BANKING ON CORPORATE

BY NEILL MAY

An empty voting feeling

William Shakespeare said that an empty vessel makes the loudest sound. Perhaps as yet more convincing evidence of my own empty vessel, I tend to interpret Shakespeare's quotes literally, because with my limitations (and legal training) I have no choice. Yet in the case of recent excitements in the corporate law world, the literal interpretation of that famous quote has turned out to be prophetic.

Specifically, there has been much ado recently, and increasing calls for regulators to do something, about "empty voting." Empty voting refers generally to the exercise of securities' voting rights that have been separated from the economic interests of the securities. This can occur for many reasons, ranging from the commonly benign (such as where a transfer of voting securities occurs after the record date for a securityholder meeting, leaving the vendor with the voting rights unless arrangements are made for the purchaser to direct the votes) to the more strategic (such as the use of derivative instruments and customized arrangements to decouple voting and economic rights).

The potential harm resulting from this separation cited by those rallying for action is readily apparent. If those parties exercising voting power at securityholder meetings do not share the economic interests of the issuer's other securityholders, they may exercise their power for strategic reasons without regard for, and even contrary to, the interests of the issuer. Selfish motives are obviously at the heart of any market, but something about sophisticated exploitation of voting rights to the detriment of a company and its shareholder base offends people (and even some lawyers).

Examples of shareholders voting in their own interests, not necessarily consistent with the best interests of the issuer and its other stakeholders, abound. The recent high-profile experience of Telus, which enjoys the public relations advantage of implicating the favourite villain of contemporary corporate drama, a hedge fund, is telling.

In early 2012, Telus announced a plan, subject to shareholder approval, to eliminate its dual-class share structure by converting the non-voting shares into voting shares on a one-for-one basis. Not surprisingly the announcement caused the gap between the trading prices for Telus' voting shares and non-voting shares to narrow. A hedge fund investor, Mason Capital Management LLC, accumulated a large block of voting shares and sold short a large block of non-voting shares. The net effect of Mason's trades was that though it had a small economic interest in Telus, and was hedged so that it was indifferent as to whether the Telus share price went up or down, it controlled a significant portion of the common share voting power. Moreover, Mason stood to profit handsomely if the gap between the trading prices between the classes widened (most obviously if Telus' plan to convert at parity were to fail). Telus ended up withdrawing its initial proposal, but has since called another shareholder meeting to consider a proposal for a one-for-one conversion. In response, Mason requisitioned a shareholder meeting to impose certain restrictions on any such conversion, and when Telus didn't act on the requisition, Mason went to court. The B.C. Supreme Court denied Mason's applications on other grounds, but in its reasons referred to empty voting as a challenge to shareholder democracy (in the court's view, it violates the premise that shareholders have a common interest to enhance the value of their investments).

It is hard to tell how much empty voting is actually occurring. This inability to measure the phenomenon was noted by the European Securities and Markets Authority in its recently issued "Feedback Statement" reflecting its views on empty voting based on a canvass of market participants. Anecdotal evidence does suggest that empty voting is growing, but we are left with the question as to whether a regulatory response is appropriate.

There are obvious practical challenges to regulation. One clear challenge would be defining empty voting and distinguishing benign and inoffensive instances from those thought to pose concern. Enforcement would be a greater challenge; because empty voting arrangements are implemented privately, not through a transparent market, monitoring would pose clear challenges.

The more interesting question, however, is whether this activity should be restricted in some way at all. Embarking on regulation of the exercise of voting rights may be treading on the proverbial slippery slope. More fundamentally, there is the principle in our corporate law that shareholders do not have fiduciary duties, either to the company that they own or to the other shareholders, and can exercise their shareholder rights as they see fit without limitation. That principle would seem to extend not only to the exercise of voting rights, but to their separation from the economics. These are the challenges, recognizing the frustration of issuers that are subject to votes where motivating influences are not consistent with or even contrary to the best interests of the issuer.

As empty experiences go, this empty voting debate is actually pretty engaging, and challenging. That Shakespeare guy knew what he was talking about. Maybe the answer of whether and how to address the matter is buried in one of his plays, or sonnets. I will have to pay closer attention. CL

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