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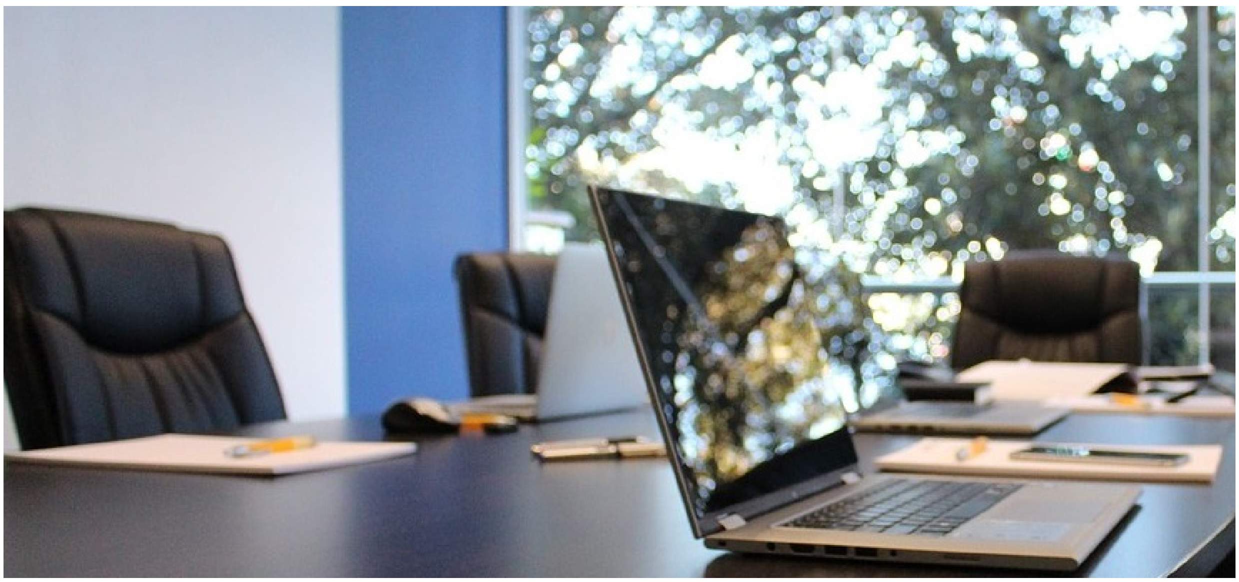
It Stays in the Family – Dual Voting Share Structures for Family Businesses

By Dierk Ullrich on April 26, 2019



For many family businesses, control of long-term direction and management of the family corporation are key issues, particularly during times of growth or periods of succession. The *Institute for Governance of Private and Public Organizations* ("**IGOPP**") recently published a new policy paper that should be of interest to family businesses and their advisors in planning the capital structure for their enterprises: *The Case for Dual-Class of Shares*, Policy Paper No. 11 (2019). The paper revisits[1] the state of dual-class public corporations in Canada, emphasizes their value to entrepreneurs, family businesses and Canadian society as a whole and makes a number of structuring recommendations, which are outlined below.

What is a Dual-Class Share Structure?

Canadian corporate statutes generally permit companies to adopt capital structures with multiple classes of shares with different rights or attributes (for example voting and non-voting shares or shares with preferential dividend, conversion or redemption rights). While the default approach is one vote per share, the flexibility of corporate laws permits the creation of several share classes with multiples votes, no voting rights or differential voting rights on certain matters (such as the election of the board of directors).[2] In this context, IGOPP's paper focuses on share structures with two classes, one of which is given multiple votes per share. Among publicly traded Canadian corporations with dual class structures, voting ratios can range from 1:0 (a class of voting shares and a class of non-voting shares) to 100:1 (a class of superior voting shares with 100 votes per share and a class of subordinate shares with one vote each). The central feature of a dual-class share structure is that ownership and control over the corporation can be decoupled. Or, to put it differently, a minority ownership position in the corporation's equity may still hold the majority of the votes.

Benefits of a Dual Class Share Structure for Family Businesses

Dual-class share structures for public companies are controversial and the debate has been raging for a considerable time.[3] The principal arguments against such structures are based on notions of shareholder democracy and protection of minority rights. Perhaps as a result, the number of publicly traded companies in Canada with a dual-class share structure has dropped from 100 in 2005 to 69 in 2018.[4]

Nevertheless, the benefits of such structures identified by IGOPP and other commentators may be of particular interest to family-run businesses. Superior voting rights permit families to plan and manage their businesses in the long term and facilitate generational change, while, at the same time, being able to access outside investor capital to support the growth of the business. The dual-class structure affords protection against hostile take-overs and what IGOPP perceives as shareholder activism driven by short-term (and perhaps short-sighted) profit maximization. Or, as put by IGOPP: "… the coupling of dual-class and family ownership brings about longer survivorship, better integration the social fabric of host societies, less vulnerability to transient shareholders and more resistance to strategic and financial fashions."[5]

Recommended Features for a Dual Class Share Structure

In order to balance the advantages of a family controlled business, access to outside capital and the interests of minority shareholders, IGOPP recommends a number of features, including the following:

- **A voting ratio of 4:1** – This ratio retains a voting majority for family business at an ownership level above 20% and a blocking minority with respect to fundamental changes with an ownership interest of 11.1%. Reflecting research indicating that increasing variances between voting power and ownership level tends to negatively affect the quality of overall governance and favour self-interested, rather than business focused decision-making, this recommendation aims to balance legitimate family and overall business interests.
- **Minority Board Representation** – One third of board members should be elected by the single-vote share class. This measure would give non-family investors a substantial indirect say in the management or supervision of the family business. To ensure continuity and compatibility with the family vision and values, IGOPP further proposes that minority directors be elected from a candidate pool nominated by the existing board.
- **"Coat Tail" Provisions –** A major point of criticism of dual share structures has been price premium placed on multiple voting shares in case of a sale. The "uniquely Canadian" response to this issue is to treat all share classes equally on a sale.[6] IGOPP's recommendation that family corporations adopt such "coat tail" provisions in their articles or bylaws to guarantee that all shareholders can participate in a sale of the family business on the same terms and conditions at the same price, would thus overcome the "private benefit" concerns.
- **Dilution Sunset Clauses** – In the context of dual share structures, a sunset clause would trigger the abolition of superior voting rights if the justification for their existence has fallen away. For family businesses, this would typically be the case when the business loses its essential character as a family enterprise. There is a wide range of possible triggers. Examples are time-based (e.g. 20 years after an IPO) or event-based (e.g. on the exit, retirement or death of the founder). However, these approaches typically do not meet the needs of a multi-generational family business. On the other hand, as family involvement the business may diminish over the years, a sunset clause could be tied to a level of family ownership interest. This notion is connected to the proposed voting ratio and its rationale. For example, at a 4:1 voting ratio, the dilution sunset could be triggered if and when the controlling shareholders' equity dropped below the blocking minority of 11.1% – the point when self-interest may typically outweigh the overall business interests.

There are, of course, many possible variations and combinations on how these basic recommendations could be implemented to meet the specific goals and needs of each family business. If you have any questions about corporate share structures, legal issues affecting family businesses or wish to learn more about Fasken's private client services, please see here: Fasken Private Client Services.

[1] IGOPP first examined dual-class corporations in 2006: see *Dual-class share structures in Canada:Review and Recommendations*, Policy Paper No. 1 (October 2006).

[2] See, for example, ss. 24(3) and (4) and 140 of the *Canada Business Corporations Act* or ss. 58 and 173(1) of the *Business Corporations Act* (British Columbia).

[3] See, for example, Ryan Modesto, "The case for investing in companies with dual class shares" *The Globe and Mail* (April 16, 2016, last updated June 19, 2017) or Shannon Bond and Nicole Bullock, "Lyft IPO revs up debate on dual class shares structures", *Financial Times* (February 25, 2019).

[4] IGOPP, Policy Paper No. 11, p. 15.

[5] IGOPP, Policy Paper No. 11, p. 12.

[6] The Toronto Stock Exchange has, for over 30 years, listings for classes of "restricted securities", that do not provide "takeover protective provisions", which in effect ensure that these securities would be acquired for the same price as common securities. For more detail, please see s. 624 of the TSX Company Manual.