

**UNIFICATION OF DUAL CLASS SHARES IN CANADA WITH CLINICAL CASE ON
MAGNA INTERNATIONAL**

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Executive Summary

In recent years, many companies in Canada and Europe have moved to eliminate their dual class structure. The percentage of dual class firms listed on the TSX decreased from 14% in 1993 to 6% in 2010. This paper discusses the reasons for this trend and analyzes 32 unifications of dual class companies on the TSX from 1989 to 2010. We find that the elimination of dual class structure increases stock prices and improves the liquidity of the stock. Like Magna, the unification provides an opportunity to restructure the board. We also examine the returns to the control group and to outside shareholders under these various unification schemes. In only 2 of 32 cases do we clearly determine that the control group earned higher returns than outside shareholders. In 2003, Sherritt's founder Ian Delaney received a special \$9.2 million payout at the time of the unification of its dual class structure equal to 98% of his investment in the company. In the recent Magna unification the company's founder, Frank Stronach, earned a payout worth \$983 million providing him a 1,933% return far in excess of the return to outside shareholders at the time of the announcement. Thus, Stronach's compensation upon reclassification was clearly excessive relative to the 31 other unification transactions. We recommend that the dual class structure continue to be permitted but that a series of policy measures be instituted to curb potential agency problems.

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Introduction

The financing of corporations with dual class shares has been a source of corporate governance controversy in countries which have listed dual class equity shares. The debate ranges between absolute ban of dual class shares because of lack of symmetry between voting and cash flow rights and the argument that there is no inherent problem with such securities and, hence, they should continue to be issued to finance corporations (Pajuste, 2005). The current study uses data of 32 Canadian listed firms which unified their dual class shares into single class from 1989 to 2010 to evaluate the impact of the announcement of the unification on the firms' value and also identify the cross-sectional factors which help to explain the impact of the unification on firm value.

The analysis will also look at Magna's recent dual class unification as a clinical case to show the impact of the unification announcement on the firm's value and the implications of the exit compensation package approved for the controlling shareholder, Frank Stronach and his family trust.

The results of the statistical analysis show that on announcement of the dual class unification, share price increased by 8% (during the -1 to +5 event window) and the cross-sectional analysis also indicated that firms with higher management voting leverage (voting vs. equity wedge) tend to have a higher increase in shares but those with lower debt-to-equity ratio tend to have a higher share price increase. As expected, trading liquidity improved with the unification of dual class shares. Thus, the general inference that can be drawn from the analysis is that unification of dual class shares, is value-enhancing, and the improvement in trading liquidity also lowers the cost of equity capital.

With reference to the unification of Magna, the data show that share price increased by 20% during the -1 to +5 event window. However, this could have been the result of confounding effects from other positive announcements. We document that the payout to Stronach generated a 1,933% return to him and it was clearly very high when compared to the return to controlling shareholders in all previous unifications.

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Why do Companies Create Dual Class Shares?

Though the focus of this research is on the unification of dual class shares, we need to briefly present the reasons for the creation of dual class shares as a form of corporate source of financing.

It has been argued in many studies that companies usually issue dual class shares to raise external equity capital without the threat of losing or diluting control. Unless the controlling shareholder decides to sell the controlling interest, buying all the restricted shares in the market does not provide the acquirer with enough votes to take control of the company. Given this effective takeover defence, the dual class structure also facilitates intergenerational transfer of control from founders to their heirs. For the dual class companies which pay preferential dividends to the holders of restricted shares, it is argued that the structure satisfies investors with different interests. Those who would like to get involved in corporate control issues will buy the superior voting shares and other investors who are just interested in investment returns, would buy restricted shares which may pay more dividends. In industries where Canadian ownership regulatory requirements are needed, using dual class structure allows the regulatory requirements to be met by getting the superior voting shares to be purchased by Canadians and the restricted voting shares to be purchased by other investors, including foreign investors.

The Economic Consequences of Dual Class Share Structure

There are serious corporate governance consequences of dual class structure which are undesirable to some investors. These consequences might make some investors, especially institutional investors, avoid dual class shares (Li, et al, 2008).

Dual class structure gives rise to bigger agency problems because there are three groups of common equity shareholders who may at times have differing interests in the management of the company. First, there is the controlling shareholder who controls the company with very limited equity investment. Second, there is the minority shareholder group which holds some superior voting shares but not enough votes to fight the decisions of the controlling shareholder. Third, there is a large minority shareholder group which holds the lion's share of the company's equity but does not have enough votes to affect the direction of the company.

Empirical evidence indicates that controlling shareholders and their family extract private benefits and excessive compensation from their firms (Masulis, et al, 2008). Baulkaran (2010) provides evidence that dual class firms also pay out lower dividends than a set of matching closely held single class companies and suggests that cash flows are being retained for the benefit of the controlling group.

Some studies, such as Amoako-Adu and Smith (2001), document some of the legal conflicts which arise during takeovers and consolidations in dual class companies. The 1987 attempted takeover of Canadian Tire by the franchisees is a noted example of such conflicts. In this case, the conflict ended up in court and the Ontario Securities Commission also had to rule on the fairness of the takeover.

It is also argued that in a dual class company, the controlling shareholder controls the board and, hence, the board becomes a puppet of the controlling shareholder. Given that management and the board are controlled by the controlling shareholder, private benefits can be extracted by the controlling shareholder. Studies, such as Baulkaran (2010), and Amoako-Adu, Smith and Baulkaran (2011) indicate that the controlling shareholder and the family members who are in management tend to get paid higher compensation than that of non-family members.

Again it is argued that management and the corporate board will be entrenched to the extent that even in the face of losses, they continue to be employed and tend to hold on to their tenure longer than those in comparable single class companies. Such entrenchment could be considered as non-pecuniary benefit for the controlling shareholder because the entrenched management and the board will continue to act in the interest of the controlling shareholder.

The consequence of all the agency and corporate governance problems associated with dual class structure is that dual class companies are discounted in value compared to single class companies with concentrated ownership. A recent research paper by Smith B., Amoako-Adu, and Kalimipalli (2009) finds that between 1998 and 2002, TSX-listed dual class firms sold at a discount of 14% compared to single class firms with concentrated ownership. A similar discount is observed with US dual class firms (Masulis, et al., 2008), (Baulkaran, 2010).

Why Unify Dual Class Shares?

Exhibit 1 tabulates the reasons given by dual class companies as to why they unify their shares. Related to the agency problems discussed above, the unification of dual class shares will minimize or eliminate agency problems. The three shareholder groups will be reduced to a standard one (widely-held) or two groups of controlling and minority shareholders.

The minimization of shareholder agency problems will eliminate the dual class value discount and increase the market value of the company. It will also allow shareholders to have proportionate voting interest in the company. This is considered as the democratization of shareholding.

Exhibit 1
Most Frequently Cited Reasons by Dual Class Companies for Unification

Reasons	Frequency
1. Increase Liquidity and Marketability	9
2. Increase Investor Appeal and attract Institutional Investor Interests	6
3. Retirement Plan for Founder	4
4. Reorganization of the Company	4
5. Corporate Governance Concerns	4
6. Introduction of Shareholder Rights Plan	3
7. Alignment of Interests	2
8. Facilitate Sales of Control Block	2
9. Others	8

Note: Others include reasons such as, eliminate discount on dual class shares, the company is no longer concerned that it will violate Canadian ownership restrictions, dual class structure was no longer necessary as company's rapid growth period was complete, the unification was done to help raise capital through an issue of special warrants and the company was in financial distress and hence, unification was done to make it more attractive to potential acquirers.

The unification of dual class shares also improves trading liquidity of shares after the unification because investor interest in the shares increases. The improvement of trading liquidity lowers the required return on the shares and consequently, lowers the cost of equity capital of the unified firm.

Some argue that dual class firms underperform their comparable single class firms. The correct comparison in performance should be between dual class firms and single class firms with concentrated ownership where most of the agency problems of control may exist. There is no convincing empirical evidence that dual class firms underperform single class firms (Jog et al, 2010). A dual class firm selling at a discount does not necessarily imply that its performance is less than that of a single class firm. Investors in dual class companies do not earn a lower risk-adjusted return than those in single class companies with concentrated ownership.

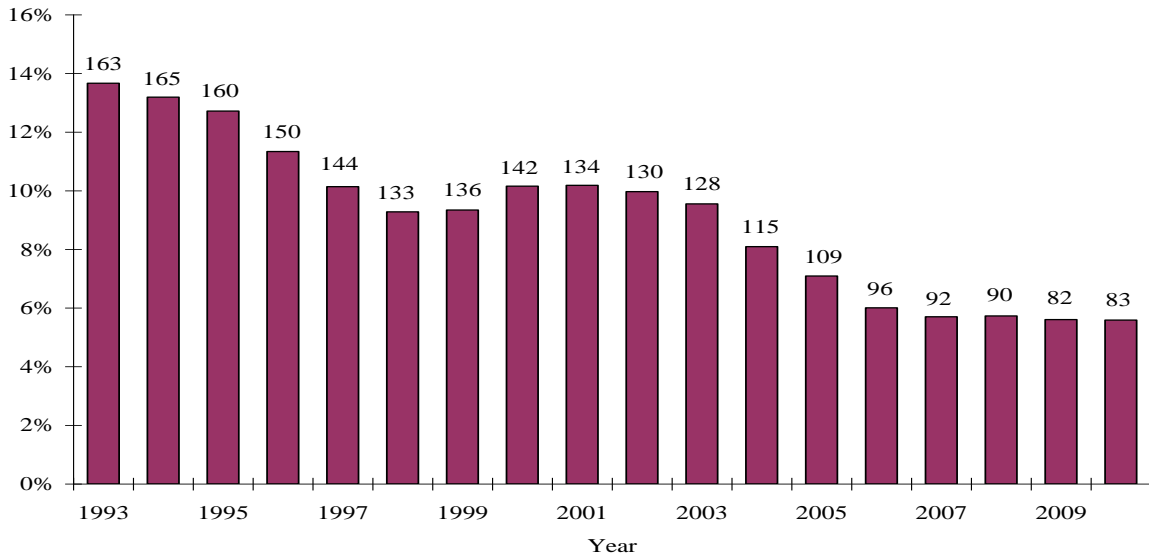
Empirical Analysis of Canadian Dual Class Unifications (1989-2010)

Before analyzing the sample of firms which unified their shares, we looked at the proportion of TSX-listed companies which had dual class shares from 1989 to 2010. As shown in Exhibit 2, the proportion of dual class shares declined from 14% to 6%. This may be a reflection of the concerns raised with the corporate governance problems associated with dual class shares. A

similar trend is observed in Europe by Pajuste (2005) who analyzed a sample of dual class listed stocks in seven European countries. In Exhibit 3, over the 1995 to 2001 she shows that the proportion of listed dual class companies declined by 42%.

Exhibit 2

Percentage (Number) of Dual Class Firms Listed on the Toronto Stock Exchange



For the sample of TSX-listed dual class companies which unified their shares over the 1989 to 2010 period, after controlling for the general market movement, share prices increased by about 8% during the -1 to +5 event window (See Exhibit 5). This implies that dual class unification is value-enhancing because investors expect the benefit of reduction in agency problems. The positive share price response on announcement is consistent with the empirical findings of Khalil and Magnan (2008). We re-measured the stock price reaction by excluding Magna and Sherritt (the two companies with special payouts to controlling shareholders). The results were similar to those in Exhibit 5.

Prior to unification, the average voting leverage of the dual class firms was 8.37. That means, the shareholder could control 8.37% of all votes with just 1% of the total equity. Excluding Magna (whose voting leverage exceeded 100) from the sample, the average voting leverage drops to 3.10. The disparity between Frank Stronach's voting rights and equity position in Magna was the most extreme among the sample of companies. With the exception of three companies, all the firms in our sample had coattail protection for the restricted shareholders.

Exhibit 3

Decline in Dual Class Firms on European Stock Exchanges from 1995 to 2001

Country	% in 1995	% in 2001	Change 1995 to 2001
Denmark	59.7%	36.6%	-39%
Finland	45.5%	23.9%	-47%
Germany	24.3%	11.5%	-53%
Italy	41.0%	34.6%	-16%
Norway	23.9%	7.4%	-69%
Sweden	61.3%	46.3%	-24%
Switzerland	46.7%	26.4%	-44%
AVERAGE	41.1%	21.6%	-42%

After the unification, it was observed that controlling shareholder equity holdings generally decreased from 1 year before the unification to one year after the unification. Thus, unification can be viewed as a step in the process of controlling shareholders liquidating their holdings in a dual class company.

We examined how trading liquidity was affected by unification. We observed a statistically significant reduction in the mean of two measures of liquidity—the Amihud (2002) measure and the relative bid-ask spread. The Amihud (2002) measure is a ratio of the absolute percentage price change per dollar of daily trading volume and the relative bid-ask spread is a ratio of the bid-ask spread over the mid-quote. The bigger these measures are, the more illiquid the stocks are. A decrease in each measure indicates improvement in liquidity. Thus, there is evidence that unification of dual class shares enhances trading liquidity.

Cross-sectional analysis of the announcement gains indicates that firms with higher management voting leverage (bigger voting right versus equity right) had a bigger gain, and firms with lower financial leverage also had a higher return.² Agency theory argues that firms with higher financial leverage will have lower agency problems because of creditor monitoring and discipline. Hence, the unification should have a smaller impact on companies with higher financial leverage. The inverse relationship between CAR and the illiquidity measure implies that firms which were more illiquid responded less.

² In the cross-sectional analysis, we could not examine the impact of the exchange ratio on CAR as there were very few companies which used an exchange ratio different from one.

Exhibit # 4

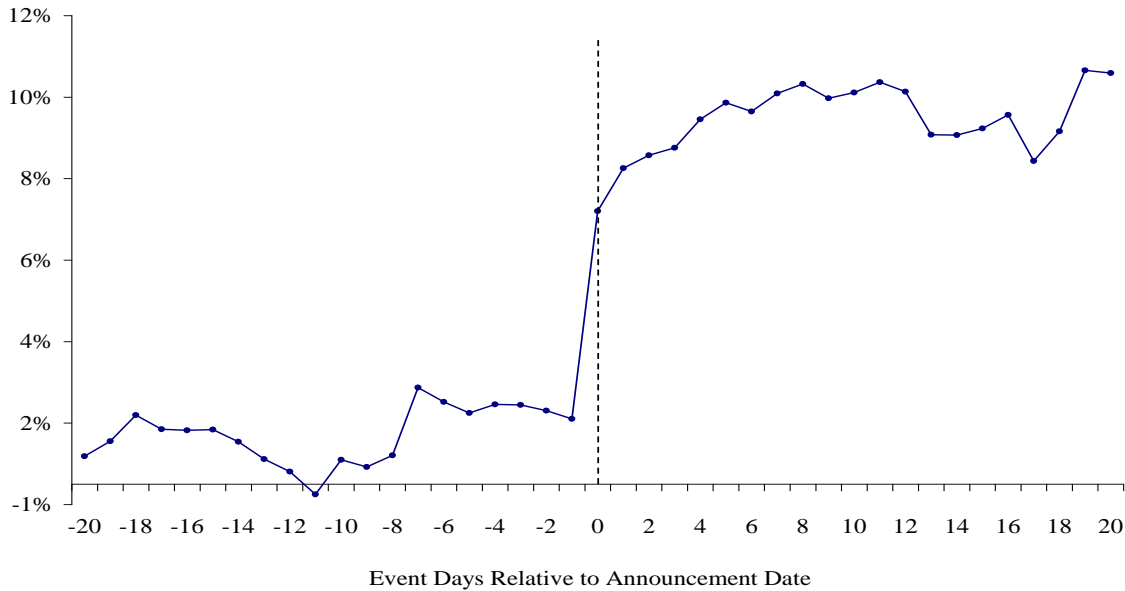
Cross-sectional factors which explain the announcement gains (CAR)

Management voting leverage is the ratio of percentage of votes controlled by management to percentage of equity owned. *** and ** denote the results are significantly different from zero at the 1% and 5% levels, respectively.

Cross-sectional variables	CAR 0 to +5		CAR -1 to +5	
	Est.	t-stat	Est.	t-stat
Size - Log (Market Value)	-0.006	-0.85	-0.008	-1.16
Debt-to-Equity	-0.015	-2.37**	-0.012	-2.53**
Management Voting Leverage	0.018	2.14**	0.017	2.10**
Amihud Illiquidity Measure x 1000	-0.046	-3.46***	-0.064	-4.85***
Preferential Dividends	-0.005	-0.20	-0.005	-0.18
Intercept	0.073	2.03**	0.085	2.22**
R-squared	0.39		0.38	
Observations	28		28	

Exhibit 5

**Cumulative abnormal returns for sample of 29 firms that announced unification (1989-2010)
(Excludes three firms with missing data)**



Gains of Controlling Shareholders vs. Outside Shareholders in these unifications

An important question to consider is how well did the controlling shareholders fare in these transactions relative to outside shareholders? As shown in Exhibit 6, in 20 cases, the exchange ratio of superior voting to new common shares was 1, the same as that for restricted voting shares. In these cases, the controlling shareholders unequivocally did not have a higher percentage gain than their restricted share counterparts.

In seven cases, the exchange ratio of superior voting shares to new common shares was greater than 1. The exchange ratio ranged from 1.05 to 1.26 with an average of 1.10. In these cases, company proxy circulars justified the ratios on the basis that they reflected the relative prices of superior voting over restricted voting shares in the open market prior to the unification announcement. That is, if a company's superior voting shares previously traded in the open market at \$10.50 per share and the restricted shares traded at \$10 per share, the company would offer a 1.05 exchange ratio to superior voting shareholders. By being paid 5% more for each of their shares, the superior voting shareholders were being compensated for the 5% higher value of the shares in the market. Thus, the exchange ratio was set in such a way as to lead superior voting and restricted shareholders to the same percentage gain over the value of their investment in the open market. On this basis, the controlling shareholders in these seven cases did not get a better deal than outside restricted shareholders.

There was one case in which there were multiple voting preferred shares that were reclassified into common shares on a preset ratio. As the ratio was known by the company's restricted shareholders prior to the announcement of unification, it is expected that shareholders would have adjusted the prices of their shares for this potential exchange. Furthermore, there were two cases in which the firm split itself into one company with single class shares and a second company with dual class shares. By taking this action the company eliminated the dual class structure over a subset of its assets. Thus, the control over part of the company's assets by controlling shareholders was reduced without any special compensation to them. Here again, the controlling shareholders did not earn a higher return upon unification than their restricted share counterpart.

There were only two cases in the controlling shareholder clearly earned a percentage return greater than the outside shareholders. The cases were Sherritt in 2003 and Magna in 2010. These cases are reported in Exhibit 6.

Exhibit 6

Controlling Shareholder Gains in 32 Unification Cases on TSX

# of Cases	Exchange Ratio of Superior Voting to New Common Shares	Special Payout to Controlling Shareholder	% Gain to Controlling Shareholder > % Gain to Outside Shareholders
20	1.00	None	No
7	1.05 to 1.26 (average 1.10)	None	No as exchange ratio was approximately equal to ratio of open market prices of superior voting versus restricted shares
1	Multiple voting preferred shares were reclassified into common shares by preset ratio	None	No as preset ratio known to investors
2	Firm split itself into one company with single class shares and a second company with dual class shares	None	No as dual class structure eliminated over subset of company assets
2	1.00	Yes: Sherritt in 2003 & Magna in 2010	Yes, in these cases, payout is much greater than value of superior voting stock exchanged
32			

Magna's Dual Class Unification

Details of the Unification Proposal

On May 6, 2010, Magna announced that it was going to eliminate its dual class structure by buying back and cancelling all 726,829 class B shares held by the Stronach Trust. Each share carried 300 votes thereby allowing Frank Stronach to control 66.1% of the votes of the company with only 0.64% of the equity. With the elimination of class B shares, the class A subordinate voting shares were reclassified as common shares and the Stronach Trust ceded control of the company to outside shareholders.

In exchange for the class B shares, the company paid Stronach US\$300 million cash plus 9 million common shares of Magna issued from treasury. This would give the Stronach Trust 7.44% of the common shares. In addition, Stronach was awarded a consulting agreement with the company worth about \$120 million. The final key component of the unification proposal was a commitment by Magna to invest the majority of the money into an electric car venture

controlled by Frank Stronach. In particular, Magna would indirectly invest US\$220 million for a 73.33% interest in the partnership. The Stronach Trust would indirectly invest US\$80 million for a 26.67% interest in the partnership but be able to appoint three of the five members of the management committee of general partners. Magna would also have effective veto rights in respect of certain fundamental changes and specified business decisions.

The reasons Magna provided for the unification were as follows.

1. Reduce or eliminate Magna's trading value discount
2. Enhance the marketability and liquidity of the stock
3. Address alignment of interest concerns
4. Address the disproportionate voting versus equity holdings
5. Allow for orderly transition of control of founder
6. Enable Magna to share in the investment risk and benefit of E-vehicle joint venture

The first four reasons listed above are connected. By eliminating the dual class structure, there will no longer be a control group of shareholders who holds only a small percentage of the equity. This will lead to a better alignment of interests among shareholders. The academic research would suggest that the better alignment of interests among shareholders will reduce excess compensation of management, increase dividend payout and reduce management entrenchment. These changes in turn will lead to a reduced discount on the value of the equity of the company. Furthermore, moving to a one-vote one-share structure will attract investors who were unwilling to invest in firms with dual class structure. This would increase the marketability and liquidity of the stock that would also raise the value of the company's publicly traded equity. Of course, this aim could be thwarted if the payout to the control group was so large that it offset the increase in equity value from removing the dual class discount on the stock.

The fifth reason listed above is consistent with the interests of both the Stronach Trust and the outside shareholders. An orderly transition of control is inherently positive for both groups since it preserves the value of the company. The final reason noted above—enabling Magna to invest in an electric vehicle company—reflects the interests of Frank Stronach but not necessarily those of the other shareholders of Magna. This is shown by the fact that Magna will be responsible for approximately three-quarters of the investment in the venture but Stronach will have the right to appoint 60% of its directors.

Was the compensation to Stronach excessive?

The most interesting aspect of the Magna unification was the size of the payout to the founder. Excluding the E-vehicle joint venture, the combined value of the payout to the Stronachs was \$983 million:

Cash Payout	\$300 million
9 million common shares @ US\$62.53 ³	\$563 million
Four year Consulting Contract	<u>\$120 million</u>
Total	\$983 million

Using May 5, 2010 closing stock price of the publicly traded class A shares of US\$62.53, the value of Stronach Trust share holdings of 726,829 shares was \$45.45 million. Thus, in exchanging this position for \$983 million in compensation, the return on the Stronach's equity investment was 2,063% ($\$983/\$45.45-1$).

Arguably, the base value of the class B shares should be raised to reflect the normal premium of these shares over subordinate voting Class A shares. The average premium of class B over class A shares equals 6.42% over the 10 years prior to the class B shares being delisted in 2007. Thus, although the class B shares were not traded on the open market on May 5, 2010, a reasonable estimate of their value would have been \$66.54. That is 6.42% higher than the class A stock price of US\$62.53. With the adjusted B price, the value of the 726,829 shares of Stronach Trust would be \$48.36 million. The gain still would have been 1,933% ($\$983/\$48.36-1$).

Even if one were to consider the \$120 million consulting fee as a fair return for services rendered by Stronach rather than part of his payout for ceding control, the percentage gain would still be 1,685% ($\$863/\$48.36-1$). Of course as we should impute some value for the fact that Stronach was granted control of the electric car venture in exchange for contributing approximately one-quarter of the capital, his percentage return from tendering his class B shares would be higher.

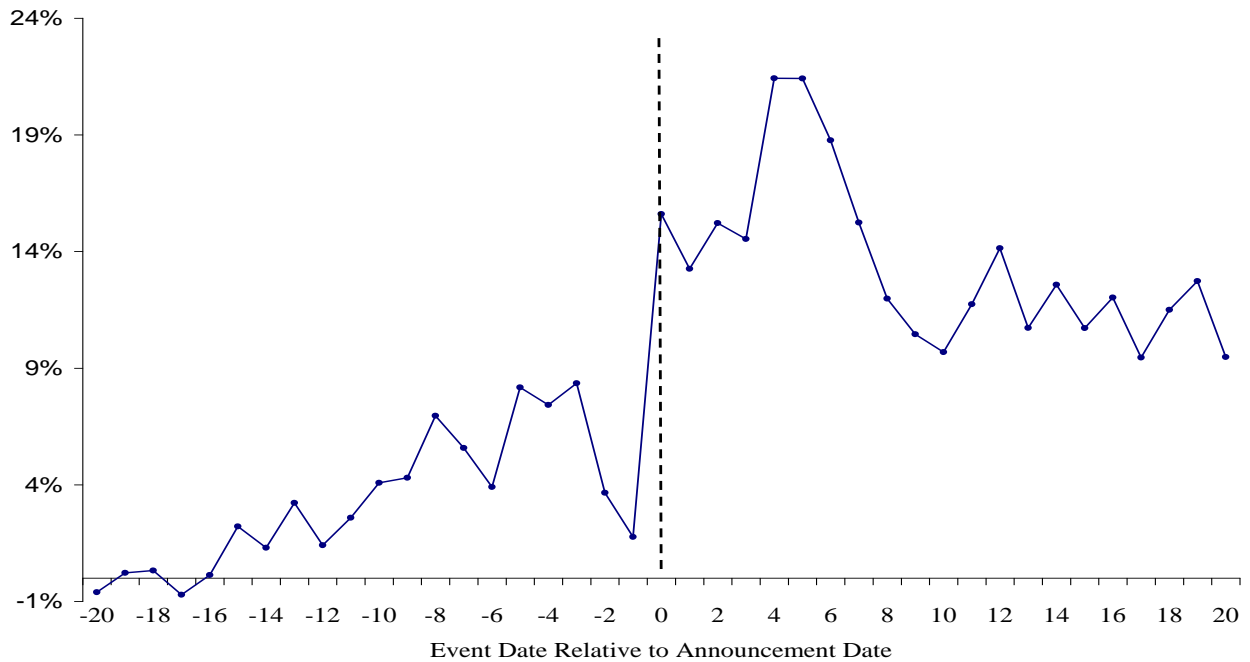
In comparison, as shown in Exhibit 7 outside shareholders of Magna earned a return of 20% over the -1 to +5 days surrounding the May 6, 2010 announcement of the proposal. Thus, outside shareholders experienced between one-eighty-fourth and one-hundredth of the percentage gain of Stronach. Of course, the relative performance of the outside shareholders should be considered even worse if we attribute part of the 20% gain to Magna's concurrent positive news announcements. On May 6, 2010, Magna also announced that its earnings for the

³ Closing price of Class A shares on May 5, 2010

first quarter beat analyst expectations by 132%, that it was reinstating a dividend and that it increased its revenue guidance for 2010 by \$2 billion.

Exhibit 7

Magna's Cumulative Abnormal Returns in the days around the announcement of unification



We can also compare Stronach's percentage return to what other companies paid their controlling shareholders who held superior voting shareholders. As noted above, of the 31 previous cases of unification on the TSX, only one had a special payout to the controlling shareholder similar to that of Magna. In 2003, Ian Delaney, the founder and controlling shareholder of Sherritt proposed a succession plan in which the shares of the company would be unified on a one-to-one basis. Delaney held 100 multiple voting shares which gave him majority control of the company with over 130 million subordinate voting shares outstanding. He proposed a retirement compensation package we estimate was worth \$9.2 million or 1.2% of the value of the company. In contrast, the Stronach package was worth approximately \$938 million or 12.4% of the company. On a comparative basis with other unification deals, the Stronach case is exceptionally large.

It is also interesting to contrast the treatment of the Stronach Trust in 2010 with that of the outside class B shareholders in 2007. In July 2007, it was announced that all the Class B shares not held by the Stronach Trust were to be repurchased by Magna at a price of \$114 per share.

This was 11% above its open market price just prior to the repurchase announcement and 20% above what the Class A subordinate voting shares had traded in the open market. The repurchase was completed in September 2007. By this measure, in 2007 outside class B shareholders received a tiny fraction of the payout to the Stronachs for their class B shares in 2010. This stands in contrast to all other unifications in which all holders of superior voting shares (public and control group) received the same extra payout. There were no public shareholders of superior voting shares in the case of Sherritt.

Despite the abnormally generous payout package for Stronach, a majority of the outside shareholders of Magna voted in favour of the proposal. Some institutional investors contested the proposal through the courts. The Court decided that the payout was 'fair and reasonable'. Institutional investors appealed the Court decision to the Divisional Court, where the original decision was upheld.

The longer term stock returns subsequent to the May 5, 2010 proposal may suggest that investors have not been hurt by the unification agreement. As shown in Exhibit 8, Magna's stock has outperformed 11 of the 12 auto parts manufacturers with at least a billion dollar market capitalization on a U.S. stock exchange. Magna's stock price increased 88.0% from May 5, 2010 to January 19, 2011 versus an average of 49.7% for the others. We note however that the relative strong performance may also be attributed to the company beating analyst expectations in recent quarters and to other positive announcements. Thus, it is difficult to disentangle these confounding effects from those of unification.

One reason why Magna's shares may have reacted positively is that there will be changes that will add to shareholder value but cannot be measured over a few months. For example, shareholders may expect that the company will cease its frequently criticized acquisitions outside of the automotive parts sector. In addition, beyond the \$120 million four year consulting fees for Stronach, it is likely such deals will not be repeated and that Magna's future executive compensation will decline and be considered less excessive. These changes again would be consistent with research findings of dual versus single class companies in the same industry. See Baulkaran (2010).

Exhibit 8

Magna International versus Other U.S. Auto Parts Companies

	Stock Price May 5, 2010	Stock Price January 19, 2011	% Gain in Stock Price	Market Capitalization (US \$Billions)
TRW Automotive Holdings	\$ 30.24	\$ 60.24	99.2%	7.3
Magna International	\$ 31.27	\$ 58.78	88.0%	14.2
Tenneco	\$ 24.38	\$ 44.12	81.0%	2.6
BorgWarner	\$ 40.23	\$ 69.75	73.4%	7.9
American Axle	\$ 9.65	\$ 15.20	57.5%	1.0
Autoliv	\$ 51.49	\$ 79.44	54.3%	7.1
Gentex Corporation	\$ 20.87	\$ 31.60	51.4%	4.5
Dana Holding Corporation	\$ 12.62	\$ 17.94	42.2%	2.5
Lear Corporation	\$ 76.96	\$ 106.14	37.9%	5.4
ArvinMeritor	\$ 15.55	\$ 20.93	34.6%	2.0
Federal-Mogul Corporation	\$ 18.43	\$ 23.18	25.8%	2.3
Johnson Controls	\$ 32.16	\$ 40.07	24.6%	27.0
LKQ Corporation	\$ 20.42	\$ 23.39	14.5%	3.4

Source: Google Finance

Note: Prices are adjusted for splits and dividends

In summary, the compensation to Stronach was excessive relative to all previous unifications in the Canadian market. Outside shareholders fared relatively poorly compared to the control group. In addition, because of the confounding effects of unification and positive earnings news on the stock returns of Magna, we cannot state unequivocally that the cost of the payout was smaller than the increase in outside shareholder's wealth unlocked by the unification.

Magna is a fascinating story for scholars of corporate governance. Supporters of dual class shares can point to Magna as an example of a small Canadian company whose founder used

them as a method of financing that allowed him to implement his aggressive growth plans without fear of loss of control. Opponents of dual class firms can point to the excessive pay of its founder, including the payout under the unification proposal, as well as the limited cash distributions to shareholders and some value-destroying non-automotive acquisitions when Stronach controlled the company with less than 1% of the equity. With vociferous arguments on each side, it is not surprising that the case continues to stir controversy over dual class shares.

Policy Implications

We propose a series of policy measures that serve to preserve the dual class share structure as a legitimate tool of corporate finance but lessen the possibility of egregious treatment of outside shareholders as witnessed in the case of Magna:

- Dual class shares should continue to be issued to finance growth without the fear of dilution or the loss of control which may be a concern for owners.
- Regulators should make sure that full information is provided to protect investors against extraction of private benefits. Full disclosure about who is drawing money from the corporation and for what reason should be disclosed to investors.
- The coattail protection for the holders of restricted shares should be legally binding and not just a listing requirement. Also, it is suggested that the coattail should be made retroactive beyond 1987 when it was introduced as a listing requirement on the TSX. This implies that all dual class listed companies should have coattail protection for restricted shareholders.
- The coattail protection should be expanded to include equal treatment of superior voting and restricted shares upon unification.
- It is suggested that all non-voting shares should be converted to subordinate shares so that all shareholders can have some votes at a joint shareholders meeting.
- The ratio of votes held by each superior voting share to each restricted shares should be restricted to a maximum of 10:1. This would eliminate the excessive wedge between voting and equity rights. By implication, non-voting shares should be converted to subordinate voting shares, as suggested above.
- Ontario Securities Commission should require sunset clauses with automatic trigger and reclassification upon the exit of the founder or controlling shareholder. Any special compensation to be provided should be specified in the sunset clause which should have been approved by two-thirds of the shareholders. A shareholder vote should be required every five years to renew the terms of the sunset clause.

- Subject to the above policy improvements, and with timely and full disclosure of the nature and conditions surrounding the issuing of the securities, dual class shares should not be abolished.
- Consistent with the conclusions of Allaire (2006), dual class share structure should not be abolished but rather it should be left for the companies voluntarily to decide to unify their shares. However, as suggested some policies can be put in place to improve both transparency and information disclosure. This conclusion is similar to that of Pajuste (2005) and OECD (2007) studies which recommend that dual class structure may be temporary, and the market and controlling shareholders will decide whether companies should unify their share classes.

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