Dual Class Share Structures: Recent Developments and Emerging Issues

Robert M. Yalden

Stephen Sigurdson Professor in Corporate Law and Finance

Queen's University LAW

128 Union Street, Queen’s University, Kingston, Ontario, K7L 3N6

| E-mail robert.yalden@queensu.ca |

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Table of Contents

Introduction 1

Executive Summary 3

I. Setting the Stage 5

II. Global Developments & Emerging Issues 6

III. Market Perspectives 9

IV. Regulatory Perspectives 13

V. Mandatory & Enabling Frameworks 16

Conclusion 18

Introduction*

The saga that unfolded inside and outside of the boardroom at Rogers Communications Inc. (“**Rogers**”) in late 2021 was a stark reminder that governance concerns are central to the debate about what place, if any, dual class share (“**DCS**”) structures should have in Canada.[1] Some were quick to point to the events at Rogers as proof positive that it is time to ban the use of DCS structures by Canadian public companies. They emphasized that all too often these structures have not only allowed an individual or family to exercise control through a class of multiple voting shares (“**MVSs**”) well after these shares no longer represent a meaningful percentage of the company’s equity, but to do so in defiance of best practices in corporate governance.[2] And yet institutional investor appetite for subordinate voting shares (“**SVSs**”) issued by founder led companies remains high, with some 20 to 25 per cent of all initial public offerings (“**IPOs**”) in North America in 2021 involving companies that adopted a DCS structure in the run up to their IPO.[3] Some therefore point to this reality, stressing both that DCS structures play an important role in ensuring that investors are able to participate in the growth of founder led companies, and that the question is not whether to allow DCS structures but what regulatory constraints they should be subject to.[4]

Once one gets past provocative headlines that episodes like the Rogers saga generate, and starts digging into questions about what accounts for the appeal of DCS structures and, given this appeal, how best to deal with them, it rapidly becomes clear that there are no simple “one size fits all” solutions. This is not only because the many contexts in which DCS structures are adopted vary significantly,[5] but also because as public companies with DCS structures mature the governance challenges associated with these structures evolve. Approaches to dealing with these challenges therefore need to be carefully considered. They must be alert to the multi-layered landscape in which DCS structures get used, as well as to a range of perspectives held by market participants, regulators and policy makers on the nature of the challenges at play.

* Professor Yalden wishes to extend special thanks to Ben Fickling and Phil Abraham, both graduates of Queen’s Law and associates with Osler, Hoskin & Harcourt LLP, for their valuable support in organizing the Roundtable and in preparing this report. The views expressed by OSC staff and ISED staff at the Roundtable and summarized in this report are their own personal views and do not necessarily express the views of the OSC, ISED, Staff of the OSC or ISED, the Minister of Innovation, Science and Industry or the Government of Canada.

[1] For extensive coverage of the ins and outs of the Rogers saga, see the reporting provided by A. Posadzki of the Globe and Mail, who is expected to publish a book on the story in late 2023: https://www.theglobeandmail.com/arts/books/article-globe-and-mail-reporter-alexandra-posadzki-to-write-book-on-rogers/

[2] See, for example, M. Wiseman, “Rethinking Rogers dual-class share structure”, The Globe and Mail, October 25, 2021 https://www.theglobeandmail.com/business/commentary/article-dual-class-share-structures-always-end-in-tears/

[3] See I. Galea, “Investors call for limits on dual-class shares in light of Rogers battle”, The Globe and Mail, November 4, 2021 https://www.theglobeandmail.com/business/article-investors-call-for-limits-on-dual-class-shares-in-light-of-rogers/

[4] See, for example, observations made by D. Beatty (Academic Director, David and Sharon Johnston Centre for Corporate Governance Innovation) in the article cited in footnote 4 above.

[5] These range, for example, from early-stage founder led companies, to companies seeking to raise equity in the face of foreign ownership rules that restrict the percentage of votes that may be held by non-Canadians (e.g. in the telecommunication or airlines sector), to mature companies that are not founder/family led, but that nevertheless seek to retain control of a division that they are taking public (see, for example, TELUS International (Cda) Inc.’s February 2021 IPO discussed at footnote 7 below).

On December 11, 2021, Professor Robert Yalden hosted a Roundtable on Dual Class Share Structures that focused on the implications of recent developments for the debate concerning DCS structures. A cross-section of experienced capital markets advisors, parties that represent or interact regularly with institutional investors, former and current regulators, academics and policy makers met virtually for a half-day discussion.

The forum provided participants the opportunity to have a vibrant, informed and frank conversation about where the market is at when it comes to DCS structures, the need and prospects for reform, perspectives from which to consider relevant policy issues, and how best to move forward on proposals for reform. While the discussions were subject to "Chatham House Rules",[6] and while this report therefore does not constitute a comprehensive record of "who said what", participants agreed that the substance of the conversation should be shared in order to help foster informed discussion about current issues concerning DCS structures in Canada.

Participants in the Roundtable included:

- Robert Yalden, Stephen Sigurdson Professor in Corporate Law and Finance, Faculty of Law, Queen's University (formerly a senior partner with Osler, Hoskin & Harcourt LLP)
- Naizam Kanji, General Counsel, Ontario Securities Commission ("**OSC**")
- Mohamed Khimji, Allgood Professor in Business Law, Faculty of Law, Queen's University
- Jason Koskela, Director, Office of Mergers & Acquisitions, OSC
- Gilles Leclerc, Counsel, Leader Securities Management, Fasken (formerly Superintendent of securities markets and a member of the executive committee of Quebec's Autorité des marchés financiers)
- Jeffrey MacIntosh, Toronto Stock Exchange Chair in Capital Markets Law, Faculty of Law, University of Toronto
- Catherine McCall, Executive Director, Canadian Coalition for Good Governance
- Jennifer Miller, Director General, Marketplace Framework Policy, Strategy and Innovation Policy Sector, Innovation, Science and Economic Development ("**ISED**"), Government of Canada
- Poonam Puri, Professor of Business Law and Corporate Governance, Osgoode Hall Law School, York University
- Stéphane Rousseau, Chair in Governance and Business Law, Faculty of Law, Université de Montréal
- Paul Spafford, former Vice-Chair, CIBC World Markets
- Tyler Swan, Head of Equity Capital Markets, CIBC World Markets

[6] https://www.chathamhouse.org/about-us/chatham-house-rule

Executive Summary

A number of significant themes emerged during the Roundtable.

1. **Market participants and regulators involved in developing the framework that shapes DCS structures must keep an eye firmly on global developments.** Capital markets and stock exchanges around the globe are engaged in intense competition to attract strong founder led businesses. As a result, several countries have recently modified listing requirements in order to attract companies with DCS structures. There is considerable diversity in the approaches that these countries have taken to DCS structures, and insights can be gained from studying the strategies that they have adopted. Canadian capital markets cannot afford to ignore this global push to attract founder led companies and, in turn, what this means for the best approach to the regulation of companies with DCS structures. Too often Canadian stock markets have underperformed relative to global competitors because their listings contain a higher proportion of aging companies. Failing to attract dynamic founder led companies risks hurting Canadian investors, who will find themselves constrained in their ability to participate in the growth that often accompanies this kind of company (including through products linked to the performance of Canadian stock indices).

2. **North American institutional investors are focused on identifying founder led companies with high-growth potential. As a result, they regularly invest in founder led companies that adopt a DCS structure prior to going public, provided that certain constraints are built into the DCS structure.** DCS terms that institutional investors view as acceptable are evolving, and it is important to be alert to these developments when considering what role, if any, regulators should play. For example, Canadian DCS structures in founder led companies now typically provide for an event-based sunset clause that is triggered when the founder ceases to play a meaningful role in the business. The market has also pushed successfully to cap the number of votes per MVS, such that it is now quite unusual in Canada to see more than 10 votes per MVS. Furthermore, non-voting shares (once common in public company DCS structures) are no longer tolerated, such that the public will now invest through a class of SVSs with one vote per share.

3. **Some market driven constraints on DCS structures are now well accepted; others are more controversial.** Founders do not today typically object to event-based sunsets tied to their ongoing involvement with the company, but there is far less consensus on what might constitute appropriate time-based sunset clauses. Accordingly, one continues to see considerable diversity in approaches. Similarly, there is little appetite among founder led companies to adopt time-based sunsets with a relatively short duration (i.e., 5 to 7 years) that could then be renewed subject to a majority of SVSs voting to approve renewal. This is because institutional investors are perceived as having little incentive to vote for renewal.

4. **Given that market dynamics are constraining DCS structures and given global competition for new listings, it is unlikely that in the short term regulators in North America will move aggressively to regulate the terms of DCS structures.** Regulators are instead more likely to focus on ways to adapt the existing portfolio of regulatory tools used to address transactions between significant shareholders and companies they control, as well as the governance practices in such companies, so that these tools are responsive to challenges that arise in a DCS context.

5. **Whereas the focus in the past has tended to be on ensuring that SVS holders can participate in change of control transactions on an equal footing with MVS holders, increasingly the regulatory focus is on governance and disclosure issues that affect SVS holders**. It can be expected that particular attention will be paid to questions concerning director independence. In this regard, improvements may need to be made to issuers' disclosure obligations regarding the independence of directors.

6. **Notwithstanding the prevalence of DCS structures in North America, there is evidence of informational inefficiency in IPO pricing that is a particularly acute problem for smaller issuers adopting DCS structures. It may well be that investors would be better off if some DCS companies were not brought to the public markets.** And even when the impact of DCS structures are accurately factored into IPO pricing, they can still ultimately inflict a cost on the economy by entrenching inefficient controllers and managers, thereby hampering innovation and growth. The evidence concerning informational efficiency suggests that while it is may be appropriate for regulators and policy makers to favour an enabling bias for larger companies, a mandatory bias is called for with respect to small companies. However, more research is needed in Canada on the costs associated with DCS structures in order to make informed decisions about which features of DCS structures call for particular attention and the most appropriate form of regulation.

7. **Sustained and informed discussion is essential if Canada is to deal with DCS structures effectively.** More dialogue that includes other relevant stakeholders such as index providers, proxy advisors and stock exchanges would be useful given their role in shaping the Canadian capital markets, as well as the direct and indirect rules and forms of pressure that they bring to the table.

I. Setting the Stage

The following report highlights issues and themes that the participants explored as part of the Roundtable. Participants began with a discussion of the global context and recent developments in order to better understand where Canada stands amongst its peers. The proceedings turned next to the Canadian capital markets and the market for IPOs. Participants heard and explored how market realities and ongoing commercial negotiations help shape conditions that a company seeking to achieve a DCS-structured IPO must abide by. Participants also considered the Canadian regulatory overlay and the policy perspectives and priorities that regulators have brought when considering whether and how to regulate areas of concern. Finally, participants considered questions concerning informational efficiency in the public markets and their implications for whether regulators and policy makers should favour an enabling bias or a mandatory bias when assessing whether to regulate DCS structures.

The conversation surfaced a number of important perspectives and insights into the challenges facing any attempt to regulate DCS structures. It also made clear that DCS structures give rise to governance issues which may be best addressed not by dictating conditions to which DCS structures must adhere, but rather by looking at the disclosure, governance and minority protection regimes that apply where there is a significant controlling shareholder – a phenomenon that is by no means limited to companies with DCS structures.

II. Global Developments & Emerging Issues

The proceedings began with Professor Yalden providing an overview of the global context and recent developments surrounding DCS structures. He observed that many countries have listed companies with DCS structures. The spectrum ranges from some countries where a very significant percentage (i.e., 30%-40%) of listed companies have DCS structures (e.g., Sweden and Denmark), to others where the percentage is quite small (5% or less). The situation in Canada (where data suggests the number is somewhere between 5%-10% of listed companies) is therefore not as pronounced as in some jurisdictions, even if Canada does have a developed history of DCS companies that puts us either marginally ahead of, or on a par with, other countries such as the U.S., Germany, the Netherlands and South Korea. Different countries have also taken a range of positions regarding the extent to which they should regulate DCS structures, with some jurisdictions favouring a highly permissive regime (e.g., Sweden or the U.S.), some a more restrictive approach (e.g., Singapore or the U.K.) and others prohibiting DCS structures outright (e.g., Australia).

It was noted that there is considerable global competition between stock exchanges for new listings consisting of strong founder-led businesses. Some observed that Canada in particular needs to be alert to this competitive landscape when thinking about its approach to regulation, given that our exchanges have tended to lag others in attracting a steady stream of new founder led companies. Globally, the trend right now is very much toward exchanges being more open to listing companies with DCS structures in order to counter the attraction of the U.S.'s permissive regulatory environment. In this regard, Professor Yalden noted that the last four years have seen the Hong Kong, Singapore and Shanghai exchanges open their doors to some DCS structures, and that in December, 2021 (after extensive consultation) the U.K. announced the adoption of new listing rules for the premium segment of the London Stock Exchange that also allow some DCS structures to be listed (provided they comply with requirements that are nevertheless more restrictive than anything adopted by major U.S. exchanges).

Turning next to some of the constraints that markets and/or regulators have imposed on DCS structures, it was noted that once again there is considerable diversity in the approaches adopted in different jurisdictions:

a. **Adoption of time-based or event-based 'sunsets'** which trigger a collapse of the DCS structure after a specified period has elapsed or a specific event has occurred.

   - With respect to time-based sunsets (which are not mandated in North American or Asia), the North American norm has to date been market driven and is currently around seven to ten years for the limited number of companies that have adopted time-based sunsets. In contrast, other

jurisdictions like the U.K. and India have opted for shorter time-based sunsets (e.g., five years) that the regulator has mandated.

- In North America, event-based sunsets are far more common than time-based sunsets, and are usually triggered when a founder's economic stake in the company is no longer above a specified threshold and/or when the founder leaves the board or management team. While the equity threshold is often in the 5%-10% range, one does sometimes see a higher threshold, with the trigger that the market is comfortable with often being influenced by the size of the founder's stake prior to an IPO (i.e., the larger the stake the higher the trigger and, conversely, the smaller the stake the lower the trigger). Interestingly, although North American regulators have not mandated sunsets, jurisdictions that have imposed event-based sunsets have chosen thresholds that are generally aligned with where the market is currently at in North America (e.g. Hong Kong at 10%).

b. **Caps on superior voting rights**. In some jurisdictions, stock exchanges or other regulatory authorities place a cap on the permissible number of votes per share. In jurisdictions like Hong Kong, Singapore and Shanghai the cap is 10 votes per share, whereas the recent U.K. reforms for the premium listing segment set the cap at 20 votes per share. It was noted that in North America, although in recent years a limited number of companies have sought to go public with a class of shares having 20 votes per share, the market has now clearly settled in its view that there should be no more than 10 votes per share. It is also increasingly rare for North American markets to accept DCS structures that involve a class of non-voting shares rather than SVSs.

c. **Suitability conditions**. Some jurisdictions impose suitability requirements on corporations that wish to list with a DCS structure. Hong Kong's stock exchange, for example, will only accept DCS structures for companies deemed to be in emerging and innovative sectors that have a proposed market cap of at least HK $10 billion, and the holder of MVSs must be a person responsible for the growth of the business who also continues to play an active role in the business.

d. **One vote per share on certain matters**. Singapore's exchange mandates that on certain matters MVSs may only have one vote per share: e.g., the removal of independent directors or auditors, the variation of rights attached to a class of shares, reverse take-overs or the winding-up of the company.

Participants were reminded of the mix of measures that proxy advisory firms (e.g., Institutional Shareholder Services (**ISS**); Glass Lewis), other organizations concerned to advance good corporate governance (e.g., the Canadian Coalition for Good Governance (**CCGG**); Institute for governance of private and public organizations (**IGOPP**)) and various academics have called for. These proposals vary depending on whether DCS structures are seen to have a legitimate role to play in some contexts, but typically call for sunsets of some kind, a cap on the number of votes per MVS, and a ban on the use of

non-voting shares. Some also favour having a certain number of board seats set aside for election by holders of SVSs.

In light of this discussion, Professor Yalden noted a number of important issues that the debate concerning DCS structures needs to consider, including:

1. Can the market strike a satisfactory balance between facilitating the listing of founder led companies and ensuring the long term challenges with DCS structures are properly managed? If so, has the market succeeded in striking this balance in Canada?

2. Is regulatory overlay needed given the governance issues that DCS structures can give rise to if left unchecked?

3. In this context, what is the right balance between permissive/facilitative corporate law and mandatory regulatory law?

4. What is the best way to understand the relationship between: (i) the regulation of DCS structures; (ii) corporate governance rules designed to contain problems that flow from having a significant controlling shareholder; and (iii) a country's minority shareholder protection regime? Does being strong on the last two fronts mean that a lighter touch on DCS regulation may be appropriate (e.g., has Sweden struck a satisfactory balance between a liberal DCS regime but strong minority shareholder protections)?

5. Should DCS issues be viewed in isolation, or as part of a larger set of issues concerning significant shareholder arrangements – some of which also arise in single class share structures – such that a broader focus is needed?

6. Can one regulatory size fit all? Founder led company DCS issues are not always the same as those that may arise in second or third generation controlled companies (e.g., Bombardier, Power or Rogers). Foreign ownership rules also need to be factored into the equation in sectors that are capital intensive yet subject to foreign ownership limits – sectors that have often had to resort to some sort of DCS structure in order to be able to raise equity capital outside of Canada.

7. Should we be concerned that in some companies that go public with DCS structures, even though institutional investors may stay out of the MVS class as a matter of principle, some of these very same investors are nevertheless parties to Investor Rights Agreements that give them special governance rights that are neither available to other SVS shareholders, nor consistent with the view that all shares of a given class of shares should carry equal voting power (e.g, nomination rights to one or more directors so long as the owner of the SVS shares in question continues to a hold given percentage of the company's issued and outstanding shares)?

III. Market Perspectives

The proceedings turned next to a review of the current state of Canadian capital markets, particularly the market for IPOs involving founder led companies. Participants with extensive market experience noted that the market generally likes founder led companies because these companies often perform well. The practical reality when putting together an IPO for a founder led company is that a balance has to be struck between a founder's desire to raise funds in the public markets while retaining control of the company, and the willingness of investors (notably institutional investors) to accept a founder retaining that kind of effective control. It was clear that, in recent years, institutional investors have in fact been quite prepared to invest in DCS structures when dealing with founder led companies (but not typically with other kinds of companies – where a DCS structure is usually seen as a non-starter).[7] That said, most institutional investors do want to see constraints built into DCS structures before investing (e.g., event based sunset provisions tied to the founder's involvement in the business). Nevertheless, the reality is that many institutional investors are operating with an investment horizon that means that they are not ultimately concerned about the impact that a DCS structure might have on the company's governance many years out, since they do not ultimately expect to be holding their position beyond a limited number of years.

Founders remain the single largest driving force behind the decision to IPO with a DCS structure. In a seller's market, especially, investors consider the structure the "price to pay" to get access to founder-led businesses. When institutional investors are approached regarding a deal's size, its terms and the proposed share structure, the IPO is then subject to ongoing commercial negotiations on a range of investment related considerations that are dealt with as a package, and that are informed by where market practice is currently at.

Approximately 20% to 25% of Canadian IPOs in 2021 had DCS structures. A similar percentage of recent U.S. IPOs have also involved DCS structures. Importantly, the presence and specific characteristics of DCS structures in the founder led company segment of the IPO market were described as a function of how the investor community is reacting to these structures. Participants noted that a majority of shares in Canadian and U.S. IPOs are sold to institutional investors, who typically purchase 80% of the shares sold in an IPO in Canada and 90% of the shares sold in an IPO in the U.S.. Institutional investors are therefore front and centre in negotiations over DCS structures, and they have consistently shown a

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[7] One recent and notable exception to this market norm is TELUS International (Cda) Inc.'s February 2021 IPO, which saw TELUS Corporation take this subsidiary public using a DCS structure. A class of MVSs was put in place that is held exclusively by TELUS and TELUS International's other significant shareholder (an entity controlled by the Baring Private Equity Asia Group Limited). Post-IPO this structure provided TELUS and Baring with approximately 67% and 30.7%, respectively, of the voting power associated with TELUS International's shares.

willingness to invest in these structures when there is a founder seen as important to the long-term success of the business. This means that retail investors that wish to participate in an IPO must, in effect, accept the commercial terms that are negotiated with institutional investors.

It was observed that given the focus on founder led companies, most of the recent DCS structures put in place in Canada do have an event-based sunset provision tied to the founder continuing to play a meaningful role in the business. Participants with market experience noted that founders do not typically object to event based sunsets tied to the founder's ongoing involvement with the company. Other features that are regularly seen in Canadian markets today include a market driven cap on the number of votes per MVS, with the cap often depending on the relative size of the founder's equity stake. Where a founder has a lower equity stake (e.g., ten percent or less), the founder is more likely to negotiate for up to 10 votes per MVS. The higher the equity stake maintained, the more palatable a lower voting ratio becomes: e.g., 4 votes per MVS. Votes per share in excess of 10 votes per share were now quite unusual in a Canadian context. Furthermore, non-voting shares are no longer seen in Canadian DCS structures (even if they are still seen on occasion in the U.S.), reflecting areas where market pressure has resulted in constraints being placed on these structures.

Participants noted that DCS structures remain controversial among institutional investors, with different institutional investors holding different views on just how problematic they really are and what constraints to insist on. Many are opposed as a matter of principle, while others either subscribe to the doctrine of *caveat emptor* or are even of the view that DCS structures can play a useful role in preventing unwelcome foreign takeovers in sectors where the government has not enacted foreign ownership rules. While a majority would prefer to see a one-share one-vote principle applied across the board, many are nevertheless prepared to invest in DCS structures involving founder led companies where certain conditions are met. These conditions may include ones relating: (i) to the eventual collapse of the structure (e.g., a time-based or event-based sunset clauses); (ii) a cap on the number of directors that MVS holders may nominate; (iii) a reasonable cap on the number of votes per MVS; (iv) the outright prohibition of non-voting shares; (v) the presence of coattails and other provisions designed to ensure subordinate voting shareholders receive the same consideration per share as MVSs in any change of control transaction; and (vi) the assurance that no premium will be paid to a controlling shareholder upon the collapse of the DCS (although there is less consensus among institutional shareholders about the need for this last condition).

There was also discussion about a proposal that some have called for in recent years that would see time-based sunsets with a relatively short 5-7 year trigger but that would also contain an option to extend the end date, provided that holders of SVSs vote in favour of such an extension.[8] The view of

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[8] For a perspective that is favourable to this extension option, see, for example, Anita Anand, "Governance Complexities in Firms with Dual Class Shares" (2018) 3:3 *Annals of Corporate Governance* 184.

those with regular exposure to institutional investor sentiment was that no matter how well the company was doing, institutional investors would not typically support such an extension. From a practical perspective, adding this kind of extension option would not therefore result in founders viewing shorter time-based sunsets more favourably. Some participants pointed to the example of Couche-Tard, which had been unable to muster sufficient shareholder support to move forward with a proposed extension to its sunset clause, notwithstanding the company's considerable success at the hands of founders that were still very much involved with the business.

A discussion then ensued about whether inserting sunset clauses might push Canadian founders to launch IPOs in the U.S. rather than Canada. The view was that this would not be the likely outcome since U.S. founder led companies that had gone public in recent years also had DCS structures with sunset provisions. Nevertheless, some argued that further efforts were needed to ensure that Canadian capital markets were seen as an attractive place for founders led companies to list their shares (noting that Ontario's recent Capital Markets Modernization Taskforce had been focused on this issue). It was emphasized that Ontario is generating a meaningful number of successful start-up companies, but that if they do not list on Canadian exchanges then Canadian investors lose out on what are typically above average growth opportunities. This also serves to compound a problem with Canadian stock exchange indexes: namely, their historical underperformance relative to U.S. stock indexes due to the higher proportion of aging companies and their inability to capture a sufficient portion of growing sectors like the tech industry. Serious thought therefore needs to be given to the question how best to ensure that these companies will choose Canada as their principal jurisdiction when going public and when subsequently raising capital. Some participants stressed that regulators need to be sensitive to the competitive nature of global capital markets and how regulatory change may affect a company's willingness to raise capital in Canada. However, others observed that this concern must go hand in hand with ensuring that investor protection in Canada is strengthened since this is also important to fostering attractive capital markets.

The proceedings then saw participants consider whether there was any inconsistency between some institutional investors' opposition to DCS structures and their insistence, as part of some IPO processes, that investor rights agreements be put in place that ensure that they get to nominate a number of board members that is sometimes disproportionate relative to the size of the shareholdings that they are required to retain in order to preserve this right (thereby in effect deviating from the logic underpinning a commitment to the principle of "one share one vote").[9] It was observed that while there might well be some inconsistency, the practice was most often seen in situations where a sponsor who does not wish to hold MVSs nevertheless wants to ensure that they have some control over how the founder will

[9] Examples of Investor Rights Agreements of this kind being entered in conjunction with an IPO include the ones entered into in connection with IPOs for Lightspeed POS Inc. (March 2019), GFL Environmental Inc. (March 2020), and dentalcorp Holdings Ltd (May 2021).

vote her or his MVSs with respect to board members (thereby ensuring there is some check on the founder's ability to determine board composition). In assessing what the regulatory perspective should be on parties entering into these arrangements, some observed that for the time being the preference has been to focus on ensuring that there is adequate disclosure about the terms of these arrangements and the rights that are being contractually conferred.

Finally, participants discussed the fact that founders often see DCS structures as a form of protection from take-overs and shareholder activism, especially in circumstances where sudden market wide downturns can push share prices in directions that do not reflect the company's long-term prospects. The rise of shareholder activism has renewed concern on the part of founders who look at growing the value of their companies through the lens of a longer-term investment horizon than that often favoured by hedge funds and other shareholders looking for a short term lift in share price. One participant suggested, however, that the use of DCS structures has implications for market efficiency as it frustrates the successful execution of takeover bids, which a considerable body of research argues helps to displace inefficient management and to foster value enhancing synergies. Others suggested, however, that any outright prohibition on DCS structures would only increase pressure on companies to resort to a range of M&A defensive tactics, which give rise to their own inefficiencies. Indeed, it was suggested that one of the reasons that securities regulators in Canada have long been open to regulating defensive tactics has been the fact that DCS structures are part of the corporate landscape in Canada.

IV. Regulatory Perspectives

Professor Rousseau chaired the next segment in the roundtable's proceedings, which focused on regulatory perspectives, notably concerning the range of factors and constraints that regulators have to consider when assessing how best to address DCS related issues in Canada. These include:

(i) sensitivity to evolving pressures shaping market driven norms with respect to the conditions that have to be satisfied before institutional investors are prepared to invest in a given DCS structure;

(ii) an appreciation for the larger regulatory framework governing corporate governance practices within, as well as transactions with, corporations with significant shareholders – a framework which is already in place and which imposes meaningful obligations on companies with DCS structures; and,

(iii) an understanding of the practical realities governing the context in which Canadian securities regulators have to act, which do not typically leave much space for significant regulatory action unless there is a clear understanding of the "evil" or market failure that must be addressed, combined with meaningful consensus that regulatory intervention is needed and government support for the regulatory initiative in question (given that enacting securities rules ultimately requires Ministerial approval).

It was acknowledged that there are a range of difficult issues that can affect almost any public company with a significant shareholder, but that these are often amplified when dealing with DCS companies. These include issues concerning contestability of control, self-dealing and conflicts of interest, as well as corporate governance practices. In Canada, the regulators' approach to DCS structures has generally been permissive so long as certain restrictions are respected. The regulatory overlay applicable to DCS companies was described as comprehensive and as involving at least five elements which reveal an increase over time in the regulators' focus on governance practices:

1. **Shareholder choice:** regulators understand that many are of the view that investors should be free to make their own investment decisions and that all that is called for is a disclosure overlay that will ensure investors make an informed decision. But regulators have for some time taken the view that minority shareholder approval is also required in some instances, for example if an existing company wants to put a DCS structure in place, and this is reflected in NI 41-101 (Part 12 - Restricted Securities) (as well as in OSC Rule 56-501);

2. **Disclosure**: holders of SVSs must be provided with full disclosure concerning the rights and restrictions associated with their shares. Several rules have been put in place that set out the

detailed disclosure that must be provided, including NI 41-101, OSC Rule 56-501 and NI 51-102 (Part 10 – Restricted Security Disclosure). Together they create a meaningful baseline that governs naming conventions, the use of defined terms (such as SVS or NVS), the description of rights provided under coattails, and risks inherent in the DCS structure;

3. **Equal treatment:** subordinate shareholders are required to be treated equally in the event of a takeover bid. The TSX's provisions on mandated coattail provisions (found in its Policy 3.5), for example, provide specific guidance on what equal treatment looks like in the context of a take-over bid;

4. **Self-dealing in conflicted transactions:** MI 61-101 *Protection of Minority Shareholders in Special Transactions* ("**MI 61-101**") is a major instrument that applies to a range of transactions involving significant shareholders and is therefore frequently triggered by companies with DCS structures. The situations in which this can arise range from more routine transactions between holders of MVSs and the company, all the way to proposals to amend the DCS structure itself. MI 61-101 sets out several requirements that may then have to be complied with, including the use of independent committees and specified board processes, majority of the minority approval requirements, valuations that must comply with MI 61-101's requirements, and enhanced disclosure. Once triggered, MI 61-101 provides significant protection for minority shareholders and is therefore a meaningful part of the regulatory framework governing DCS structures. Furthermore, Multilateral CSA Staff Notice 61-302 sets out additional guidance with respect to what staff at several Canadian securities regulators (i.e., Ontario, Québec, Alberta, Manitoba and New Brunswick) ("**Staff**") view as best practice with respect to corporate governance and disclosure practices with respect to conflicted transactions. Staff oversight is a crucial dimension of this regime: Staff will scrutinize special transactions and may object to a transaction proceeding if additional measures, such as enhanced disclosure, are not taken; and

5. **Good governance and independence of directors:** NI 51-101 and NP 58-201 encourage independence and promote good governance. This is achieved by setting out specific disclosure requirements: e.g., how independent judgment is facilitated where one does not have a majority independent directors. Once again, commentary under Staff Notice 61-302 is important in this regard.

It was noted that in addition to this comprehensive framework, securities regulators continue to have public interest powers that they may resort to in dealing with cases that are not otherwise capable of being dealt with through existing instruments. At the same time, it was observed that while this public interest jurisdiction can be used in novel circumstances or to address unanticipated gaps in the current regulatory framework, the powers made available are likely to continue to be used sparingly, and in any event are not suited to advancing broad policy initiatives. The suggestion was also made that where

regulators have considered whether to exercise their public interest jurisdiction (e.g., in cases such as *Canadian Tire* and *Magna)*,[10] the circumstances that gave rise to its application have either not arisen again or have ultimately been addressed through policy initiatives (and the adoption of rules) that have made it unnecessary to rely again on public interest powers.

The point was reiterated that, as a practical matter, regulators will need "an evil to address" before putting additional regulatory constraints in place - otherwise such measures are unlikely to get stakeholder buy-in. In the past, before the framework outlined above was put in place, it was easier to find "evils" associated with DCS structures that called for a firm regulatory response. However, the evolution and improvement of the regulatory regime, including the implementation of MI 61-101 and the mandated use of coattails, mean that there are fewer obvious instances which call for regulation focused solely on DCS structures, rather than relying on instruments governing transactions with significant shareholders and good corporate governance practices. Furthermore, it was noted that market standards have emerged concerning acceptable DCS structures and these too place constraints on the kinds of DCS structures that can now be taken to investors.

These observations led to a discussion about whether improvements could nevertheless be made to: (i) the range of conflict situations that are subject to enhanced disclosure; (ii) issuers' disclosure obligations regarding their governance practices; and (iii) the definition of independence as it relates, for example, to the concept of an independent director. Some suggested that enhancements were needed to ensure that more conflict situations were subject to disclosure obligations, and that securities regulators should be more assertive about their expectations regarding appropriate board processes in these circumstances. At the same time, others spoke to the practical challenges associated with regulators successfully defining concepts such as "independence" or "objective".

Finally, consideration was given to the role of market participants such as proxy advisors or index providers in shaping a framework governing acceptable or unacceptable DCS structures. One commentator observed that regulators are required to go through a cost benefit analysis that is a balancing exercise and that constrains the ways in which regulators can act. In contrast, market participants – including proxy advisors or index providers - can speak for themselves, and their latest views on acceptable DCS structures may in turn have some impact on the way market pressures evolve. But ultimately it is these market pressures (and the negotiations they give rise to as companies go public or seek to alter their DCS structures) that will have the most direct influence in shaping DCS structures, and the key to progress does not necessarily lie in looking to regulators to dictate the conditions that DCS structures must comply with.

[10] See *Re Canadian Tire* (1987) 10 O.S.C.B. 857; *Magna International Inc. (Re)* (2010), 34 O.S.C.B. 1290

V. Mandatory & Enabling Frameworks

The panelists next shifted their focus to issues concerning how best to think about the corporate and securities law regulatory framework that should govern the creation and operation of DCS structures. Professor MacIntosh explained that under an enabling view, markets are seen as efficient, and all market information is reflected in a company's share price. On this view, the risk-return profile of DCS companies will therefore be fully reflected in these companies' share price and there is no need for mandatory provisions governing DCS structures. Under a mandatory view, however, the perspective is a different one: risk-return profiles are not seen as always properly reflected in a company's share price, and opportunities exist for issuers to take advantage of investors by adopting inferior governance structures that are not then appropriately reflected in the share price. On this view, corporate and securities law need to step in to address these inefficiencies, mandating specific features of governance, corporate disclosure and other matters that companies must comply with.

A company's jurisdiction of incorporation is relevant to discussion about what kind of regulatory framework should be adopted. For example, British Columbia is often considered an "enabling" jurisdiction because it starts from a "memorandum of association model" that gives issuers considerable flexibility (even if it is now in many ways a hybrid jurisdiction that also has features drawn from "articles of incorporation" jurisdictions). This stands in contrast to strict "articles of incorporation" jurisdictions, which lean more towards the "mandatory" end of the spectrum. The recent *Rogers* decision shone a light on British Columbia,[11] making clear that it is in important respects an enabling jurisdiction: there is no other jurisdiction in Canada where Edward Rogers could have removed directors from a public company board by simply signing a shareholder resolution.

Even the most vigorous proponents of each of the enabling and mandatory perspectives accept there is a role for each perspective. As a result, the question one ultimately has to grapple with when thinking about corporate and securities law regulatory frameworks is which features should be enabling, and which should instead be mandatory.

When it comes to answering this question as it applies to DCS structures, one of the challenges is determining whether there are in fact pricing inefficiencies in the Canadian market with respect to DCS companies. Professor MacIntosh noted that the limited research that has been done in this regard (notably the empirical study IGOPP published in 2019) is split: 49% of 37 studies done on the relationship between DCS structures and company performance between 2007 and 2018 suggest that DCS structures had a favourable or neutral impact on company's performance, while 51% suggest an

[11] *Rogers v. Rogers Communications Inc.* 2021 BCSC 2184

unfavourable impact on performance. [12] Professor MacIntosh suggested that we can expect DCS market inefficiencies, especially with respect to smaller Canadian companies that adopt DCS structures when going public. In his view, this conclusion is consistent with research done in the U.S. that concludes that the largest U.S. companies are generally informationally efficient, but that one sees informational inefficiency in smaller listed companies. This discrepancy in informational efficiency suggests an enabling bias for larger companies and a mandatory bias for small companies. But it does not get us closer to identifying the specific provisions that should be enabling or mandatory.

Research on the performance of companies going public through an IPO also adds colour to the debate on informational efficiency. Despite a short-term uptick in share price post-IPO, many companies' share prices perform poorly three to five years post-IPO. The evidence suggests that there is informational inefficiency in IPO pricing and that this a particularly acute problem for smaller issuers where a more significant percentage of shares are typically being purchased by retail investors than is the case with IPOs involving larger issuers. It may well be, then, that investors would in fact be better off if some DCS companies were not brought to the public markets. Furthermore, DCS structures serve to frustrate take-over bids for public companies, even though research has demonstrated that take-over bids are an effective way to displace inefficient management.

Turning specifically to the *Rogers* saga, Edward Rogers' decision to re-constitute the Board took the market by surprise and his ability to do so had not previously been factored into the company's share price. Indeed, the market seems to have been caught by surprise when it learned that he was in a position to remove directors with the stroke of a pen. In Professor MacIntosh's view, the judge's decision in the *Rogers* litigation was therefore flawed in its examination of investors' "reasonable expectations" and it was surprising that an oppression claim did not form part of the proceedings. He also noted that history has shown that there may be societal losses stemming from DCS structures. In this regard, one need not look further than *Magna,* where the aggregate value paid to the MVS holder (Frank Stronach) in order to collapse the structure was more than 50% in excess of Magna's pre-transaction value. These and other episodes strongly suggest that whatever cost of capital penalty there may be is not enough to deter controlling shareholders from adopting and then maintaining DCS structures. Moreover, the evidence concerning IPOs suggests there are weaknesses in the argument that we must permit DCS structures in order to induce entrepreneurial firms to go public. And even if DCS structures were accurately priced, they still inflict a cost on the economy by entrenching inefficient controllers, thereby ultimately hampering innovation and growth.

Professor MacIntosh concluded that more research is needed in Canada on the costs associated with DCS structures in order to make informed decisions about the most appropriate way to regulate them. What evidence there is suggests that limits of the kind the CCGG favours are warranted.

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[12] Institute for governance of private and public organizations, *The Case for Dual-Class of Shares*, Policy Paper No. 11, Montreal, Q.C., 2019: https://igopp.org/wp-content/uploads/2019/02/IGOPP_PP_CaseDualShareClass_PP11_EN_v9_WEB.pdf

Conclusion

The Roundtable concluded with Professor Poonam Puri providing an overview of the principal themes that had emerged over the course of the proceedings. Professors Puri and Yalden then co-chaired a free-flowing discussion between participants about these themes. The following observations of particular interest were surfaced during this discussion:

1. In thinking about potential regulatory responses, it is important to bear in mind the importance of path dependence: some countries such as the U.K. have not historically allowed DCS structures and so are in a position to come at their introduction and regulation in ways that are different than jurisdictions like Canada that have long had publicly listed DCS companies. At the same time, countries with a longstanding commitment to the "one share one vote" principle may be subject to constraints when developing regulatory responses that others that have been more accepting of DCS structures are not.

2. Regulators and public policy makers need more than one-off episodes to warrant significant intervention. They often need to be confronted with clear market failure before consensus emerges that regulatory intervention is warranted.

3. The market keeps evolving and the norms today in Canada governing acceptable DCS structures have advanced relative to where they were several decades ago. Care must therefore be taken not to let problems that arise with respect to companies that put DCS structures in place decades ago drive regulatory solutions that would be inappropriate for companies putting in place DCS structures that are responsive to where market norms are today.

4. There may nevertheless be important steps to be taken in the Canadian context: for example, ensuring that SVS voting results are broken out on a stand-alone basis and disclosed, or enhanced disclosure on director independence. Governance focused initiatives of this kind would be a positive development and stock exchanges in Canada may well have a role to play as well in pushing some of these initiatives forward.

5. Issues concerning the adequacy of disclosure with respect to independent directors are not unique to DCS companies. They also arise when considering other kinds of controlled companies. We need to advance thinking on the type of disclosure and governance enhancements that would be appropriate for DCS companies. But we also need to appreciate that approaches here may well have to be integrated into overarching solutions intended to address challenges that arise with different kinds of controlled companies, including ones that have a single class share structure.