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CONSULTATION ON THE CANADA BUSINESS CORPORATION ACT (THE "CBCA")

Dear Sirs/Mesdames:

TELUS is pleased to submit the attached paper in response to Industry Canada's public consultation on amendments to the CBCA. While Industry Canada's consultation paper raised a number of issues related to the governance framework of corporations, TELUS has restricted its submission to the issue of empty voting because of TELUS' recent experience with this phenomenon and the significant implications it has to corporate governance. TELUS has seen first hand the negative effects of empty voting and the lack of legislative tools available to help our judiciary, corporate boards and shareholders respond. Industry Canada has a unique opportunity today to correct this imbalance.

The practice of empty voting has gained the attention of regulators and lawmakers because of its implication to a fundmental principle of corporate governance; that shareholders will exercise their voting rights in support of increasing corporate value. Shareholders acquire voting rights because of the economic investment they make in a corporation. It is expected therefore that they will exercise those rights in alignment with the corporation's success. However, when hedge funds and activists decouple this relationship and separate the voting right from the economic risk, they exercise voting rights in support of a private benefit and undermine the integrity of shareholder democracy. In TELUS' case, the empty voter sought not only to profit at the expense of TELUS' interest but also to the detriment of TELUS' shareholders.

It is essential that corporate Canada respond to this growing investment practice. Although TELUS was ultimately successful in its battle against empty voting, the effort consumed significant time, resources and attention that are not necessarily available to all corporate targets. It also highlighted the absence of any effective legislative tools to help corporations respond when this threat arises. Our judiciary has expressed concerns with the practice and indicated they look to our legislators and regulators to help resolve the problem.

In support of this objective, TELUS has identified specific areas of concern in the CBCA where shareholders with no interest in a company can access statutory rights that should be reserved for

shareholders that have held a beneficial interest for a meaningful period of time. The CBCA also allows opportunistic investors to engage major corporate steps like requisitioning a meeting while concealing their true identity and purposes. Additionally, the CBCA as currently worded does not provide Courts with the discretion to resolve the problem of empty voting. These shortcomings can be easily addressed to provide Canadian corporations and their shareholders adequate tools to respond to the short-term, self-serving tactics of arbitragers.

Shareholder proposals and meeting requisitions under sections 137 and 143 of the CBCA should be limited to the beneficial owner of the shares who has held those shares for a meaningful period of time and section 144 should be amended to make clear Courts have the authority, where they consider it equitable, to disqualify votes at a meeting if the holder of those votes does not have an economic interest in the corporation commensurate with its voting position. The rationale and means to implement these simple yet effective solutions are set out in further detail in the attached paper.

As noted by Industry Canada, when the CBCA first came into force it was considered a leading-edge corporate law statute further enhanced by wide-sweeping changes in 2001 and now open for further improvements to deal with the growing challenges raised by increasingly complex capital markets. One of these challenges is the threat to corporate governance posed by the advent of empty voting. To ensure the CBCA remains a leading framework that supports the success of Canada’s corporate regime, we strongly urge Industry Canada to consider TELUS’ innovative and simple solutions which right the balance and allow Canadian companies to effectively respond to the threat of empty voting.

Yours truly,

Monique Mercier,
Executive Vice President, Corporate Affairs, Chief Legal Officer & Corporate Secretary
Member of the TELUS team

Encl.

TELUS SUBMISSION IN RESPECT OF EMPTY VOTING AND THE NEED FOR AMENDMENTS TO THE CANADA BUSINESS CORPORATIONS ACT

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A. INTRODUCTION

Empty voting is a relatively recent and troublesome investment phenomenon that threatens shareholder democracy. It arises where an investor in a company acquires the right to vote on matters affecting the company, but has reduced or eliminated its economic interest in the company. This situation conflicts with a fundamental assumption underlying Canada's system of corporate governance, that shareholders are entitled to make certain decisions by virtue of the fact that they have a real, economic interest in the outcome of those decisions. As such, in cases of empty voting, shareholder voting is no longer able to serve its assigned role, resulting in perverse consequences for the affected company and its remaining shareholders.

Empty voting and its negative consequences have been recognized by academics and professionals for several years, with numerous corporate governance symposiums and summits being held to discuss the problem and brainstorm possible solutions.[1] Further, recently international regulators have considered implementing changes and have sought comments from market participants on the topic.[2]

However, confirmation of the actual use and extent of empty voting has recently made its way to Canada, with real, adverse effects. In 2012, TELUS Corporation ("**TELUS**"), a leading national telecommunications company incorporated under the British Columbia *Business Corporations Act*, S.B.C. 2002, c. 57 (the "**BCBCA**") experienced firsthand the incredible costs arising from empty voting. As is described in more detail later in this paper, this occurred when a New York hedge fund, Mason Capital Management LLC ("**Mason**") attempted to exploit an opportunity to game the system to try and profit at the expense of TELUS and its approximately 225,000 shareholders. While TELUS is a BCBCA corporation, many of the challenges that it experienced arise equally in the context of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "**CBCA**"). While TELUS' experience with Mason demonstrated the clear adverse effects of empty voting, unfortunately few steps have been taken to date in Canada to resolve the practice.

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[1] For example, the Canadian Society of Corporate Secretaries Shareholder Democracy Summit (October 2011) and the Shareholder Voting Symposium co-hosted by RBC Dexia Investor Services Limited, the British Columbia Management Corporation and the Canadian Coalition for Good Governance (June 2011).

[2] See the European Securities and Market Authority Call for Evidence on Empty Voting (14 September 2011), ESMA/2011/288 and the U.S. Securities and Exchange Commission Concept Release on the U.S. Proxy System (July 14, 2010), 2010-122

In the course of TELUS' legal battles with Mason, the issue of empty voting came before the British Columbian Courts on a multitude of occasions. While the Court of Appeal recognized the concerns associated with empty voting, it concluded that the Court's hands were tied and that the remedy "must lie in legislative and regulatory change".[3] Similar conclusions have been reached at the various corporate voting symposiums and summits across the country.

However, TELUS is of the view that the shortcomings addressed in the proposed changes to the BCBCA, should similarly be addressed under the CBCA. Uniformity among the various corporate statutes in Canada will eliminate complexities that exist today. Accordingly, TELUS is taking this opportunity to respond to the *Consultation on the Canada Business Corporations Act*, initiated by Industry Canada, to propose certain amendments to the CBCA.

If implemented, the proposed amendments will address several of the damaging tactics that empty voters utilize to improperly further their arbitrage strategies. First, the proposed amendments ensure that shareholders that seek to engage in costly and time-consuming corporate procedures (such as requisitioning a shareholders' meeting or bringing forward a shareholders' proposal) must first hold a genuine interest in the company, for a meaningful period of time. Second, the proposed amendments empower Canadian courts with the statutory authority to intervene, in appropriate cases, to prevent abuses arising from empty voting tactics. Third, the proposed amendments will provide a proactive solution that will discourage the practice of empty voting and thereby prevent harm before it occurs. Finally, the proposed amendments are consistent with the overriding goals of the Canadian securities regulators, who seek to encourage and protect transparency within the system.

Overall, the proposed amendments will constitute a significant improvement to the CBCA, and will ensure that all federally incorporated companies are better equipped to deal with strategies employed by opportunistic investors for their enrichment at the expense of the balance of shareholders. This ensures that Canada remains on the forefront of regulatory change and encourages companies to remain, or become incorporated in Canada.

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[3] *TELUS Corporation v. Mason Capital Management LLC*, 2012 BCCA 403 at para. 81.

B. EMPTY VOTING

1. WHAT IS EMPTY VOTING?

Empty voting is a term originally coined in academic literature to describe a situation where an investor in a corporation is able to separate its economic interest in the shares of the corporation from the voting rights attached to those shares.[4] Often described as "decoupling" economic ownership from voting power,[5] empty voting occurs where an investor maintains the right to vote, but has reduced or eliminated its economic exposure to the stock.[6]

In Canada, the British Columbia Court of Appeal recently simply defined empty voting as the "accumulation of votes by a party that has a very limited financial stake in a company".[7]

2. HOW EMPTY VOTING ARISES

Empty voting may arise through the use of a variety of different mechanisms. Some of these mechanisms are the intentional part of an arbitrage strategy, while in other situations empty voting arises as the unintentional result of another transaction.[8] While all empty voting results in a situation where an investor is left with a vote in a corporation, but lacks any corresponding economic interest, some forms of empty voting are more detrimental than others.

In some cases, empty voting arises merely as an unintentional consequence of inefficiencies in the mechanics of the share transfer and voting systems. For example, empty voting arises when a shareholder sells his or her shares in a company after the record date for a shareholders' meeting, but does not promptly take the necessary steps to transfer the share to the purchaser. This leaves the seller with the shares' voting rights but not with any corresponding economic interest in the company.[9] These timing consequences may also be used to intentionally decouple the voting and economic rights of a share, by way of a practice referred to as "record date capture". Record date

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[4] Carol Hansell *et al., The Quality of the Shareholder Vote in Canada* (Discussion Paper, October 22, 2010) at p. 129.
[5] Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership,* (2006) 79:4 S. Cal. L. Rev. 811 at 825
[6] *Hansell et al, supra* at p. 124.
[7] *BCCA Decision, supra* at para. 73.
[8] *Hansell et al, supra* at p. 124.
[9] *Hansell et al*, *supra* at p. 124

capture occurs where an investor borrows shares immediately prior to a record date and then returns them to the lender immediately following the record date.[10]

The use of financial instruments, such a derivatives and swap transactions, may also give rise to empty voting, as these instruments can be used to reduce or neutralize a shareholders' economic interest in the company, while maintaining the right to vote.[11] Again, empty voting in this context may arise as an unintended (albeit still problematic) consequence of an investor's intention to reduce its economic exposure to the share.

However, empty voting may also arise in a more destructive context. This form of empty voting is sometimes referred to as "negative voting". Negative voting occurs where an investor not only eliminates its economic interest in a company, but actually establishes a negative economic exposure to a corporation's share price, while continuing to retain the right to vote. In this situation, the investor will actually benefit financially when the share price decreases, giving the investor an incentive to vote in a way that is counter to the best interests of the corporation and its other shareholders.[12]

3. THE PROBLEM WITH EMPTY VOTING

In Canada, the right to vote on matters affecting the corporation is a fundamental feature of share ownership. It gives the shareholder a say in selecting the directors and auditors of a company, and the ability to approve or disapprove fundamental changes and transactions.[13]

By its very definition, empty voting conflicts with the fundamental principle of corporate governance that shareholders have the right to vote on important corporate decisions, because they have an economic interest in the company. As explained by one corporate governance expert:

> … corporate voting should be structured so that pure residual claimants have the general ability to control the corporation's decisions since they gain or lose at the margin. The corollary to this position is that those shareholders with encumbered positions should

[10] *Hansell et al*, *supra* at p. 125.
[11] *Hansell et al, supra* at pp. 124-125.
[12] *Hansell et al*, *supra* at p. 124.
[13] Canadian Securities Administrators, Consultation Paper 54-401 - *Review of the Proxy Voting Infrastructure*, (2013), 36 OSCB 8130, August 15, 2013.

> not be entitled to vote, since such shareholders would favour proposals that would not maximize the value of the corporation.[14]

As the source of risk capital for companies, shareholders are afforded a special role in corporate governance, which provides them with voting rights to approve certain matters of fundamental importance to the company. While shareholders are not always homogenous in their interests and may disagree on the merits of different decisions, they are assumed to have a real economic interest in the outcome of the company, and therefore in the decision itself. This gives rise to an entitlement to vote on the decision. The system of corporate governance in Canada accepts that decisions made by holders of a majority of the shares or in certain circumstances, a specified percentage of shares, are valid.

As such, the practice of empty voting contradicts a fundamental assumption that underlies Canada's system of corporate governance, impairing shareholder democracy.[15]

In British Columbia specifically, the Supreme Court recently emphasized the conflict between empty voting and the "traditional hallmarks of the relationship between a company and its shareholders" by citing Professor Henry T.C. Hu, a leading expert on empty voting:

> Ownership of shares customarily conveys economic, voting, and other rights and obligations, including certain disclosure obligations. Law and business practice typically assume that the elements of this package of rights and obligations cannot be readily "decoupled" — that, for instance, voting rights cannot be separated from an economic interest in the corporation. The nearly-universal (in the U.S.) "one share-one vote" corporate ownership and governance model is an example of this assumption. ...
>
> ... If one of the basic goals of all corporations is to increase shareholder wealth (i.e., the share price), we want those who have a stake in shareholder wealth to be in a position to select management and to pressure them to maximize shareholder wealth. There is a close, integral relationship among the core pecuniary objective of corporate management (i.e., shareholder wealth maximization), the concept of "economic ownership" in Hu & Black (i.e., one determined

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[14] Shaun Martin and Frank Partnoy, Encumbered Shares (2005) U. Ill. L. Rev. 775 at 787-804.
[15] *Hansell et al, supra* at pp. 1, 16, 18-19, 157.

> by shareholders' entitlement to returns on shares), and the rationale for shareholders having voting rights.[16]

Likewise, American Courts have recognized the policy problems created by empty voting. In *Crown EMAK Partners, LLC v. Kurz*, the Delaware court stated that the legitimacy of a shareholder vote is based on the "premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization".[17] A concern arises when this premise is not correct. The public policy concerns arising from empty voting were later expanded on by the Delaware court in *TR Investors v. Genger*, where Vice Chancellor Strine stated the following:

> Separating voting control from stock ownership - which can result in "empty voting," where an investor votes stock without having an accompanying economic interest - raises important public policy concerns. For example, the decoupling of shareholder voting rights and economic interest, which is increasingly common and only loosely regulated by the securities laws, is of concern because empty voting can theoretically allow investors with voting power but with an economic interest adverse to the firm to vote in ways that reduce the company's share price.
>
> Our Supreme Court's recent decision *in Crown EMAK Partners, LLC v. Kurz* underscores the importance of those public policy concerns. There, the Supreme Court affirmed this court's decision that third-party vote buying merits judicial review when it disenfranchises shareholders by affecting the outcome of a vote, and confirmed this court's conclusion that the voting arrangement at issue was proper. Its reason for so concluding is important: "[w]e hold that the Court of Chancery correctly concluded that there was no improper vote buying, because the economic interests and the voting interests of the shares remained aligned … In other instances, the temptations for self-dealing that arise when persons with a relatively small economic interest in a corporation has voting control have resulted in serious harm to the corporation and its other investors.[18] [Emphasis Added]

In addition to academics and Courts, even market participants have recognized the problematic nature of empty voting. For example, J.P. Morgan, who acts as a securities

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[16] *TELUS Corporation (Re),* 2012 BCSC 1919 at para. 337.

[17] 992 A. 2d 377 (Sup. Ct. Del., 2010), at p. 28.

[18] *TR Investors v. Genger*, 2010 Del. Ch. LEXIS 153 (July 23, 2010), aff'd in part and rev'd in part, sub nom. *Genger v. TR Investors*, 26 A.3d 180 (Del. 2011) at 70-1.

lender and borrower has stated that it recognizes "the importance of meaningful transparency and would highlight our view that empty voting, as a practice, is inappropriate".[19]

At best, empty voting results in a situation where the investor no longer has any economic exposure to the value of the issuer, misaligning the empty voter's interest from the interests of all shareholders with an actual economic interest in the company. However, in the extreme case of "negative voting", empty voting has even more adverse consequences: the empty voter has a skewed economic incentive to vote to decrease the value of the company.[20] Clearly such a practice is detrimental to both the affected company and its remaining shareholders.

In recent years, shareholder activism has been on a rapid rise. In the five year period of 2008-2012, 101 proxy contests occurred in Canada, representing an increase of 84% over the 55 proxy contests that occurred during the preceding period of 2003-2007.[21] Presently, more American hedge funds are coming to Canada in search for opportunities to engage in strategic gamesmanship through the use of empty voting, and we can expect them to exploit whatever opportunities they find. It is a great cause for concern that such tactics may be utilized by opportunistic investors, to profit at the direct expense of Canadian companies and their shareholders.

C. TWO EXAMPLES OF EMPTY VOTING

It is apparent that the potential exists for opportunistic investors to use empty voting for abuse. To date, there have been several high profile examples of the results of empty voting in the United States. These examples have garnered the attention of the public and organizations that aim to improve the Canadian public capital markets. Two of these examples are described below.

One such example that demonstrates the potential impact of empty voting is the American Court decision of *High River Ltd. P'ship v. Mylan Labs, Inc*, 353 F. Supp. 2d 487 (M.D. Pa. 2005) ("***Mylan Labs***"). In *Mylan Labs*, Mylan Laboratories ("**Mylan**") entered into a plan of merger with King Pharmaceuticals, Inc. ("**King**"). Following the

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[19] Letter from J.P.Morgan to the European Securites and Markets Authority, November 25, 2011 at p. 1 (available online at http://www.esma.europa.eu/consultation/Call-evidence-Empty-voting)

[20] *Hansell*, *supra* at para. 129.

[21] Fasken Martineau, 2013 Canadian Proxy Contest Study (2013).

merger announcement, Mylan's share value dropped sharply. Perry Capital Management ("**Perry**"), a hedge fund with a significant interest in King, ensured that Mylan's shareholders would approve the merger by buying a 9.9% stake in Mylan. Perry fully hedged its position in Mylan by shorting an equal number of Mylan's shares through equity swaps. Perry's share ownership in King put it in a position where it had financial incentive for the merger to complete, at the lowest price to King possible.[22]

Perry's actions in the Mylan transaction were subsequently described as orchestrating "the nightmare of corporate governance - some of those in control of the corporation had financial incentives to drive it into the ground". Ultimately, the Court's involvement in the matter became moot, when Mylan abandoned the transaction due to accounting problems at King. However, the decision remains instructive as to the type of empty voting strategies that could be employed by hedge funds.

A second example of empty voting is in the decision of *Multi-Fineline Electronix, Inc. v. WBL Corp.*[23] In that decision, Multi-Fineline Electronix, Inc. ("**M-Flex**") offered to purchase all of the outstanding shares of MFS Technology Ltd. ("**MFS**"), subject to obtaining majority approval of all of M-Flex's shareholders, as well as a majority of M-Flex's minority shareholders. At the time, WBL Corporation Ltd. ("**WBL**") was the majority owner of both MFS and M-Flex and entered into a lock-up agreement with M-Flex to vote its M-Flex shares in favour of the acquisition. WBL maintained its commitment, even after the special committee set up by M-Flex to consider the transaction reconsidered and withdrew its recommendation in favour of the transaction.

Shortly thereafter, a hedge fund, Stark Investments ("**Stark**") purchased substantial blocks of M-Flex's shares, ultimately obtaining 18.4% of total M-Flex shares or approximately 48% of the minority shares. At the same time, Stark hedged most of its interest in M-Flex, eliminating its economic interest in the company. However, Stark also owned approximately 5% of the shares in MFS and therefore stood to make a significant profit if the proposed acquisition closed at the highest possible price: the more M-Flex overpaid for the MFS shares, the more Stark stood to profit from the transaction. Again, the *Multi-Fineline Electronix* decision demonstrates the abuse that a hedge fund may create, at the expense of legitimate shareholders, in an attempt to personally profit.

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[22] *Hansell et al, supra* at 128.
[23] 2006 WL 4781677 (Del. Ch. October 17, 2006).

Presently, there is very little in corporate statutes preventing this type of abuse from occurring.

D. CONCERNS ARISING IN CANADA

While empty voting has for many years appeared to be an issue of only academic importance in Canada, confined to the arena of risky American investment strategies, this has recently dramatically changed. Indeed, more organizations and regulators have begun to recognize that empty voting is occurring in Canada and the problems that arise from it, and have emphasize the necessity of finding a solution.

One of the earliest, and most influential, of such publications is *The Quality of the Shareholder Vote in Canada*, published by Davies Ward Phillips & Vineberg LLP (the "**Hansell Paper**"). The Hansell Paper accepted that "there is no question that empty voting occurs", and that if it is happening more than rarely it could have a material impact on the results of shareholder votes, bringing the basis of shareholder decision making into question.[24] At the time of the drafting of the Hansell Paper, the authors noted that empty voting was somewhat elusive, making it very difficult to accurately determine the extent of its occurrence and adverse impacts.[25] It indicated that it would be necessary to find ways to become better informed on the incidence of empty voting, and to regulate in a manner to encourage behaviors that minimize the practice of empty voting.[26]

While the Hansell Paper provides an early Canadian discussion on empty voting, it recognized that the problems associated with empty voting had previously been discussed elsewhere in the world. The Hansell Paper names the International Corporate Governance Network ("**ICGN**"), an international network of experts in the area of corporate governance, as a leader in addressing empty voting from an investor perspective.[27] The ICGG's Code of Best Practices for Securities Lending (the "**ICGG Code**") aims to promote good corporate governance worldwide.[28] In discussing empty voting, the ICGG Codes states that:

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[24] *Hansell et al, supra* at p. v.
[25] *Hansell et al, supra* at p. 157.
[26] *Hansell et al, supra* at p. 158.
[27] *Hansell et al, supra* at p. 160.
[28] International Corporate Governance Network, Code of Best Practices for Securities Lending (2007) at p. 2.

> It is bad practice to borrow shares for the purpose of voting. Lenders and their agents, therefore, should make best endeavours to discourage such practice.
>
> Borrowers have every right to sell the shares they have acquired. Equally the subsequent purchaser has every right to exercise the vote. However, the exercise of a vote by a borrower who has, by private contract, only a temporary interest in the shares, can distort the result of general meetings, bring the governance process into disrepute and ultimately undermine confidence in the market.

While the ICGG Code discourages empty voting, it is not binding and is unable to prevent the occurrence of empty voting or its adverse affects. However, it reflects the attitude that empty voting is problematic, and that steps should be taken to prevent its occurrence.

The topic of empty voting again rose in June 2011 when RBC Dexia Investor Services Limited, the British Columbia Investment Management Corporation and the Canadian Coalition for Good Governance ("**CCGG**") co-hosted a Shareholder Voting Symposium. The Summary Report of the symposium (the "**RBC Dexia Report**") states that "Shareholder voting and issues surrounding the Canadian proxy voting system continue to prompt concern and widespread industry debate".[29] One of the key principles recognized by the RBC Dexia Report was that the votes attached to the security of an issuer should be cast by those investors that hold the economic interest associated with those securities.[30] While the RBC Dexia Report concluded that overall shareholder voting in Canada works relatively well, there are areas that need to be improved to ensure the integrity of the shareholder vote.[31]

In October 2011, the Canadian Society of Corporate Secretaries' ("**CSCS**") held a Shareholder Democracy Summit, during which the topic of empty voting arose on many occasions. The Summary Report of the summit (the "**CSCS Summit Report**") states that the practice of share lending can give rise to both empty voting and over voting, and that measures must be implemented to resolve these problems.[32]

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[29] RBC Dexia Investor Services, A Case for Change: Shareholder voting symposium summary report (October 2011) at p. 3.
[30] RBC Dexia Report, *supra* at p. 4.
[31] RBC Dexia Report, *supra* at p. 11.
[32] CSCS Inaugural Report, Shareholder Democracy Summit (October 2011) at p. 18.

Most concerning, the CSCS Summit Report emphasizes how easily legitimate and valid shareholder votes may be disenfranchised as a result of empty and over voting, without the legitimate shareholder even realizing that it is occurring.[33] Empty voting was named as some of the "low hanging fruit" in protecting the integrity of the shareholder vote, due to the fact that it is presently not always the person with the economic interest in the company that is the one able to cast a vote. The possibility of legislative change being necessary to prevent empty voting was discussed.[34]

In recent years the CCGG has also taken an active role in providing comments on concerns with empty voting. For example, on May 23, 2012, it provided comments to the Ontario Securities Commission ("**OSC**"), stating that:

> … empty voting is a serious threat to the integrity of our capital markets. Problems caused by over voting and the complexities of securities lending are also well-known by market participants. We encourage the OSC to take concrete steps in the upcoming year to develop proposals that will address systemic problems in the proxy voting system.[35]

Likewise, on October 19, 2010, the CCGG sent comments to the Securities and Exchange Commission on the topic of empty voting, stating that:

> CCGG agrees that in certain circumstances empty voting could threaten the integrity of the process. <u>We would be particularly concerned about the use of empty voting not accompanied by corresponding equity interests by significant shareholders, executives or other insiders for an improper purpose, especially if the voting and ownership positions are not fully transparent to all market participants</u>.[36]

In March 2013, the Canadian Securities Administrators (the "**CSA**") published for comment proposed amendments to the Canadian early warning regime, which includes National Instrument 62-103 – *Early Warning System and Related Take-Over Bid and Insider Reporting Issues*.[37] The proposed amendments are intended to provide greater

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[33] CSCS Summit Report, *supra* at p. 22.
[34] CSCS Summit Report, *supra* at p. 60.
[35] Letter from CCGG to the Ontario Securities Commission, May 29, 2012 at p. 2 (available online at http://www.ccgg.ca/site/ccgg/assets/pdf/submission_re_draft_2012-2013_stmt_of_priorities_-_signed.pdf)
[36] Letter from the CCGG to the Securities and Exchange Commission, October 19, 2010 at p. 2 (available online at http://www.ccgg.ca/site/ccgg/assets/pdf/Submission_re_Concept_Release_on_the_U_S__Proxy_System.pdf).
[37] CSA Notice and Request for Comment, Proposed Amendments to Multilateral Instrument 62-104 Take-over Bids and Issuer Bids, National Policy 62-203 Take-over Bids and Issuer Bids and National Instrument 62-103 Early Warning System and Related Take-over Bid and Insider Reporting Issues (March 13, 2013).

transparency regarding securities holdings, by reducing reporting thresholds and requiring the disclosure of hidden ownership strategies, such as empty voting, that may significantly undermine the early warning regime.[38] While the CSA is presently considering these amendments, to date they have not been implemented. If implemented, the CSA amendments will address some of the transparency concerns associated with empty voting. However, to address other empty voting concerns an amendment to corporate statutes remains necessary, to give the Court the discretion to deal with empty voting and to place certain limitations on shareholder access to corporate remedies. If implemented, the amendments proposed in this paper will directly complement the amendments being considered by the CSA with respect to National Instrument 62-103.

Most recently, on August 2013, the CSA issued the CSA Consultation Paper 54-401 (the "**CSA Consultation Paper**") seeking input from stakeholders on Canadian proxy voting infrastructure. The CSA Consultation Paper recognizes that shareholder voting is "one of the most important methods by which shareholders can affect governance, communicate preferences and signify confidence or lack of confidence in an issuer's management and oversight", making it "fundamental" to the quality and integrity of Canadian public capital markets.[39] In this regard, it recognizes that there has recently been a lack of confidence in the reliability of the proxy voting infrastructure in Canada.[40]

While the CSA Consultation Paper notes that there are many areas that may give rise to concerns for stakeholders, it seeks feedback from stakeholders predominately on two specific issues related to proxy voting infrastructure: vote reconciliation and vote confirmation systems.[41] While empty voting is not directly captured by this, the CSA Consultation Paper identifies five specific factors, based on feedback that it received, that have contributed to the complexity of proxy voting and its resulting challenges:

> (1) <u>the multiple layers of rights to securities associated with the intermediated system of holding securities</u>;
>
> (2) <u>the practice of securities lending</u>;
>
> (3) the use of voting agents by investors, typically in connection with accounts managed by professional investment advisors; and

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[38] CSA Notice 62-103, *supra*.
[39] CSA Consultation Paper, *supra* at 8131.
[40] CSA Consultation Paper, *supra* at 8132.
[41] CSA Consultation Paper, *supra* at 8133.

> (4) the right of objecting beneficial owners, which make up an increasing number and already more than half of beneficial owner accounts in Canada, not to disclose their identities to issuers and others.[42]

Notably, the first and second of these factors is directly linked to the practice of empty voting. This consultation period may likely result in further discussion on the topic of empty voting in the coming months, but may not be able to address empty voting as the most important empty voting concerns need to be addressed by amendments to corporate statutes.

E. TELUS' EXPERIENCE

While empty voting has been discussed frequently in recent years, as was noted in the Hansell Paper, the exact extent of its occurrence and harm has remained somewhat illusive. However, a recent situation involving TELUS has made the damaging effects of empty voting to Canadian companies and its shareholders much more transparent.

In 2012, TELUS, a major Canadian telecommunications company headquartered in Vancouver directly experienced the detrimental results of an arbitrage strategy utilizing empty voting tactics. This occurrence is precedent-setting, and provides clear evidence that empty voting is happening in Canada. It also reveals that immediate legislative action must be taken to provide Canadian companies, as well as the courts, with the tools to defend against such tactics.

1. The Facts

TELUS' experience with empty voting arbitrages arises from what was intended to be a simple proposal, designed to ensure that the company remained aligned with corporate best practices. Due to the involvement of Mason, it turned into a year-long battle involving endless company resources and over fifteen Court appearances. While TELUS was ultimately successful in implementing its proposal, Mason's interference along the way came at great expense to TELUS and its other shareholders.

TELUS' proposal stems from the fact that it has historically been required to maintain a dual-class share structure, comprised of a class of Common Shares (with voting rights)

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[42] CSA Consultation Paper, *supra* at 8134.

and a class of Non-Voting Shares (as the name suggests, without voting rights). The necessity for this structure was occasioned by certain foreign ownership requirements mandated by the *Telecommunications Act*, which state that at least 66 2/3 percent of TELUS' voting shares be owned by Canadians. While the dual-class share structure was historically necessary to ensure compliance due to the presence of a major American shareholder, it is not consistent with generally accepted corporate governance best practices, which recognize the benefits of having a single class of equity shares (one share/one vote).

Accordingly, when foreign-ownership levels in TELUS declined following the departure of a major American shareholder, TELUS decided to move towards a single share class. In February 2012, TELUS announced that it would seek shareholder approval of a proposal to eliminate its dual class share structure (the "**Initial Proposal**"). The Initial Proposal involved the conversion of Non-Voting Shares into Common Shares, with the end result that TELUS would be left with only one class of Common Shares.

This reasonably straightforward exercise turned into a very complicated, lengthy and expensive process because of New York hedge fund Mason's decision to profit through the use of an arbitrage strategy.

Prior to TELUS' February 2012 announcement of the Initial Proposal, Mason held no shares in TELUS. Immediately following the announcement, Mason executed its arbitrage strategy by acquiring almost 20% of TELUS' Common Shares, while simultaneously shorting a roughly equivalent number of TELUS Non-Voting Shares. Although a hedging strategy may be implemented in a number of ways, Mason likely used proceeds from the sale of the borrowed TELUS shares to help offset the cost of acquiring the TELUS voting shares. The early warning reports filed by Mason as of March 31, 2012, August 31, 2012 and December 31, 2012[43] all identified the nominal net economic interest that Mason held in TELUS. As at August 31, 2012, that position consisted of 32,765,829 owned common shares and 32,694,929 borrowed shares, representing net holdings of 70,900 TELUS shares or a mere 0.021% of TELUS' issued and outstanding shares.

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[43] National Instrument 62-103 *Early Warning System and Related Take-Over Bid and Insider Reporting Issues* requires investors to disclose when their holdings of securities exceed prescribed thresholds. Certain institutional investors that have a "passive intent" with respect to their securities of reporting issuers follow a more relaxed regime in terms of timing and scope of disclosure. Mason took advantage of that regime in respect of its filings in March, August and December.

Mason's arbitrage was premised on exploiting the price differential that existed between the trading prices of Common Shares and Non-Voting Shares. Historically, TELUS' Non-Voting Shares had traded at a lower price than the Common Shares. At the time of the announcement of the Initial Proposal, the market responded and the historic spread between the two types of shares decreased. Mason's hedged position put it in a position where it would not profit or lose as a result of price fluctuations in TELUS' shares, but rather its financial success or failure was linked to the amount of the price spread: Mason stood to profit significantly if the price spread increased back to its historical levels. As a result, Mason's interests were no longer aligned with other TELUS shareholders. Mason sought to achieve a profit by utilizing it's almost 20% voting position in TELUS to defeat the proposal.

Given Mason's substantial voting position, TELUS was required to withdraw the Initial Proposal shortly before it was to be considered by shareholders. Recognizing the real benefits of a single share class, as well as the immense support of its shareholders (excluding Mason), TELUS remained committed to achieving a single share class.

Despite TELUS' withdrawal of the Initial Proposal, its continued support for a single share class prevented the spread between share prices of the two classes from returning to its historic levels, and Mason could not profitably exit its position in TELUS. Instead, Mason found other mechanisms to utilize its large (empty) position in TELUS to attempt to defeat any future proposals for a single share class.

On August 2, 2012, Canada's national security depository CDS & CO ("**CDS**") purported to requisition a general meeting of TELUS' shareholders, to consider resolutions that, if passed, would prevent TELUS from creating a single share class (the "**Mason Resolutions**"). At the time, Mason did not hold a single registered share in TELUS, and instead held all of its shares through CDS. While CDS itself took no position on the merits of the CDS Requisition and it did not identify the beneficial owner of the shares used to requisition the meeting, Mason publicly took credit for the requisition. When TELUS rejected this requisition, Mason had CDS call a meeting of TELUS' 225,000 shareholders on Mason's behalf. When TELUS successfully applied to the court to have CDS's requisition and meeting found invalid, Mason appealed and was allowed to put the Mason Resolutions to the shareholders. When TELUS made a new proposal to exchange the Non-Voting Shares into Common Shares in August 2012 (the "**Second Proposal**"), Mason applied to the Court to have TELUS' meeting postponed.

Ultimately, after many intervening court proceedings, the Second Proposal and the Mason Resolutions were each considered at special meetings of TELUS' shareholders, held on October 17, 2012. Despite Mason's barrage of strategic tactics, TELUS' Second Proposal received the overwhelming approval of more than 99.5% of the Non-Voting Shares voted at the meeting and 84.4% of the Common Shares voted at the meeting (excluding Mason). Mason's proposals were defeated.

On December 18, 2012, the Second Proposal also received the approval of the British Columbia Supreme Court, with the Court concluding that:" [t]he Arrangement has arisen through a robust process that has been independently and favourably reviewed. The benefits to be achieved by the Arrangement are real and substantial" and "... are benefits that will materially affect TELUS' ability to compete with other entities in the market place".[44]

Notwithstanding these findings, Mason appealed the decision, using judicial proceedings to thwart the will of the overwhelming majority of TELUS' long term shareholders. Ultimately, in February 2013, the appeal was abandoned and the Second Proposal implemented. More than a year after the first announcement of the Initial Proposal, TELUS had its single class of Common Shares.

2. THE COURT'S COMMENTS ON EMPTY VOTING

Prior to 2012, the issue of empty voting had never been directly considered by a Canadian court. However, through the course of Mason's attempts to defeat TELUS' proposals, the Canadian courts have on numerous occasions commented on Mason's empty voting techniques. The comments made reflect the real concerns caused by empty voting, as well as the fact that the Courts believe that it will be the legislatures and regulators that must ultimately resolve the problem.

In one such decision, Mr. Justice Savage of the Supreme Court of British Columbia noted the following concerns arising from empty voting at paragraphs 104 and 105:

> The practice of empty voting presents a challenge to shareholder democracy. Shareholder democracy rests on the premise that shareholders have a common interest: a desire to enhance the value of their investment. Even when shareholders have different

[44] *Fitzpatrick Decision, supra* at para. 435.

> investment objectives, the shareholder vote is intended to reflect the best interests of the company in the pursuit of wealth maximization.
>
> When a party has a vote in a company but no economic interest in that company, that party's interests may not lie in the wellbeing of the company itself. The interests of such an empty voter and the other shareholders are no longer aligned and the premise underlying the shareholder vote is subverted.[45]

Likewise, Mr. Justice Groberman of the Court of Appeal stated the following at paragraph 81 of his decision:

> The fact that Mason has hedged its position to the extent that it has is cause for concern. There is, at the very least, a strong concern that its interests are not aligned with the economic well-being of the company. That said, there is no indication that it is violating any laws, nor is there any statutory provision that would allow the court to intervene on broad equitable grounds. To the extent that cases of "empty voting" are subverting the goals of shareholder democracy, the remedy must lie in legislative and regulatory change.[46] [Emphasis Added]

These comments were later cited by Madam Justice Fitzpatrick of the Supreme Court of British Columbia. She indicated that "at best, one could describe Mason as an "opportunistic investor".[47] In concluding that the Second Proposal was fair and reasonable and should be approved, Madam Justice Fitzpatrick stated the following at paragraphs 436 to 438:

> All evidence on this application points to the conclusion that the Arrangement which has been proposed to the Non-Voting Shareholders is fair and reasonable. TELUS has additionally proposed, quite reasonably, that the interests of the Common Shareholders should also be considered. I agree that the level of support required by the Common Shareholder vote (i.e. a simple majority) was reasonably set. While the legal rights of the Common Shareholders are not affected, arguably their economic interests are. Nevertheless and importantly, the shareholders, including the Common Shareholders who have a real economic interest in TELUS, overwhelmingly support the Arrangement.

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[45] *TELUS Corporation v. CDS Clearing and Depository Services Inc.*, 2012 BCSC 1350 (overturned by *BCCA Decision, supra*, but cited with respect to its comments on empty voting in *Fitzpatrick Decision*, supra)
[46] *BCCA Decision, supra* at para. 81.
[47] *Fitzpatrick Decision, supra* at para. 328

> Finally, Mason's opposition must be viewed through the lens of its unique strategy, which has nothing to do with the well-being of TELUS and its shareholders. I do not make this comment in the sense of disregarding Mason's vote, but in the sense of understanding its vote. Mason stands alone and its submissions are clearly directed at the benefits it alone will achieve by defeating the Arrangement.
>
> I conclude that the terms of the Arrangement are fair and reasonable. [Emphasis Added]

While TELUS' arrangement was ultimately successful, it was only after a year of expense and complications. Mason's strategy consumed resources that TELUS would have preferred to see deployed in dealing with more constructive challenges, which would have ensured that TELUS remains a leading contributor to the economy in British Columbia and Canada.

TELUS is greatly troubled that an opportunistic hedge fund was able to thwart the wishes of shareholders with a real economic interest in TELUS that consistently supported the proposal to move towards a capital structure with a single class of outstanding equity shares. Mason was able to move rapidly into TELUS' stock, utilizing a trading strategy that involves having no material economic interest in TELUS, and to deploy a strategy designed to profit at the expense of TELUS' other shareholders.

The process that TELUS endured through 2012 has made it abundantly clear that there is a need for specific amendments to the BCBCA and other Canadian corporate statutes, including the CBCA. These amendments would ensure that Canadian companies are held accountable by shareholders with a real economic interest in the company, and are not subject to damaging strategies deployed by opportunistic investors, with little economic interest, whose agenda is at odds with the long term well-being of the company and its shareholders.

F. THE PROPOSED AMENDMENTS

While empty voting is a complex problem that gives rise to a number of concerns, the recent discussions on the topic and TELUS' experience with Mason has revealed at least two phenomena that give rise to a need for immediate legislative action. Specifically, as presently enacted the CBCA allows shareholders with no true interest in a company to access certain statutory rights that should be reserved for shareholders that have held an actual beneficial interest in the company for a meaningful period of

time. Further, the current wording of the CBCA enables opportunistic investors to engage these major corporate steps, while concealing their true identity and interest in the company from the Board of Directors and the company's other shareholders.

Second, while the Courts have recognized the policy concerns associated with empty voting, the CBCA presently does not provide them with any discretion to resolve the problem. In British Columbia, the Court has held that it does not have any authority to address votes made by shareholders with no economic interest in the company, even where circumstances dictate that this would be an appropriate response.[48] Much like the BCBCA, the CBCA also does not expressly grant the Courts with this authority, giving rise to the same concern that they may not adequately respond to the problem of empty voting.

As a result, as presently enacted several provisions in the CBCA do not provide adequate protection for companies incorporated in Canada or their shareholders, from the unscrupulous tactics of arbitragers. To remedy this problem, the following amendments are suggested.

1. Access to the Right to take "Shareholder Action"

There are several provisions in the CBCA that provide shareholders with the right to access statutory rights and remedies, where the shareholders meet certain qualifying criteria. Specifically, section 137 allows certain qualified shareholders to put forward a shareholder proposal at a meeting, while section 143 allows certain qualified shareholders to requisition a shareholders' meeting for the consideration of specific business. The term "**Shareholder Action**" will be used to collectively refer to both a shareholder proposal and a shareholder requisition in this paper.

The policy reasons for the existence of sections 137 and 143 are clear: a shareholder with a sufficiently material interest in the company should have an opportunity to put a matter of proposed business to the shareholders for a vote, either at an annual general meeting of the company, or a specially requisitioned meeting. However, the qualifications that restrict the shareholders entitled to take Shareholder Action stem from the fact that taking these corporate steps is a material and expensive undertaking that involves the company as a whole, including all of its shareholders. The qualifying criteria demonstrate that utilizing these corporate steps is not to be taken lightly, and

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[48] *BCCA Decision, supra* at para. 81.

instead should be reserved only for those shareholders with a sufficiently material interest in the company to justify the undertaking.

While the intentions of sections 137 and 143 are clear, as presently enacted their express wording leaves open two loopholes that allow short term, opportunistic investors to improperly utilize Shareholder Action at the expense of the remainder of the shareholders. These problems arise from the fact that the sections allow a *registered shareholder* to take Shareholder Action, without requiring the shareholder to have a *beneficial interest* in the company. Second, with respect to section 143 (shareholder requisitions) specifically, the wording allows a shareholder to requisition a meeting without requiring the shareholder to have held an interest in the company for a meaningful period of time. As such, an arbitrager is able to move quickly into a company and immediately requisition a meeting, demanding the time and resources of the company and all other shareholders.

Shareholder Proposals Generally

Under section 137 of the CBCA, certain eligible shareholders may put forward a proposal to be considered at the annual general meeting of the company. Upon receipt of a valid proposal, the company has an obligation to send the proposal to all persons entitled to notice of the annual general meeting (s. 137(2)).

When it is aimed at benefiting only one shareholder, a shareholder proposal comes at a cost to all other shareholders in a corporation. In the case of large corporations, the receipt of a shareholder proposal requires the company to utilize its time and money to assess and send the proposal and any related information to all persons entitled to notice of the annual general meeting. For the shareholders, receipt of a proposal means additional documentation to receive and consider and when the proposal is aimed at achieving an improper purpose, it may also cause confusion amongst shareholders.

Given the significant impacts associated with a shareholder proposal, the CBCA sets out certain limitations to ensure that use of shareholder proposals is not abused. Presently, section 137(1) provides that a “registered or beneficial holder of shares that are entitled to vote at an annual general meeting of shareholders” may make a shareholder proposal. Further, section 137(1.1) provides the following additional criteria for a person to be eligible to submit a valid proposal:

> (a) must be, for at least the prescribed period, the registered holder or the beneficial owner of at least the prescribed number of outstanding shares of the corporation; or
>
> (b) must have the support of persons who, in the aggregate, and including or not including the person that submits the proposal, have been, for at least the prescribed period, the registered holders, or the beneficial owners of, at least the prescribed number of outstanding shares of the corporation.

Accordingly, a shareholders proposal may be made by either a registered owner or beneficial owner of shares in the company, provided that the shareholder has been a registered or beneficial owner for at least the prescribed period. Section 46(b) of the *Canada Business Corporations Regulations*, 2001, SOR/2001-512 (the "**CBCA Regulation**") provides that the applicable prescribed period is "the six-month period immediately before the day on which the shareholder submits the proposal".

Further, section 137(1.1) of the CBCA and 46(a) of the CBCA Regulation provides a minimum threshold of share ownership that must be met by the shareholder(s) in order for a proposal to be valid: in aggregate, the shareholder(s) who make the proposal must be the owner of at least 1/100 (or 1%) of the issued shares in the company, or hold shares with a fair market value of at least $2,000. We propose removal of the $2,000 threshold given that for most companies this represents a very small percentage of shares.

Shareholder Requisitions Generally

Much like shareholder proposals, under section 143 of the CBCA, shareholders meeting certain qualifications may requisition a general meeting of a company for the purpose of transacting any business that may be transacted at a general meeting. If a requisition is delivered to the company and found to be valid, the directors of the company must call a general meeting of shareholders, unless a certain exception is met. Where the directors do not do this, section 143(4) of the CBCA allows any of the shareholders who signed the requisition to call the meeting themselves.

As with shareholder proposals, not all shareholders are qualified to requisition a meeting, and section 143(1) of the CBCA provides that a shareholder(s) must have certain minimum holdings in the company in order to be qualified to requisition a meeting:

> (1) The holders of not less than five per cent of the issued shares of a corporation that carry the right to vote at a meeting sought to be held may requisition the directors to call a meeting of shareholders for the purposes stated in the requisition.

Accordingly, section 143 provides that a shareholder(s) may requisition a meeting if it holds at least 5% of the issued voting shares of a company. Subsection 143(2) also states that the requisition must be signed by the requisitioning shareholder(s).

With respect to what type of shareholder may requisition a meeting, the phrase "holders… of the issued shares" is used. This may be contrasted with shareholder proposals where "the registered holder or the beneficial owner" of shares are described as being qualified. This present language in section 143 suggests that a registered holder is entitled to requisition a meeting even if they are not also a beneficial owner of the shares.

This issue was considered in British Columbia, where the language of the BCBCA is different from the CBCA. In the BCBCA, the term "shareholder" is used to indicate who may requisition a meeting, which is defined by section 1(1) of the BCBCA as being "a person whose name is entered in a securities register... as a registered owner". The British Columbia Court of Appeal considered this definition in the context of the shareholder requisition sent to TELUS by CDS and held that its plain language allowed a registered shareholder to requisition a meeting on behalf of a beneficial shareholder.[49] A similar analysis has not yet occurred with respect to the CBCA language, but given its plain language and the language of section 137, it is likely that section 143 allows a mere registered shareholder to requisition a meeting.

REGISTERED VERSUS BENEFICIAL SHAREHOLDERS

Accordingly, each of sections 137 and 143 of the CBCA likely allow a mere registered shareholder to take Shareholder Action, without requiring the shareholder to have a beneficial interest in the company. In addition, worded as such, the sections do not require a registered shareholder taking Shareholder Action to reveal the true identity of the beneficial shareholder behind the action.

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[49] *BCCA Decision, supra* at para. 50.

Historically, allowing registered shareholders to take corporate steps without regard for the beneficial owner of the shares would have been less problematic than it is presently. Traditionally, corporations maintained their own share registers and most shareholders held share certificates that were fully registered in their names. When a share was to be traded, the endorsed share certificates would be physically delivered in exchange for payment.

However, this system became impractical with the advent of publicly-traded shares, which requires the expeditious transfer of shares between owners. The antiquated system of delivering share certificates gave way for new computerized trading systems, in which a central depository acts as the registered holder of share certificates. These certificates are held by the depository on deposit for the accounts of its “participants”, which are typically brokerage firms. When a share is transferred between brokerage firms, this transfer is recorded in the electronic system of the depository. As such, the physical share certificates no longer need to be physically moved.

In Canada, the main depository is the Canadian Depository for Securities Inc. (as defined previously, “CDS”). As a result, CDS is the largest registered holder of most Canadian public companies,[50] and it typically appears as the largest shareholder of widely-held Canadian companies. CDS is the registered owner of the shares, while the individual or company who actually purchased the shares is the beneficial owner.

While the use of CDS is important to ensuring trading efficiency and to reduce overall systemic risk, it also gives rise to critical policy issues, by allowing the divorce of the beneficial and registered owners.[51] It has become apparent that certain investors, such as hedge funds have utilized this holding structure to further their arbitrage tactics. For example, where an investor has deposited its shares with CDS, it may ask CDS to invoke its rights as a registered shareholder of a company. This allows CDS to act in its capacity as a sizeable registered holder of shares to take Shareholder Action, on behalf of the beneficial owner. By utilizing this process, the investor (beneficial owner) escapes satisfying many of the qualifying requirements to take Shareholder Action. Further, the investor is not required to reveal its identity or share position to the company or the other shareholders that it is directly affecting.

[50] CSA Consultation Paper, *supra* at 8135.
[51] CSA Consultation Paper, *supra* at 8138.

By preventing mere registered owners from taking Shareholder Action, beneficial owners will be required to satisfy the qualifying requirements for taking Shareholder Action, introducing the following important safeguards:

(a) the company, the board of directors and the shareholders are able to properly understand who in fact is behind the Shareholder Action;

(b) the person behind the Shareholder Action is required to take responsibility for its proposal or requisition; and

(c) the ability to take Shareholder Action will be confined to those beneficial owners whose interest in the shares entitles them to acquire a registered position (for example, a person who has borrowed shares may not, under the terms of the loan agreement, have the right to register its position. The right to borrow the shares may or may not include the right to vote the borrowed shares).

These safeguards are critical to enable a company and its shareholders to properly respond to a proposal or requisition and are completely eliminated when CDS acts on behalf of the beneficial shareholder.

For example, under sections 137(5)(b) the directors of a company are not required to respond to a shareholder proposal if it clearly appears that the primary purpose is to pursue a personal grievance. A similar exception exists with respect to shareholder requisitions under section 143(2)(c). If CDS, as a registered shareholder is permitted to take Shareholder Action on behalf of an undisclosed beneficial owner, neither the company nor the board of directors are able to make an assessment as to whether a personal grievance exits, as the person behind the grievance will remain anonymous.

Further problems arise where a beneficial owner is not required to reveal their identity, in the context of a shareholder requisition. A requisitioning shareholder must, for example, send a circular setting out information for shareholders in prescribed form. To the extent that CDS has no interest in or knowledge of the matter, we can expect that the circular will be ghost written by the beneficial owner. How then can CDS properly approve the contents of the circular? Will CDS be liable for any misrepresentations? What responsibility will the beneficial owner have for the information that is disclosed? These questions each give rise to serious corporate governance concerns. Further, these concerns are amplified by the fact that CDS, as only a registered shareholder and not a beneficial shareholder, has no interest in the merits of the Shareholder Action itself. In the TELUS and Mason battle, CDS made it very clear that it took no position

on the merits of the CDS Requisition and it disclaimed all liability and responsibility for the matter. Instead, it described itself as only a "nominal party" in the situation.[52] Accordingly, CDS acted merely to preserve its role as Canada's national security depository and clearing house.

Finally, transparency into the identity of the shareholder taking Shareholder Action is also necessary to assess if the beneficial shareholder in fact has the necessary qualifications under the statute. Clearly, in most companies CDS will be the registered owner of more than the threshold number of shares required to take Shareholder Action. Without knowing the identity of the beneficial shareholder it is impossible to determine if they actually have the required 1% (for proposals) or 5% (for requisitions) interests. Finally, the present wording nullifies the rationale underlying the minimum period of ownership required for proposals, as it is only CDS, the registered shareholder, that must have held the shares for a period of at least six months. It is presently impossible to assess if the beneficial shareholder satisfied the minimum holding period before the date of the signing of the proposal.

All of the shortcomings identified above could be used to argue that, under the present language of the CBCA, CDS may not take Shareholder Action without fully identifying the beneficial owner. However, this argument was dismissed by the British Columbia Court of Appeal which held that the requisition made by CDS on behalf of a beneficial owner was a technically compliant requisition under the BCBCA. It concluded that it did not have jurisdiction to prevent a beneficial shareholder from using its intermediary to requisition a shareholder meeting on its behalf, even where that beneficial shareholder may have a limited interest in the well-being of the company or the value of the shares.[53] It is likely that a similar analysis would apply to the CBCA.

Holding Period

The second shortcoming with the presently enacted section 143 is that it allows a shareholder to requisition a meeting without having held shares in the company for any minimum period. This is in direct contrast to section 137(1.1)(a), in which a shareholder qualified to make a proposal must have been the holder "for at least the prescribed period", which is defined by section 46(b) of the CBCA Regulation as the six-month period immediately before the day on which the shareholder submits the proposal".

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[52] *Savage Decision, supra* at para. 28.

[53] *BCCA Decision, supra* at para. 50.

As has already been described, the provisions for Shareholder Action have many similarities. In both cases, if a shareholder is going to invoke procedures that are costly and time-consuming, then the shareholder should hold a genuine interest in the company for a meaningful period of time. The current regime is anomalous in that it requires a six month holding period for a shareholder to bring forward a shareholder proposal, but no analogous period in order to requisition a shareholder meeting. If anything, requisitioning a meeting should require a longer holding period than a shareholder proposal, as it requires the calling of an entire additional meeting, rather than the consideration of additional proposals at an annual general meeting.

By not requiring a minimum holding period, section 143 allows an arbitrager with no historic connection to a company that has moved quickly into the shares of the company, to immediately call a shareholders' meeting.

The Solutions

While the present language in sections 137 and 143 provide certain restrictions on when a shareholder is qualified to take Shareholder Action, as set out above, these requirements do not sufficiently protect against abuses by opportunistic investors.

With respect to shareholder proposals under section 137 of the CBCA, the description of persons eligible to make proposals in section 137(1.1) should be amended to further restrict the qualifications that a shareholder must have in order to submit a shareholder proposal. This could be accomplished by deleting the words "the registered holder or" in clauses (a) and (b), leaving section 137(1.1) to read as follows:

> (a) must be, for at least the prescribed period, the beneficial owner of at least the prescribed number of outstanding shares of the corporation; or
>
> (b) must have the support of persons who, in the aggregate, and including or not including the person that submits the proposal, have been, for at least the prescribed period, the beneficial owners of, at least the prescribed number of outstanding shares of the corporation.

With respect to shareholder requisitions, section 143 of the BCBCA should also be amended to make it consistent with section 137 (in its proposed form above). This would involve clarifying that the requisitioning shareholder must be the beneficial owner of the shares and must have held the shares for a meaningful period of time. This may be accomplished by replacing the language "holders" with "beneficial owners" and

inserting the language "and who have held those shares as beneficial owner for at least the prescribed period", which would result in section 143(1) reading as follows:

> (1) The beneficial owners of not less than five per cent of the issued shares of a corporation that carry the right to vote at a meeting sought to be held and who have held those shares as beneficial owner for at least the prescribed period may requisition the directors to call a meeting of shareholders for the purposes stated in the requisition.

As a result of these amendments, a shareholder seeking to take Shareholder Action would be required to hold the required number of shares as a beneficial owner, for a continuous period of at least six months. This change promotes transparency into the party behind the Shareholder Action, as the party taking the corporate step will no longer be able to keep its identity hidden behind the registered shareholder, CDS. Further, the proposed wording ensures consistency between the required holding periods for shares in sections 137 and 143, and also ensures that it is the beneficial owner that is required to satisfy the minimum periods of ownership.

2. LIMITED FINANCIAL STAKE

The second phenomena that gives rise to a need for immediate legislative action is the fact that the CBCA does not provide the Courts with any authority to address votes made by shareholders with no economic interest in the company, even where circumstances dictate that this should be done.

As was described above, British Columbia Courts have acknowledged the concerns raised by empty voting tactics. The British Columbia Court of Appeal has called an empty voting position "a cause for concern",[54] but concluded that it had no inherent jurisdiction to control abuses of this kind and that it was "entitled to intervene only when they have specific authority to do so under statutory provisions".[55] Essentially, its hands are tied to prevent the abuse.

Presently, like the BCBCA, the CBCA does not contain a provision that would allow Canadian Courts to have any regard for the net economic position of an investor in a company. Specifically, the Court of Appeal observed that it could not have regard to

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[54] *BCCA Decision, supra* at para. 72.
[55] *BCCA Decision, supra* at para. 74.

whether shareholdings represent a "material interest in the company".[56] Ultimately, the Court of Appeal declined to intervene in the matter, even though it noted legitimate policy concerns with respect to empty voting, citing a lack of statutory authority. It concluded that "[t]o the extent that cases of 'empty voting' are subverting the goals of shareholder democracy, the remedy must lie in legislative and regulatory change.[57]

As a result, public companies and Courts in Canada are powerless to prevent empty voting, without legislative intervention.

To resolve this problem, section 144 of the CBCA should be amended so that a Court is given the power to issue an order disqualifying some or all of a holder's shares from being voted at a meeting, if the holder of those shares does not have an economic interest in the company that is commensurate with its voting position. This provides Courts with *discretionary,* yet substantive control over the issue which could be realized by adding two new subsections that reads as follows:

> 144 (1.1) A court, on its own motion or on the application of a director, a shareholder who is entitled to vote at a meeting of shareholders or the Director may order that some or all of a shareholder's shares shall not be voted with respect to those matters specified in the order.
>
> (1.2) The court may make an order under subsection (1.1) if the court determines that it is equitable to do so, including in the event that the court concludes that the beneficial owner of the shares does not have an economic interest in the company that is commensurate with the number of shares beneficially owned, or for any other reason the court considers appropriate.

These amendments will follow section 144(1) of the CBCA, which grants the Court the ability to call a shareholder meeting and make orders with respect to its conduct. Making this amendment will allow the Court to consider all the circumstances of a particular instance of empty voting, and where equitable, allow the Court to take action to prevent abuses caused by empty voting. Further, it is worth emphasizing that by giving the Court this discretionary power the mere possibility of a ban is likely to act as a sufficient deterrent for investors that have adopted the most damaging forms of empty voting. Given the adverse impacts of empty voting for shareholders, companies and

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[56] *BCCA Decision*, *supra* at para. 77.
[57] *BCCA Decision*, *supra* at para. 81.

corporate governance in principle, it is clear that initiatives that prevent its use rather than merely remedy its consequences should be pursued.

G. CONCLUSIONS

TELUS' experience with empty voting is an excellent illustration of the negative consequences of the practice and the Courts' willingness, but inability to effectively deal with the problem. Overall, by making this limited set of amendments, the government would make significant improvements to the CBCA and close loopholes that can be used to the detriment of Canadian companies and their shareholders. The amendments will ensure that all federally incorporated companies will be better equipped to deal with empty voting and provide Courts the tools they need to protect the integrity of the shareholder vote.

Presently, other provincial business corporation statutes in Canada contain similar deficiencies as identified with the CBCA. By implementing the changes proposed in this paper, Canada will be seen as a frontrunner in taking the legislative initiative to combat empty voting. Clearly, these proposed amendments will result in benefits for Canada, CBCA companies and their shareholders.