \textit{Magna International Inc. (Re)} (2010), 34 O.S.C. Bull. 1290, para. 103 (Can. On.) [\textit{Full Reasons}].

\textsuperscript{40} \textit{Id.} See also \textit{Magna International In. (Re)}, (2010), 33 O.S.C. Bull. 6013 (Can. On.) [\textit{Initial Reasons}]. See also Anita Anand, \textit{Was Magna in the Public Interest?} 49 Osgoode Hall L.J. 311 (2011).
These transactions may seem grossly unfair to minority shareholders given that firms benefit from their investment but do not take the burden that corresponds with being public. To explain, in addition to the large publicity that a firm often receives, firms ‘go public’ because they seek capital to which they would not otherwise have access by remaining private. In other words, neither the exempt market nor other sources of capital (e.g. bank loans) is as attractive an option for these firms. By offering their shares to the public, firms spread the risk of ownership among a broad-based group of investors and can list their shares on the stock exchange so that their respective shares trade on the secondary market.

From then on, in a typical non-MVS firm, shareholders can elect the board, appoint auditors, and approve fundamental changes in the firm. In other words, they can participate in the governance of the firm at least from a distance by electing the board who is charged with acting in the best interests of the corporation and who appoints individuals who will be running the firm on a day-to-day basis (i.e. management). They exercise their ex ante rights.

Yet MVS disrupt this equitable balance by forcing the minority shareholders to carry the financial risk of investing in the corporation without having the corresponding power to elect the board or exercise other fundamental rights. As Hu and Black explain, MVS “decouple” voting rights and economic ownership. Under MVS, common shares essentially function as preferred non-voting shares with shareholders being unable to participate in the life of the corporation. There is an inherent unfairness in this structure. An MVS taken to the extreme places the firm in the hands of a few individuals. This means that when things start to go wrong, it becomes much more difficult, expensive and time consuming for minority shareholders to bring about change.

---

Some may argue on the basis of the caveat emptor argument that the minority shareholders are not “forced” to carry this risk at all: investors can make a decision to avoid investing in MVS firms all together if they do not wish to bear the risks inherent in these firms. But prior to the firm’s IPO, investors may not accurately assess the value of the MVS securities given that the demand curve for the stock is largely unknown, there being no existing market for the firm’s shares.42 The counter argument, that investors in IPOs look at corporate structure and appropriately discount in the case of MVS, is persuasive in theory only given that in practice, investors would be unsure of the appropriate discount to apply given that demand is unknown.

Furthermore, MVS firms characterize the capital structure of some of the largest firms in Canada and the U.S. Taken to its logical conclusion, the caveat emptor argument would have detrimental economic effects by restricting possible sources of capital - including firms with MVS structures - in which individuals can invest. Some investors, especially sophisticated investors, simply decide not to invest in dual class firms on principle which has a negative impact on the value of shares overall since the share price is depressed.

Admittedly, the broader economic argument cuts both ways. One could argue that if investors are not attracted to their governance structure, MVS issuers will only go public in in jurisdictions that permit MVS which, in turn, is a loss to the domestic economy at issue. For example, Alibaba went public on the NYSE instead of the Hong Kong Stock Exchange because the latter has a “one share one vote” rule that does not allow for MVS.43 When issuers do not go public in a particular jurisdiction, the lack of capital raising arguably deprives the economy at large (at least to the extent that public investors do not get to share in potentially lucrative investment opportunities). Capital raising is pushed either to other jurisdictions in which MVS are allowed or to private markets. Indeed, private markets are able

42 See Wen, supra note 11.
43 See Jennifer Hughes, Hong Kong Opens Door to Alibaba Shares, Financial Times (June 20, 2015), http://www.ft.com/intl/cms/s/0/cb5af2da-166e-11e5-b07f-00144feabdc0.html#axzz3teqADAJ7.
to fulfill the access to capital and liquidity needs – but without the loss of control and onerous disclosure requirements.44

In light of the benefit-burden argument in this essay, I believe that MVS should be confined to private markets given that the range of possible investors is likely to be more narrow. Securities regulators could mandate, for example, that MVS issuers can raise capital only from sophisticated purchasers under, for example, the accredited investor exemption where investors have to sign a risk acknowledgement form.45 In others words, given the role that the securities regulator plays in protecting investors and maintaining the public interest,46 the public markets are not an appropriate venue for MVS.

But proponents of caveat emptor argue that MVS are positive for public shareholders. They point to the spike in share price of MVS firms upon the announcement to buy out the controlling shareholder, as in Magna, for example.47 The spike in share price at the announcement and at the conclusion of the transaction is indicative of the fact that while investors were willing to pay to be shareholders of Magna, they were not willing to pay too much as long as Mr. Stronach held power. The fact that there was a controlling shareholder and MVS structure served to depress rather than elevate the share price. The spike following the buy-out transaction indicates shareholder approval of the removal of the MVS.

The present regulatory regime relating to MVS is based on disclosure requirements, which focus on ensuring investors are not confused by nomenclature and that they know the relative voting power of the various

---

45 For the accredited investor exemption, see National Instrument 45-106 – Prospectus Exemptions.
47 Full Reasons, supra note 39, para. 90.
classes of shares. But disclosure obligations alone do not go far enough in protecting minority shareholder interests in the MVS context. The securities regulatory mandate arguably compels the commission to do more to protect minority shareholders.

Perhaps the issue here is the dominant view of the corporation being based in contract. Of course, if the corporation is a nexus of contracts then capital structure is simply one aspect of the contractual relationship between the shareholder and the firm. If investors do not like MVS, they need not invest. They are not forced into these transactions.

But the relationship is not simply contractual; it has a securities regulatory overlay. That overlay is premised on the principle of investor protection, which when put into practice, does not allow the securities regulator to overlook acts of the public corporation that silence investors by preventing them from participating in corporate decision-making. Furthermore, as the Supreme Court of Canada held in Asbestos, securities regulators have a legal duty to act in the public interest and to protect the public on a prospective and preventative basis.

Asbestos has been applied in a number of cases. In Cartaway, for example, the Supreme Court of Canada held that it was well within the meaning of Asbestos for the Commission to consider general deterrence in making an order under the public interest section. The Supreme Court further held that the public interest power should aim to deter conduct that is deleterious to capital markets. There is no doubt about the principle

---


51 Cartaway Resources Corp (Re), [2004] 1 S.C.R. 672 (Can.), para. 61 [Cartaway].
for which Asbestos and Cartaway stand: The concept of “public interest” should be applied as necessary to prevent future harm to the capital markets. This includes MVS structures, which effectively silence a certain class of shareholders in any number of transactions including changes of control.

The caveat emptor argument is persuasive, and absent the existence of a securities regulator whose mandate is to protect investors under a broad-based public interest power, it would be determinative without more. However, the role of the securities regulator is at least in part to ensure that the capital markets, and especially investors in those markets, are protected. Exercising this power may mean that MVS structures, which effectively create inequality as between minority shareholders and insiders in corporate decision-making, should be prohibited. It should be noted that this legal change could be efficient: Amoako-Adu et al. found that elimination of the MVS structures in certain Canadian firms increased stock prices and improved the liquidity of the stock.52

Of course the ultimate question is: in lieu of prohibiting MVS, what is the securities regulator to do in terms of regulating them? One may ask, for example, whether it makes sense to mandate some governance rights for minority shareholders. If they are unwilling to ban MVS altogether, securities regulators should consider the following policy options.

First, they should require that issuers subject their MVS to a sunset provision. Once a company goes public, the MVS structure would only be permitted to remain in place for a limited period of time. The superior and ordinary voting shares would collapse into a single class upon the expiration of this time period. This policy option would ameliorate some – but not all – of the problems posed by MVS to the ex ante rights of

minority shareholders by endowing them with effective voting rights in accordance with their level of economic risk once the sunset period expires.

A second, related option would be to subject the terms of the MVS buyout to certain procedural safeguards upon their collapse into a single class at the expiration of the sunset period. In particular, the terms of the MVS buyout should be subject to a majority of the minority vote, a fairness opinion and a mandatory recommendation of a special committee of the board formed for the purpose of evaluating the transaction. These safeguards would mitigate the accountability problems to which MVS give rise as a result of their diminishing effect on the minority shareholder franchise, and would go a long way in protecting against arguably unfair transactions like Magna.

Finally, securities regulation should introduce rights for MVS minority shareholders in the case of a change of control. A rule that forces MVS firms subject to a hostile bid to ensure that all shareholders have an equal number of votes (e.g. in the event that a large percentage of equity holders tenders into a hostile bid) is a minimum. A similar rule is warranted in the case of changes of control by means other than a takeover bid, such as a proxy contest. In other words, reform efforts must ensure that minority shareholders remain on a one-to-one footing with all shareholders regardless of the proposed change of control transaction and the means by which it occurs.

5. Conclusion

Arguments against MVS give rise to a broader debate about legal protections for minority shareholders and the role of the securities commission. The concepts of the public interest and investor protection are central to the mandate of securities regulation. Indeed, securities regulation places a layer of regulatory considerations over and above the contract that shareholders have entered into with the corporation. The “public interest” has traditionally meant more than shareholders’ reasonable expectations and the fairness of the transaction to the shareholders at issue.
Admittedly investors are not a homogenous group and the investor protection mandate therefore carries with it some ambiguity with regards to who should be the target group in any given instance. Yet the regulator has a distinct role to play in ensuring that all shareholders (not just majority shareholders) are protected. A first step in doing so would be to focus on the poor governance and unfairness inherent in MVS structures. In particular, if one of the benefits of going public is the ability to access equity from both inside and outside shareholders, then one of the burdens must surely be to place these shareholders on an equal footing with each other.