EMPTY VOTING AND HIDDEN OWNERSHIP IN CANADIAN JURISPRUDENCE

Maziar Peihani[1]

The classic understanding of equity encompasses a suite of economic and governance rights, which typically includes the rights to vote, receive dividends, and participate in the distribution of assets upon dissolution. This conventional view, outlined in corporate legislations, is supported by Canadian jurisprudence and corporate law scholarship. However, financial innovations have facilitated the separation of voting rights from the financial entitlements of shares, creating a marketplace where shareholder interests are reconfigured and traded in diverse ways. Derivatives and securities lending arrangements have led to phenomena known as empty voting and hidden ownership. In empty voting, an investor retains voting rights without an economic stake in the shares, challenging the assumption that shareholders' interests align with the company's welfare. Hidden ownership involves using derivatives to gain an economic interest in shares without beneficial ownership, potentially circumventing disclosure requirements and neutralizing the target company's defences. Addressing the concerns of empty voting and hidden ownership, various jurisdictions have proactively amended their regulatory frameworks to include derivatives within their early warning disclosure requirements. In contrast, Canada's stance on this issue remains unchanged, as its early warning disclosure regime has not been formally adapted to encompass such derivatives. Thus, to grasp the Canadian approach to mitigating empty voting and hidden ownership, one must delve into the judicial and regulatory landscapes. This exploration forms the crux of this article, aiming to contribute to the scholarly discourse by analyzing how Canadian courts and securities commissions navigate the complexities surrounding the decoupling of economic interest and voting power.

Selon la compréhension traditionnelle qu'on a des actions, celles-ci comprennent une série de droits économiques et de droits de gouvernance, soit habituellement les droits de voter, de recevoir des dividendes et de participer à la distribution des biens à la dissolution. Ce point de vue traditionnel, illustré dans les lois sur les sociétés, est appuyé par la jurisprudence canadienne et les travaux des chercheurs et chercheuses en droit des sociétés. Toutefois, les innovations financières ont facilité la séparation des

[1] Lawson Lundell UBC Professor in Business Law. I am grateful to the anonymous reviewers of the *Canadian Bar Review* and others who chose to remain anonymous for their valuable feedback. I also thank Jeremy Fraiberg, Jenna Green, Camden Hutchinson, Bruce MacDougall, and Meghan Maulucci for their insightful comments. Finally, I appreciate the research assistance provided by Connor Smith and Rahman Ramji.

droits de vote et des droits financiers conférés par les actions, ce qui crée un marché où les intérêts des actionnaires sont restructurés et négociés de diverses façons. Les instruments dérivés et les conventions de prêts de titres ont entraîné des phénomènes appelés le vote vide et la propriété occulte. Dans le cadre du vote vide, un investisseur conserve ses droits de vote sans intérêt financier dans les actions, ce qui remet en question l'hypothèse selon laquelle les participations des actionnaires concordent avec le bien-être de la société. La propriété occulte concerne le recours à des instruments dérivés pour obtenir un intérêt financier dans des actions sans propriété effective, ce qui pourrait permettre de passer outre aux exigences de divulgation et de neutraliser les moyens de défense de la société ciblée. De nombreux pays qui ont abordé les préoccupations concernant le vote vide et la propriété occulte ont modifié de façon proactive leurs cadres réglementaires de façon à inclure les instruments dérivés dans leurs règles du système d'alerte. À l'opposé, la position du Canada sur cette question demeure inchangée, puisque son régime d'alerte n'a pas été officiellement adapté de manière à englober ces instruments dérivés. Ainsi, pour comprendre l'approche canadienne quant à l'atténuation du vote vide et de la propriété occulte, il faut s'attarder aux contextes judiciaires et réglementaires. Cette exploration constitue le cœur du présent article, dont l'objectif est de contribuer au discours des chercheurs par l'analyse de la façon dont les tribunaux et les commissions des valeurs mobilières du Canada dénouent la complexité de la séparation de l'intérêt économique et du pouvoir de voter.

Contents

1. Introduction

The classic understanding of equity encompasses a suite of economic and governance rights, which typically includes rights to vote at shareholder meetings, receive dividends, and partake in the proceeds from the sale of the company upon dissolution. This conventional view is set out in section 24(3) of the *Canada Business Corporations Act* ("*CBCA*") and is further expounded upon through Canadian jurisprudence.[2] Notably, the Supreme Court of Canada ("SCC") in *Sparling v Québec (Caisse de Dépôt et Placement du Québec)* affirmed that shares constitute a bundle of rights and obligations that are inherently intertwined.[3] This viewpoint is echoed by corporate law scholars such as Easterbrook and Fischel, who famously stated, "it is not possible to separate the voting right from the equity interest," and "someone who wants to buy a vote must buy the stock too."[4]

The interests of those who own the shares in the company are also paramount to corporate governance. Although directors owe fiduciary duties to the corporation, they are elected by and accountable to the shareholders.[5] Furthermore, while the board of directors holds the responsibility for managing, or supervising the management of, the corporation, shareholders must approve major corporate transactions such as amalgamation, sale of all or substantially all assets of the corporation and liquidation.[6] Likewise, shareholder interests are central to corporate law remedies; the *CBCA*, and similar provincial legislation, provides shareholders with the standing to bring a derivative action in the name of the corporation or seek relief from the court for oppression.[7]

However, while traditionally voting rights are attached to share ownership, financial innovations have facilitated the separation of voting rights from the financial entitlements of shares. This evolution has spawned a marketplace where the interests of shareholders are dissected and reconstituted in myriad configurations, allowing investors to trade

---

2 *Canada Business Corporations Act*, RSC 1985, c C-44, s 24(3) [*CBCA*].

3 *Sparling v Québec (Caisse de Dépôt et Placement du Québec)*, [1988] 2 SCR 1015 at 1025–1026, 1988 CanLII 26 (SCC) at 24.

4 Frank H Easterbrook & Daniel R Fischel, "Voting in Corporate Law" (1983) 26:2 J L & Econ at 410.

5 *CBCA* ss 122(1.1), 106(3), (3.1).

6 *CBCA* ss 189(3), 183(5), 211(3).

7 *CBCA* ss 238(a), 241(1); *Sevaal Holdings Inc v LCB Properties Inc*, 2014 SKQB 47 at para 32; Kevin P McGuinness & Maurice Coombs, *Canadian Business Corporation Law* 4th ed (LexisNexis Canada, 2024) at vol 3, paras 23–8, 24–5, 24–12.

them in diverse ways.[8] Specifically, derivatives and securities lending arrangements have led to decoupling of economic ownership of shares from voting rights, which Hu and Black have described as "empty voting" and "hidden ownership."[9] In empty voting, an investor retains ownership of the securities without obtaining any economic stake in the shares.[10] This separation challenges the foundational corporate governance assumption that shareholders' interests align with the company's welfare. As the firm's residual claimants, shareholders gain from increases or suffer losses from declines in the firm's value.[11] Accordingly, they have the incentive to maximize the corporate value, as they are entitled to the remaining profits once the firm's obligations are settled.[12] As a result, shareholders are also best positioned to reduce the agency costs by monitoring the firm's management.[13] The one vote, one share regime is indeed the crystallisation of shareholder voting in proportion to the shareholder's economic interest in the corporation.[14]

This congruence between economic interests and voting rights is underpinned by extensive legal and economic literature. Black and Kraakman, for example, argue that voting power should be appropriate to economic interest, and specifically the residual interest in the corporate benefits.[15] Easterbrook and Fischel also maintain that the right to vote emanates from the residual claim, arguing that shareholders, as residual claimants, possess the correct incentives to make value-maximizing discretionary decisions.[16] However, as the forthcoming discussion on *TELUS Corporation (Re)* illustrates, an empty voter may not simply passively fail to support beneficial corporate initiatives; they might actively use their voting power to obstruct initiatives that could enhance shareholder value.[17] Consequently, negative voting by shareholders who

8 Robert B Thompson & Paul H Edelman, "Corporate Voting" (2009) 69:1 Vanderbilt L Rev at 151; *Crown EMAK Partners, LLC v Kurz*, 992 A.2d 377 at 387–388 (Del Super 2010).

9 Henry T C Hu & Bernard Black, "The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership" (2006) 79:4 Southern California L Rev at 826.

10 *Ibid* at 815.

11 Jordon M Barry, John W Hatfield & Scoot D Kominers, "On Derivatives Markets and Social Welfare: A Theory of Empty Voting and Hidden Ownership" (2013) 99:6 Virginia L Rev at 1112.

12 *Ibid*.

13 Klaas Vanneste, "Decoupling Economic Rights from Voting Rights: A Threat to the Traditional Corporate Governance Paradigm" (2014) 15:1 European Bus Organization L Rev at 63.

14 Easterbrook & Fischel, *supra* note 4 at 410.

15 Reinier Kraakman & Bernard S Black, "A Self-Enforcing Model of Corporate Law" (1996) 109:8 Harvard L Rev at 1945.

16 Easterbrook & Fischel, *supra* note 4 at 403–404.

17 *TELUS Corporation (Re),* 2012 BCSC 1919 at para 355 [*TELUS (Re)*].

have an inverse risk profile and a conflict of interest with the company can lead to destroying rather than enhancing welfare.[18] Such shareholders do not have an incentive to exercise their voting rights in the best interest of the company but rather, to the contrary, to vote in a way that decreases the company's value.[19] This behaviour allows them to extract private benefits at the expense of the company and its shareholders, thereby challenging the traditional assumptions that link shareholders' economic interests with their incentives to enhance corporate value.

In the realm of hidden ownership, an investor may leverage derivatives to gain an economic interest in a company's shares without corresponding beneficial ownership.[20] This approach can skirt the disclosure requirements typically triggered in take-over bids, as regulatory frameworks hinge on the ownership or control of voting securities. This method also allows the investor to evade the target company's defensive strategies, like poison pills, which are activated when an external party acquires a significant ownership stake.[21] Since derivative positions are not required to be publicly disclosed, the market remains unaware of them until the acquirer formally announces their target bid.[22] This strategy enables the offeror to potentially keep the target's share price suppressed, thereby undermining market efficiency and the interests of the target company's shareholders.[23]

However, the strategic use of derivatives extends beyond merely avoiding disclosure requirements or neutralizing the target's defensive mechanisms. For instance, while a cash-settled derivative contract does not confer any entitlement to the underlying shares or their voting rights, the investor could potentially secure these votes if necessary, such as by unwinding the swaps and purchasing the actual shares from the derivative counterparty.[24] This tactic, described by Hu and Black as morphing

---

18 Carl Clottens, "Empty Voting: A European Perspective" (2012) 9:4 European Company & Financial L at 422.

19 *Ibid* at 422–423.

20 Hu & Black 2006, *supra* note 9 at 815.

21 Henry T C Hu, "Governance and the Decoupling of Debt and Equity: The SEC Moves" (2022) 17:4 Capital Markets L J at 421.

22 Michael C Schouten, "The Case for Mandatory Ownership Disclosure" (2010) 15 Stanford J L, Business & Finance at 166; see also European Union, The Committee of European Securities Regulators, *Consultation Paper: CESR Proposal to extend major shareholding notifications to instrument of similar economic effect to holding shares and entitlements to acquire shares*, CESR/09-1215b (2010) at 7, online: <https://tinyurl.com/3tzmwuyt> [perma.cc/V2CV-X59F].

23 Schouten, *supra* note 22 at 166.

24 *CSX Corp v Children's Inv Fund Management (UK) LLP*, 562 F Supp 2d 511, at 523 (SDNY 2008) [*CSX Corp*].

economic ownership into full ownership, illustrates the challenges hidden ownership introduces in the context of take-over battles. As observed by the United States District Court for the Southern District of New York in *CSX Corporation v Children's Inv Fund Management (UK) LLP*, such concealed ownership can significantly alter the corporate electoral landscape, either by subjecting the voting of shares to the sway of the hidden owner or by excluding the shares from the pool of available votes.[25]

Addressing the pressing concerns of empty voting and hidden ownership, various jurisdictions have proactively amended their regulatory frameworks to include cash-settled derivatives within their early warning disclosure requirements. Notably, The European Commission, in a 2010 report, emphasized the necessity to adapt the EU's regulatory regime to keep pace with financial market innovations.[26] The report highlighted that insufficient disclosure of securities lending and cash-settled derivatives had resulted in issues related to empty voting and hidden ownership.[27] Consequently, the Transparency Directive was revised, compelling member states to expand their blockholder disclosure mandates to cover cash-settled derivatives, including swaps and contracts for differences.[28] In a similar vein, the Australian Takeovers Panel's 2021 guidance elucidated that all equity derivatives positions amounting to 5% or more must be promptly disclosed, regardless of whether cash-settled derivatives are encompassed within the "substantial holding" disclosure requirements.[29] The Hong Kong Securities and Futures Commission also stipulates that derivative positions are included in the 5% threshold for disclosure obligations of "substantial shareholders."[30]

---

25 *Ibid* at 522.

26 European Union, European Commission, *Commission Staff Working Document: The Review of the Operation of Directive 2004/109/EC: Emerging Issues* (Publications Office of the European Union, 2010) at para 7, online: <https://tinyurl.com/296ryhvn>.

27 *Ibid*; see also European Union, European Commission Directorate-General for Internal Market and Services, *Transparency Directive Assessment Report*, Prepared by F Demarigny, Mazars Group & C Clerc, Marccus Partners, Attorneys at Law (Forvis Mazars Group, 2009) at 124–125, online: <https://tinyurl.com/58jdc6ud> [perma.cc/4HVM-3R7W].

28 Official Journal of the European Union, L294, 6 November 2013, "Directive 2013/50/EU of the European Parliament And Of the Council of 22 October 2013" (2013) 56 Official J the European Union L 294:13 at para 9.

29 Takeovers Panel, *Guidance Note 20—Equity Derivatives* (Government of Australia, 2021), online: <https://tinyurl.com/2vf3as2n> at paras 2, 9.

30 Hong Kong, Securities and Futures Commission, *Outline of Part XV of The Securities And Futures Ordinance (CAP. 571)—Disclosure of Interests* (2024) at paras 1.1.3, 2.1.2(iv); Hong Kong, Securities and Futures Commission, *The Codes on Takeovers and Mergers and Share Buy-Backs* (2018) at TC-22.9.

Most recently, the United States Securities and Exchange Commission ("SEC") has adopted new guidance on beneficial ownership reporting.[31] The guidance pertains to sections 13(d) and 13(g) of the *Securities Exchange Act of 1934*,[32] in conjunction with Regulation 13D-G, which stipulate that any investor holding in excess of 5% of a particular class of equity securities must make a public disclosure by filing either a Schedule 13D or a Schedule 13G, as applicable.[33] A crucial aspect of Schedule 13D, delineated in Item 6, mandates the disclosure of any contracts, arrangements, understandings, or relationships pertaining to the securities of the issuer.[34] To enhance transparency around derivatives, the SEC has amended Item 6 of Schedule 13D.[35] This amendment mandates the disclosure of all interests in derivatives, including cash settled derivatives, that reference a covered class of securities of a reporting issuer, irrespective of their origin or whether they are offered by the issuer.[36] Furthermore, the SEC's latest guidance clarifies that cash-settled derivatives may be deemed as conferring beneficial ownership and therefore require disclosure in three scenarios: they confer voting or investment power; they are utilized as part of a plan or scheme or evade disclosure on Schedule 13D or 13G; and they grant a right to acquire beneficial ownership.[37]

How does Canada compare to these other jurisdictions? As this article will discuss, Canada's early warning disclosure regime does not formally encompass derivatives.[38] Derivatives may need to be reported if the investor "has the ability, formally or informally, to obtain the voting or equity securities or to direct the voting of voting securities held by any counterparties to the transaction."[39] Empty voting remains a similarly unresolved issue. Canada has yet to enact any specific legislation or regulatory guidelines on empty voting. As a result, courts remain the

31 United States, Securities and Exchange Commission, "Modernization of Beneficial Ownership Reporting" (2023) 88:214 *Federal Register* at 76981–76982 [88 FR].

32 *Securities Exchange Act of 1934*, 15 USC at ss 78m(d), 78m(g) [15 USC].

33 *Filing of Schedules 13D and 13G*, 17 CFR at s 240.13d-1 [17 CFR].

34 *Ibid* at s 240.13d-101; see also United States, Accredited Home Lenders Holding Co, *Schedule 13D* (Securities and Exchange Commission, 2007), online: <https://tinyurl.com/2f95dehf>.

35 88 FR, *supra* note 31at 76899, 76984; 17 CFR, *supra* note 33 at s 240.13d-101.

36 88 FR, *supra* note 31 at 76899; 17 CFR; *supra* note 33 at s 240.13d-101.

37 88 FR, *supra* note 31 at 76928-76929; see also 17 CFR, *supra* note 33 at ss 240.13d-3(a-b), (d)(1).

38 My observation specifically addresses the early warning regime and does not pertain to the insider trading reporting requirements under sections 3.2 and 3.3 of *National Instrument 55-104—Insider Reporting Requirements and Exemptions*.

39 *Changes to National Policy 62-203 Take-Over Bids and Issuer Bids*, OSC NP 62-203, (2016) 39 OSCB 4293 at s 3.1 [*NP 62-203 Changes*]; see also *National Instrument 62-104 Take-Over Bids and Issuer Bids*, OSC NI 62-104, (2016) 39 OSCB (Supp-1) 66 at ss 1.8, 5.2 [*NI 62-104*].

primary forum for resolving disputes over shareholder voting rights. Given that the right to vote is a fundamental attribute of share ownership according to corporate laws predicated on the shareholder's interest in the future value of the corporation, courts are tasked with addressing the challenges arising from the mismatch between voting rights and economic interests.

Thus, to grasp the Canadian approach to mitigating empty voting and hidden ownership, one must delve into the judicial and regulatory landscapes. Arguably, in the absence of a clear legislative framework, courts and securities commissions are compelled to employ alternative concepts—such as materiality, market abuse, or principles of fairness and reasonableness within plans of arrangement—to address challenges posed by empty voting and hidden ownership.[40] Although this approach suggests they are not indifferent to the legal and policy implications of decoupling strategies, the ad hoc solutions crafted within these frameworks face significant limitations: they may be ill-suited to the specific challenges of decoupling techniques, and their application may lack consistency across similar cases. This article contends that the regulatory approaches in the U.S. and Canada do not appear to be significantly different, with the early warning regime in both jurisdictions hinging on the concept of beneficial ownership. By reviewing the documentation of derivatives and judicial interpretations of beneficial ownership, this article demonstrates cash-settled derivatives generally fall outside the early disclosure requirements in both the U.S. and Canada. Even with the introduction of new SEC guidance on cash-settled derivatives, a close examination of CSA policy, and the rulings in *Sears Canada Inc et al*[41] and *Re Bison Acquisition Corp*,[42] reveals a strong alignment with the U.S. standard.

The article is structured as follows: It begins by detailing the mechanisms of empty voting and hidden ownership, specifically through derivatives and securities lending arrangements, to illustrate how these financial innovations disrupt the traditional alignment between share ownership and voting rights. Subsequently, the discussion sets the foundation for an in-depth analysis by outlining the Canadian regulatory landscape and the reform initiatives addressing these phenomena. The article then explores three pivotal case studies that highlight how Canadian courts and securities commissions have tackled issues of empty voting and hidden ownership, examining these cases through the lenses of judicial reasoning

40 For example, see *TELUS (Re)*, *supra* note 17 at para 337–340; see also *TELUS Corp v CDS Clearing and Depository Services Inc*, 2012 BCSC 1350 at paras 103–105, 112; reversed *TELUS Corp v CDS Clearing and Depository Services Inc*, 2012 BCCA 403 at paras 72–74, 77, 81 [*TELUS Corp*], which will be discussed in-depth later in this article.

41 *Sears Canada Inc et al*, 2006 ONSEC 13 [*Sears*].

42 *Re Bison Acquisition Corp*, 2021 ABASC 188 [*Bison*].

and the public interest jurisdiction of securities commissions. Finally, the article revisits these case studies from a comparative perspective, aiming to shed light on the current reception and impact of decoupling strategies in Canadian law.

2. Decoupling Strategies and Practices: Total Return Swaps and Securities Lending

The most common methods to obtain hidden ownership or engage in empty voting include derivatives and share lending transactions. The term "derivative" denotes a financial instrument whose value is contingent upon the price fluctuations of a separate entity, typically termed an "underlying asset" or "reference obligation," which can include securities, bank loans, or indices.[43] Within this realm, swaps represent a derivative category where two parties agree to exchange the cash flows of different financial instruments over a predetermined timeframe.[44] These swaps are usually cash-settled, meaning the parties agree to pay or receive a cash return based on the performance of a notional amount of money, as if it had been invested in a specific market.[45] Swaps generally involve trading a fixed cash flow entitlement for a floating cash flow.[46] A simple example of this is a corporation using swaps to hedge their interest rate risk. A corporation that has an outstanding loan that is subject to a floating interest rate can find a third party to take on the liabilities arising from the floating interest rate, and in exchange, the third-party pays the corporation a fixed interest rate.[47] The corporation effectively turned the floating interest rate into a fixed interest rate and is no longer subject to interest rate risk on the loan. It is important to note the underlying asset in a swap does not change parties, it is the payments that derive its value from the underlying asset that is being exchanged.

This article focuses on cash settled total return swaps ("TRS"), a swap variant wherein Counterparty A (the "short" party) and Counterparty B (the "long" party) engage in the exchange of the cash flows from a specified underlying asset against a payment from the long party.[48] This payment is reflective of the interest accruing on a mutually agreed

---

43 Clottens, *supra* note 18 at 449.

44 Margaret Grottenthaler & Philip J Henderson, *The Law of Financial Derivatives in Canada* (Toronto: Carswell, 1998) at s 1:4; Dan Awrey, "Split derivatives: Inside the world's most misunderstood contract" (2019) 36:2 Yale J on Regulation at 505.

45 Grottenthaler & Henderson, *supra* note 44 at s 1:4.

46 *Ibid* at s 1:27; Awrey, *supra* note 44 at 505.

47 Grottenthaler & Henderson, *supra* note 44 at s 1:8.

48 *CSX Corp*, *supra* note 24; Andrew M Chisholm, *Derivatives Demystified: A Step-by-Step Guide to Forwards, Futures, Swaps and Options* (New Jersey: John Wiley & Sons Ltd, 2010) at 69.

principal sum (the "notional amount") at a negotiated rate.[49] Particularly, the long party gains entitlement to all cash distributions and any market value appreciation of the reference asset, as if it directly held the asset.[50] For example, in a TRS concerning 100,000 TELUS shares, the short party commits to compensating the long party an amount representing:

1) any dividends and cash flows received, plus

2) any enhancement in the TELUS shares' market value.

Conversely, the long party is obliged to remunerate the short party with an amount equivalent to:

1) the interest expenses attributable to borrowing the notional amount, and

2) any market value depreciation it would have incurred, had it owned 100,000 TELUS shares.[51]

Practically, the TRS positions the long party in a similar economic situation to direct ownership of the reference stock, with two primary differences.[52] Firstly, the long party, lacking record ownership of the shares, is not entitled to voting rights.[53] Secondly, they depend on the short party for earnings distributions and any value appreciation, rather than the security's issuer or the market.[54] The short party's perspective also presents distinct features compared to a traditional loan: they do not physically transfer the notional amount to the long party and they assume the risk of any appreciation in the value of the reference shares during the swap's term, which is limitless.[55]

While innovative financial instruments, derivatives give rise to complex regulatory and governance challenges that can distort the fundamental principles of market transparency and corporate democracy.

---

49 N. Feder, "Deconstructing Over-The-Counter Derivatives" (2002) 2002:3 Columbia Business L Rev at 711.

50 *Ibid* at 712.

51 For a similar example of a total return swap involving Swiss equities, see Oktavia Weidmann, "Beneficial Ownership and Derivatives: An Analysis of the Decision of the Swiss Federal Supreme Court Concerning Total Return Swaps (Swiss Swaps Case)" (2016) 44:8 Intertax at 621–622.

52 *CSX Corp*, *supra* note 24 at 520; Grottenthaler & Henderson, *supra* note 44 at s 1:21.

53 *CSX Corp*, *supra* note 24 at 520.

54 *Ibid*.

55 *Ibid* at 521.

For example, investors may exploit TRS to amass significant economic interests in a company clandestinely, bypassing the public disclosures usually required of major shareholders. A notable instance is the 2008 Schaeffler Group's take-over attempt of Continental AG in Germany.[56] Schaeffler openly owned less than 3% of Continental's shares but had covertly accumulated an effective 36% stake, 28% of which was through cash-settled equity swaps. These covert holdings were not reported, with the German financial regulator BaFin concluding that Schaeffler's nondisclosure was legally permissible under the existing regulations.[57]

Furthermore, hidden ownership can obscure market understanding of the available public float—the portion of shares owned by public investors.[58] For instance, in October 2008, Porsche discreetly increased its economic stake in Volkswagen from 35% to 74.1% through cash-settled options, effectively reducing the public float to less than 6%.[59] This substantial holding was not revealed until Porsche's disclosure, a period during which hedge funds were extensively short-selling Volkswagen's stock, anticipating a decrease in its value. The revelation triggered a sharp increase in Volkswagen's stock price, as hedge funds rushed to repurchase shares from the significantly depleted pool of available stock.[60]

As it will be discussed further below, the short parties in swap transactions, often financial institutions, usually hedge their positions by buying an equivalent amount of the reference shares specified in their swap agreements.[61] These institutions, while holding no economic interest in the shares, become the beneficial owners and thereby retain the voting rights associated with the shares. This dynamic sets the stage for the phenomenon of "morphable ownership," which came to prominence in the New Zealand case *Ithaca (Custodians) Ltd v Perry Corp*.[62] Initially in this case, Perry Corporation ("Perry") owned 4.2% of Rubicon Ltd ("Rubicon")'s shares but increased its stake to 10.81% shortly after the company went public. It then entered into transactions involving the sale of shares and matching equity swaps with Deutsche Bank and UBS Warburg.

---

56 Committee of European Securities Regulators, *supra* note 22 at 7.

57 *Ibid*.

58 Schouten, *supra* note 22 at 167.

59 Richard Milne, "Hedge Funds Hit as Porsche Moves on VW" *The Financial Times* (27 October 2008), online: <https://www.ft.com/content/2ce144b0-a456-11dd-8104-000077b07658>.

60 Schouten, *supra* note 22 at 167.

61 Henry T C Hu & Bernard S Black, "Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership" (2007) 13:2–3 J Corp Finance at 349.

62 *Ithaca (Custodians) Ltd v Perry Corporation*, [2004] 1 NZLR 731 (NZ) [*Ithaca (Custodians)*].

To hedge their risks, banks held the Rubicon shares against the equity swaps. Subsequently, as Guinness Peat Group ("GPG") began acquiring shares in Rubicon in 2002, aiming to take control, Perry unwound its equity swaps and repurchased the hedged shares from the banks, which allowed it to vote at Rubicon's annual meeting. By failing to give a notice of its interest in the Rubicon shares held by the banks, Perry breached the *Securities Markets Act*, which mandated shareholders to disclose their stakes after acquiring a 5% in a company's voting securities.[63]

The High Court held that merely participating in a cash-settled equity swap transaction did not automatically trigger disclosure.[64] However, the court found that, due to the communications between the parties and the absence of testimony from certain key witnesses, Perry had an arrangement or understanding with the banks which gave it the power to reacquire the Rubicon shares.[65] It was accordingly required to disclose its interest under the *Securities Markets Act*.[66] In the forthcoming discussion, I will delve into how the trial decisions in both *Ithaca (Custodians)* and *CSX Corp* were fundamentally based on a broad interpretation of securities laws, reflecting the practical intricacies of the derivatives markets. However, these decisions did not withstand the scrutiny of the appellate courts, which adopted a more literal interpretation of the relevant disclosure legislations.

Market participants can use equity swaps to become empty voters. For instance, a hedge fund might buy shares in a corporation and simultaneously enter into a TRS as the short party for an equivalent number of shares.[67] This method makes the hedge fund a registered shareholder with voting rights but without any corresponding economic stake in the company. [68] This tactic was employed by Perry, a US hedge fund, during the proposed 2004 share-for-share merger between Mylan Laboratories and King Pharmaceuticals.[69] Perry acquired 9.89% of Mylan's shares and hedged its position by entering a short equity swap for the same number of underlying securities.[70] Consequently, Perry controlled 9.9% of Mylan's

---

63 *Securities Markets Act*, 1988/234 at ss 2, 5(1)(f), 20-22 as it appeared on 1 December 2002.

64 *Ithaca (Custodians)*, *supra* note 62 at para 29.

65 *Ibid*.

66 *Ibid*.

67 Hu & Black 2007, *supra* note 61 at 345.

68 Hu & Black 2006, *supra* note 9 at 828; Robert E P Shaw, "What We Don't Know Can Hurt Us - Ontario's Regulation of Empty Voting and Hidden (Morphable) Ownership" (2014) 29:3 Banking & Finance L Rev 517.

69 *In re Perry Corp*, Securities Exchange Act Release No. 60351, at para 15.

70 *Ibid*.

voting rights which could use to support the merger even though it had no actual economic interest in the company.[71]

Empty voting can also occur through share securities lending arrangements. For instance, an investor might borrow shares before the record date, then sell them short before the general meeting of shareholders.[72] This creates perverse incentives, as the shareholder of record will profit from a decline in the share value, enabling them to repurchase the shares at a lower price in the market and return them to the lender.[73] Another method involves a combined position strategy, where an investor purchases shares in a company while simultaneously borrowing an equivalent number to sell short.[74] This strategy, similar to using equity swaps, allows the investor to maintain voting rights as the registered owner while effectively negating any economic interest in the company. This tactic was notably employed by Mason Capital Management, LLC ("Mason"), a New York–based hedge fund, to oppose TELUS's proposal to consolidate its dual-class share structure. Mason acquired 32,722,329 voting shares and 602,300 non-voting shares, offsetting this by short selling 10,963,629 voting shares and 21,672,700 non-voting shares.[75] Despite holding an economic stake of only 0.21% in TELUS, Mason controlled approximately 19% of the voting rights, sufficient to block amendments to TELUS's articles of incorporation.[76] Although TELUS ultimately succeeded in eliminating its dual-class share structure, this episode serves as a pivotal case study in understanding the stance of Canadian courts on empty voting.

3. Navigating the Regulatory Terrain: Current Rules and (Abandoned) Proposals

Concerns regarding hidden ownership and empty voting emerged as a focal point in the Canadian Securities Administrators' ("CSA") reform agenda with the proposed amendments to MI 62-104 *Take-Over Bids and Issuer Bids*, NP 62-203 *Take-Over Bids and Issuer Bids*, and NI 62-103 *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues.* A key aspect of these instruments and policies, which collectively govern take-over bids, is the Early Warning Regime ("EWR"). The EWR mandates immediate public disclosure when a person acquires beneficial

---

71 *Ibid* at paras 15-18.

72 Hu & Black 2006, *supra* note 9; Jonathan Cohen, "Negative Voting: Why it Destroys Shareholder Value and a Proposal to Prevent it" (2008) 45:1 Harvard J on Legislation at 243.

73 Clottens, *supra* note 18 at 451.

74 Hu & Black 2007, *supra* note 61 at 344.

75 *TELUS Corp*, *supra* note 40 at para 15.

76 *Ibid* at paras 15–16.

ownership, or gains direction or control, of 10% or more of a class of an issuer's equity or voting securities.[77] The EWR also requires subsequent public disclosures for any changes in the acquirer's beneficial ownership that amount to an increase or decrease of 2% or more.[78] This reporting framework is crucial in preventing creeping take-over bids, where a party gradually acquires control of a target company without offering a control premium. [79] Furthermore, the EWR alerts the target companies of a potential take-overs, thereby allowing directors to develop response strategies, including defensive measures.[80]

In 2013, the CSA proposed expanding the EWR to capture derivative instruments, such as equity swaps. [81] The proposal was based on the risk that potential acquirers could use derivatives to amass significant economic interests in the issuer without the obligation to disclose their holdings promptly. Such instruments could later be converted into voting shares, potentially influencing shareholder vote outcomes.[82] A related issue was empty voting, where investors could use derivatives or securities lending to gain voting rights without a corresponding economic stake, potentially impacting shareholder decisions.[83] Notably, the 10% disclosure threshold under the EWR did not cover derivative arrangements, as it was based on beneficial ownership, control, or direction over voting or equity securities.[84]

To address these issues, the proposed amendments required the disclosure of an investor's economic and voting interests in the issuer. They achieved this objective by deeming an investor to exercise control or direction over both voting and equity securities that were referenced in an "equity equivalent derivative."[85] This term meant derivatives that

---

77 *NI 62-104*, *supra* note 39 at s 5.2.

78 *Ibid* at s 5.3.

79 Kathleen D Rockwell, the Honourable David Johnston & Cristie Ford, *Canadian Securities Regulation*, 5th ed (Markham: LexisNexis, 2014) at para 11.31; Christopher C Nicholls, *Securities Law*, 2nd ed (Toronto: Irwin Law, 2018) at 404.

80 Johnston, Rockwell & Ford, *supra* note 79 at para 11.31; For more on the purpose of the EWR, see *National Instrument 62-103—The Early Warning System and Related Take-Over Bid and Insider Reporting Issues*, OSC NI 62-103, (1999) 22 OSCB 8141 at prt 2.

81 Ontario Securities Commission, *Proposed Amendments to MI 62-104 Take-Over Bids and Issuer Bids, NP 62-203 Take-Over Bids and Issuer Bids, and NI 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues*, CSA Notice, (2013) 36 OSCB 2675 at 9 [CSA Notice (2013)].

82 *Ibid* at 2678.

83 *Ibid* at 2679.

84 *Ibid*.

85 *Ibid*.

essentially replicate the economic consequences of ownership. Examples of such instruments include TRS, Contracts for Difference ("CFD"s), and other derivatives that provide the holder of the notional long position with an economic interest almost identical to that of direct security ownership.[86]

However, the CSA's proposals met with significant criticism. During consultations, some commentators argued that there was no conclusive evidence of swaps being used in Canada to secretly accumulate significant economic interests in issuers.[87] They suggested that derivatives were primarily utilized for risk management or trading strategies, rather than as a tool for acquiring control in public companies.[88] Concerns were also raised regarding the breadth of the definition, the challenges in quantifying derivatives exposure for early warning triggers, and the potential for overreporting in scenarios involving a chain of derivative transactions.[89]

In response to these critiques, the CSA, in October 2014, decided against including derivative instruments in the early warning reporting threshold.[90] As such, only the beneficial ownership, or control or direction is currently subject to EWR disclosure requirements.[91] Interests in swaps and other derivatives do not contribute to reaching the early warning thresholds. However, the CSA added a new provision to NP 62-203 which states that in certain circumstances an investor who is a party to an equity derivative can be deemed to have beneficial ownership, or control or direction, over the referenced voting or equity securities. This could occur when the investor has the "ability, formally or informally, to obtain the voting or equity securities or to direct the voting of voting securities held by any counterparties to the transaction."[92]

The 2013 CSA consultation also considered mandating the disclosure of securities lending arrangements, which could enable an investor to

---

86 *Ibid.*

87 Ontario Securities Comission, *CSA Notice of Amendments to Early Warning System—Amendments to MI 62-104 Take-Over Bids and Issuer Bids, NI 62-103 The Early Warning System and Related Take-Over Bid and Insider Reporting Issues, and Changes to NP 62-203 Take-Over Bids and Issuer Bids*, CSA Notice, (2016) 39 OSCB 1745 at 1748 [CSA Notice (2016)].

88 *Ibid.*

89 *Ibid*, Annex B Summary of Comments and CSA Responses, at 1758-1760.

90 Ontario Securities Comission, *CSA Notice 62-307 Update on Proposed Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, National Instrument 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues and National Policy 62-203 Take-Over Bids and Issuer Bids*, CSA Notice 62-307, (2014) 37 OSCB 9367 at 9368.

91 *NI 62-104*, *supra* note 39 at s 5.2.

92 *NP 62-203 Changes*, *supra* note 39 at s 3.1.

acquire voting rights in an issuer without a corresponding economic interest (empty voting).[93] As previously mentioned, securities lending is a market practice where one party ("lender") temporarily transfers securities to another party ("borrower") in exchange for a fee.[94] In this arrangement, the borrower is obligated to return identical securities to the lender either on demand or at the end of the loan term. Although commonly referred to as loans, these transactions actually involve the transfer of the legal title of the securities to the borrower. Consequently, as the owner of the securities, the borrower is entitled to vote them.[95] However, since the economic benefits of the securities are eventually returned to the lender, and the borrower must pay the lender for any dividends or price increases received, the borrower essentially acts as an empty voter.[96]

The CSA's proposed changes to the EWR would now include securities borrowed or lent under securities lending arrangements.[97] For example, if an investor who already owned 4% of a reporting issuer's common shares borrowed an additional 10%, they were required to file an early warning report.[98] Similarly, a lender who lent out 10% or more of a public company's common shares had to also file a report.[99] The proposed changes suggested that securities lent out should be counted when determining if the early warning threshold had been crossed.[100] Additionally, lenders were required to report any changes in their holdings, including both increases and decreases of 2% or more in share ownership. Consequently, lenders who disposed of 2% or more of the applicable securities needed to file an early warning report, ensuring transparency in significant ownership shifts.[101]

However, akin to the issue of hidden ownership, the CSA decided against implementing these amendments due to opposition from market participants who were against expanding the EWR requirements to include securities lending arrangements.[102] Notably, the CSA introduced an exemption from the EWR for borrowers in securities lending arrangements.[103] This exemption was based on the understanding that investors typically borrow securities for commercial or investment

---

93 CSA Notice (2013), *supra* note 81 at 2680-2682.
94 *Ibid* at 2680.
95 *Ibid*.
96 *Ibid*.
97 *Ibid*.
98 *Ibid*.
99 *Ibid* at 2680–2681.
100 *Ibid* at 2681.
101 *Ibid*.
102 CSA Notice (2016), *supra* note 87 at 1760–1761.
103 *Ibid* at 1748.

reasons, rather than with the intention of influencing or exercising the voting rights associated with the borrowed securities.[104] Consequently, borrowers were granted an exemption from the EWR, provided they dispose of the borrowed securities within three business days without intending to vote or actually voting the securities.[105]

4. The TELUS Dilemma: When Empty Voters' Interests Clash with Company Welfare

TELUS Corporation ("TELUS"), a prominent Canadian telecommunications company, historically operated with a dual-share class structure, comprising common shares and non-voting shares.[106] While both classes of shares came with similar dividends and rights to participate in distribution of assets upon dissolution, the non-voting shares generally traded at a discount to voting shares. The genesis of the non-voting shares dates back to 1999, stemming from the amalgamation of two telecommunications companies in British Columbia and Alberta.[107] This strategic move facilitated a longstanding American shareholder, originally GTE Corporation ("GTE") which later became Verizon Communications Inc. ("Verizon"), to maintain a majority stake in TELUS.[108] Crucially, this strategy was crafted to align with Canadian regulations on foreign ownership, enabling Verizon to hold significant influence without contravening these restrictions.[109]

After Verizon divested its stake in TELUS, the levels of foreign ownership remained relatively constant, staying well below the permissible thresholds. This stability, coupled with the advantages of a simpler share structure, led TELUS to reconsider the necessity of maintaining non-voting shares.[110] Consequently, the TELUS board, after extensive deliberations and upon the recommendations of legal and financial advisors, opted

---

104 *Ibid.*

105 *Ibid.*

106 Technically, TELUS had a multiple share class structure which included preferred shares; however, it is pertinent to note that, despite being authorised by the company's articles, there were no issued and outstanding preferred shares; see *TELUS (Re)*, *supra* note 17 at para 10.

107 Monique Mercier, *Response to the Canadian Securities Administrators' Notice and Request for Comments to Proposed Amendments to Multilateral Instrument 62-104, National Instrument 62-203 and National Policy 62-103 (the "Proposed Amendments")* (TELUS Corporation, 2013) at 2, online: <https://www.osc.ca/sites/default/files/pdfs/irps/comments/com_20130702_62-203_teluscorp.pdf> [perma.cc/5XA6-WUL4].

108 *Ibid.*

109 *TELUS (Re)*, *supra* note 17 at para 13.

110 Mercier, *supra* note 107 at 2; *TELUS (Re)*, *supra* note 17 at para 14.

to eliminate the non-voting shares.[111] This strategic decision aimed to enhance the liquidity and marketability of TELUS shares.[112] It also sought to improve corporate governance by enabling the holders of non-voting shares, who accounted for approximately 46% of TELUS's issued and outstanding shares, to have voting rights.[113]

After evaluating various potential conversion ratios, a special committee of independent directors at TELUS concluded that a one-for-one conversion ratio was the fairest option for both Non-Voting and Common Shareholders.[114] Consequently, the TELUS board proposed a plan of arrangement reflecting this ratio, scheduled for shareholder approval on May 9, 2012.[115] The market responded positively to this proposal, evidenced by the narrowing of the price gap between the non-voting and common shares—from approximately a 3.8% discount on February 21 to about 0.9% the following day.[116]

In response to this announcement and the resulting reduced spread, Mason formulated an arbitrage strategy to block TELUS's plan to eliminate the non-voting shares.[117] Notably, Mason was not a TELUS shareholder prior to the announcement.[118] However, by March 2012, Mason had acquired positions where it was long more than 33 million shares and short almost an equivalent number.[119] Mason aimed to thwart the TELUS proposal, intending to profit significantly from the reinstatement of the historical price difference between the two share classes.[120] This strategy enabled Mason to control 19% of TELUS's common shares, despite having no economic stake in the company.[121]

Faced with Mason's opposition, TELUS revaluated its strategy. The TELUS board recognized that achieving the necessary special majorities to amend its articles and proceed with its proposal was improbable.[122] Consequently, on May 8, 2012, a day prior to the company's annual general meeting, TELUS announced the withdrawal of its proposal.[123]

---

111 *TELUS (Re)*, *supra* note 17 at para 15.
112 *Ibid* at paras 2–3.
113 *Ibid*.
114 *Ibid* at para 24.
115 *Ibid* at para 25.
116 *Ibid* at para 29.
117 Mercier, *supra* note 107 at 2.
118 *Ibid*.
119 *TELUS (Re)*, *supra* note 17 at para 36.
120 *Ibid* at para 37.
121 *TELUS (Re), supra* note 17 at para 48; Mercier, *supra* note 107 at 2.
122 *TELUS (Re)*, *supra* note 17 at para 52.
123 *Ibid* at para 52.

Nevertheless, the company reiterated its commitment to pursuing a one-for-one exchange of non-voting shares for common shares.[124] Despite the lack of a formal vote on the initial proposal, the proxies received indicated strong shareholder support; excluding Mason's votes, 92.4% of all shares voted were in favour of the Initial Proposal, with 84.2% of Common Shares and 98.6% of Non-Voting Shares voting in support.[125]

By the end of August 2012, TELUS had formulated a revised plan of arrangement.[126] This second proposal differed significantly from the initial one; it did not entail amending the company's articles or altering its capital structure.[127] Under this new proposal, while non-voting shares would be exchanged for common shares and thus cancelled, the company's articles would still authorize the issuance of such shares. Consequently, this plan required the approval of a two-thirds majority of the non-voting shareholders, but only a simple majority of the common shareholders.[128] Despite facing continued opposition from Mason Capital, which led to multiple court proceedings and a proxy battle, the revised proposal eventually gained approval. In February 2013, a court order sanctioned the plan, enabling its implementation.[129]

The legal disputes between TELUS and Mason included Mason's requisition for a shareholder meeting and its opposition to TELUS's revised plan of arrangement. Mason's request for a shareholder meeting proposed four resolutions, offering exchange ratios different from TELUS's one-to-one ratio, and favouring holders of voting common shares.[130] In response, TELUS contested Mason's request by seeking a court declaration that the requisition did not comply with Section 167 of the *British Columbia Business Corporations Act* ("*BCBCA*").[131] Writing for the British Columbia Supreme Court, Justice Savage ordered the cancellation of Mason's meeting, citing requisition defects.[132] In its submissions, TELUS highlighted Mason's position as an 'empty voter,' asserting that Mason had decoupled its economic interests from its voting rights through strategic trading.[133] Conversely, Mason contended that the concept of empty voting was irrelevant and that Section 179 precluded judicial examination of a shareholder's economic interests beyond their

124 *Ibid*.
125 *Ibid* at para 53.
126 *Ibid* at paras 54–69.
127 *Ibid* at para 61.
128 *Ibid* at para 62.
129 *Ibid* at para 440.
130 *Ibid* at para 30.
131 *Ibid* at paras 36–37.
132 *Ibid* at para 119.
133 *Ibid* at para 108.

voting rights.[134] Justice Savage dismissed Mason's argument, stating the court had the authority to scrutinize the motives behind a requisition and broad discretion in matters concerning the calling, holding, and conducting of shareholder meetings. [135] Ultimately, he did not deem it necessary to exercise this jurisdiction due to other flaws invalidating Mason's requisition.[136]

On appeal, the British Columbia Court of Appeal, led by Justice Groberman, overturned Justice Savage's decision regarding the requisition's validity.[137] Justice Groberman, noted the absence of specific statutory authority allowing the court to address potential abuses arising from empty voting. He emphasized that Section 167(2) focuses solely on the possession of a certain proportion of issued voting shares, without reference to the shareholder's net investment.[138] Mason met this criterion, and the statute did not permit judicial inquiry into the correspondence between shareholding and economic interest. Furthermore, Justice Groberman, rejected the notion that Section 186 empowered the court to disenfranchise shareholders based on suspicions of empty voting.[139] While the Court of Appeal recognized the potential divergence between Mason's interests and the company's economic welfare, it emphasized that addressing the challenges posed by empty voting should be the domain of legislative and regulatory reform.[140] The court noted that remedies for such issues ought not to stem from judicial intervention predicated on broad equitable grounds.[141]

However, when TELUS's revised plan of arrangement was presented to the British Columbia Supreme Court, Mason's opposition proved insufficient to hinder the plan's advancement. Mason contended that the court should disregard its status as an empty voter, alleging that the plan failed to properly consider the appropriate exchange ratio.[142] Justice Fitzpatrick, however, emphasized that the exchange ratio was just one aspect of determining the plan's fairness and reasonableness[143]. It was imperative for the court to view Mason's opposition in the context of its arbitrage strategy, which was disconnected from the welfare of TELUS

---

134 *Ibid* at para 109.
135 *TELUS (Re)*, *supra* note 17 at para 110.
136 *Ibid* at para 111.
137 *TELUS Corp*, *supra* note 40 at para 86.
138 *Ibid* at para 77.
139 *Ibid* at para 79.
140 *Ibid* at para 81.
141 *Ibid.*
142 *TELUS (Re)*, *supra* note 17 at para 355.
143 *Ibid* at para 361.

and its wider shareholder community[144]. In other words, while the court recognized Mason's voting rights, it also factored in how Mason's trading strategy and its lack of any genuine interest in the arrangement's wider benefits set it apart from other shareholders. The court concluded that, given the arrangement's foundation in a comprehensive and inclusive process—encompassing a special committee's involvement, thorough fairness evaluations, and strong support from both non-voting and common shareholders (excluding Mason)—along with the significant benefits it offered, the arrangement was fair and reasonable.[145]

5. Unveiling Hidden Ownership in Take-over Battles: The *Sears* Decision

Sears was the first decision in which the use of derivatives in takeover bid transactions appeared before a Canadian securities Commission.[146] In *Sears*, a subsidiary of Sears Holdings Corporation ("Sears Holdings") proposed acquiring all outstanding common shares of Sears Canada Inc. ("Sears Canada") with an aim to privatize the company post-acquisition.[147] Sears Holdings applied to the Ontario Securities Commission ("OSC"), seeking orders against several entities, including Pershing Square Capital Management L.P. ("Pershing"), for alleged violations of the *Ontario Securities Act*.[148] Pershing, a New York-based hedge fund led by William Ackman, held an 11.6% economic interest in Sears Canada, divided between 5.2% in shares and 6.4% through total return swaps.[149]

Sears Holdings accused Pershing of circumventing the Early Warning Regime ("EWR") by arranging for 6.9 million common shares of Sears Canada, related to the swaps, to be held by its counterparty, SunTrust. Under s 102(1) of the *Ontario Securities Act* at the time, when a third party acquires beneficial ownership of or control or direction over 5% or more of the outstanding shares during the course of a formal take-over bid, an early warning report was required.[150] The purpose of section 102, which can now be found in section 5.4 of *NI 62-104*,[151] is to alert the market that competing bidders might be interested in making a bid or blocking an existing bid.[152] Sears Holdings alleged that the swaps were structured with the understanding that they could be terminated, allowing the shares—

144 *Ibid* at para 355.
145 *Ibid* at para 435.
146 *Sears, supra* note 41.
147 *Ibid* at paras 1–2.
148 *Ibid* at para 4.
149 *Ibid* at para 11.
150 *Securities Act*, RSO 1990, c S.5 at s 102(1), as it appeared on March 2006.
151 *NI 62-104*, *supra* note 39 at s 5.4.
152 *Sears*, *supra* note 41 at para 65.

and their voting rights—to be directed by Pershing or not voted at all, thereby diminishing the likelihood of Sears Holdings' take-over bid's success.[153]Essentially, Sears Holdings contended that Pershing covertly amassed Sears shares without proper disclosure of its control or direction over the attached voting rights.[154]

However, the OSC concluded that Sears Holdings had not provided sufficient evidence of an agreement between the swap counterparties regarding the return or voting availability of the shares that would qualify Pershing to exert "control or direction" over them as defined under section 102 of *the Ontario Securities Act* at that time.[155]The OSC also declined to use its public interest jurisdiction to hold Pershing's use of swaps abusive of capital markets. It acknowledged the common market practice among investors of entering into swaps, especially when they have a strong belief in the company's stock appreciation but prefer not to hold the shares directly.[156]

The OSC accepted Pershing's submission that it had used swaps to minimize its exposure to Canadian withholding taxes by disposing of the Sears Canada shares prior to dividend declarations.[157] According to Ackman's affidavit, Pershing had entered the swaps before the take-over bid offer was made to Sears Canada shareholders.[158] Ackman further explained that he opted for swaps to avoid conflicts with Sears Holdings' CEO, Eddie Lampert, "a significant figure in the U.S. capital markets, with whom he expected to have business dealings with in the future."[159] Direct share purchases by Pershing could have positioned it as a rival to Sears Holdings in its acquisition attempts of Sears Canada.[160]

Although the OSC accepted Ackman's statements, they became less convincing upon scrutiny. It is important to note that the total return swaps in this case fell into two categories. The first category, the 2005 Pershing Swaps, were agreements entered into prior to the proposed bid. Before the bid, Sears Canada had sold off its financing business and declared cash distributions consisting of a return of capital and an extraordinary dividend in the aggregate amount of approximately $2 billion.[161] To avoid incurring significant withholding taxes on these payments, some non-

153 *Ibid* at para 92.
154 *Ibid* at para 93.
155 *Ibid* at para 104.
156 *Ibid* at para 98.
157 *Ibid* at para 60.
158 *Ibid*.
159 *Ibid* at para 102.
160 *Ibid* at para 101.
161 *Sears*, *supra* note 41 at paras 17, 19.

resident shareholders, including Pershing, entered into total return swaps. Pershing arranged these swaps with its U.S. bank, SunTrust, between October 31, 2005, and December 8, 2005, in anticipation of the $4.38 per share dividend and $14.26 per share return of capital scheduled for December 16, 2005.[162]

On March 31, 2006 entered into another total return swap agreement with SunTrust for 1.6 million shares (the "2006 Pershing Swaps").[163] In contrast to the earlier swaps, which could have been explained by a desire to not incur substantial withholding taxes, no such rationale existed for the 2006 Pershing Swaps, as they were entered into long after the distributions to shareholders had been made.

Furthermore, Ackman's submissions to the Commission were at odds with his actual conduct. In fact, Ackman scrambled to unwind the swap agreements to capture the voting rights needed to defeat Sears Holdings' bid.[164] When the swap counterparty declined due to conflicts of interest in investment banking, Ackman expressed his frustration in a Wall Street Journal article, stating, "It is the convention in the swap market for a swap dealer to abstain from voting for corporate actions of any kind."[165] He further remarked, "the notion that a conflicted swap dealer might vote in favour of a transaction that squeezes out their customer and all other minority shareholders at a discount to market and at an enormous discount to fair value is abhorrent. We are looking forward to regulatory and legal scrutiny of this transaction."[166] It is therefore difficult to accept the proposition that Ackman simply entered into swaps having had no interest in the control of Sears Canada and only wanting to avoid conflict with the CEO of Sears Holdings.

Although it remains unclear why the OSC held that the circumstances of this case did not warrant intervention, it highlighted that scenarios could arise, "in the context of a take-over bid, where the [strategic] use of swaps to 'park securities' [and]… avoid reporting obligations could constitute abusive conduct…."[167] Such practices could trigger the Commission's public interest jurisdiction, signaling a readiness to act under different circumstances.[168] The OSC's observation set the stage for

---

162 *Ibid* at para 22.

163 *Ibid* at para 40.

164 Hu & Black, *supra* note 9 at 839; Jesse Eisinger, "In Canada, a Face-Off Over Sears: Rival Hedge-Fund Managers Take On Battle for Share Price Of Iconic Retailer's Northern Unit" *The Wall Street Journal* (12 April 2006).

165 Eisinger, *supra* at note 164.

166 *Ibid*.

167 *Sears*, *supra* note 41 at para 111.

168 *Ibid*.

regulatory scrutiny of swap transactions in *Bison* which is explored in the next section.

6. Swaps and Market Abuse: The *Bison* Decision

Most recently, the use of swaps in take-over bids was considered at length by the Alberta Securities Commission ("ASC"). At the centre was a hostile bid by Brookfield Asset Management Inc. ("Brookfield") for Inter Pipeline Ltd. ("IPL").[169] Brookfield's announcement on February 10, 2021, of its intention to make a hostile bid for IPL also marked the first public disclosure of Brookfield's significant ownership and economic interest in IPL through swaps:

> Brookfield … is currently the largest investor in IPL with an aggregate economic interest in 84,341,555 IPL Shares, representing approximately 19.65% of the issued and outstanding shares of IPL on an undiluted basis. Brookfield … began to accumulate a position in [IPL] for investment purposes beginning in March 2020.
>
> This position is comprised of beneficial ownership and control of an aggregate of 41,848,857 IPL Shares, representing approximately 9.75% of the issued and outstanding IPL Shares on an undiluted basis, and in addition, a cash-settled [Swap] that provides Brookfield … with economic exposure to an aggregate of 42,492,698 IPL Shares. The [Swap] affords economic exposure comparable to beneficial ownership but does not give Brookfield … any right to vote, or direct or influence the voting, acquisition, or disposition of any IPL Shares.[170]

The IPL swaps were governed by two swap standard ISDA 2002 Master Agreements between the Bank of Montreal ("BMO") and Brookfield, stipulating BMO's ability to hedge its position by acquiring IPL shares. Notably, these agreements specified that Brookfield could not vote, direct, influence, or control the disposition of these shares, nor dictate the unwinding of BMO's hedge, though Brookfield retained the option to terminate the swaps.[171]

Brookfield consistently echoed the information shared in its February offer during subsequent communications with IPL shareholders.[172] It underscored having "no right to vote, or direct or influence the voting, acquisition, or disposition of any [IPL] Shares," yet it identified itself as "the largest single investor in IPL, with an aggregate economic interest of

---

169 *Bison, supra* note 42 at para 3.
170 *Ibid* at para 351.
171 *Ibid* at para 347.
172 *Ibid* at para 352.

19.65%."[173] Essentially, Brookfield reiterated that, despite the swaps not granting any voting rights or influence over the shares involved in these swaps, it combined the shares it directly owned with those in which it had an economic interest through swaps into a collective grouping, the "Brookfield Block."[174] This approach became particularly pronounced when Pembina Pipeline Corporation ("Pembina") and IPL formulated an arrangement agreement, under which Pembina, subject to specific conditions, would acquire all the issued and outstanding IPL Shares in exchange for Pembina shares. In a notable press release dated June 4, 2021, Brookfield expressed its criticism towards IPL and Pembina, highlighting its stance:

> As IPL's largest shareholder, with 9.75% ownership of IPL shares and a total economic interest in [IPL] of 19.65%, we are not supportive of the all-share [Pembina Arrangement] and intend to vote against it. In the event the [Pembina Arrangement] is successful, Brookfield … will become a significant shareholder in Pembina with up to an approximately C$1.6 billion economic interest ("Brookfield Block").[175]

Brookfield frequently referenced the term 'Brookfield Block' in press releases, emphasizing its capacity to obstruct the merger between IPL and Pembina.[176] In their application to the ASC, IPL and Pembina raised concerns about the integrity of the bid process due to perceived inadequacies in Brookfield's swap disclosures.[177] They argued that Brookfield's strategic use of swaps was a deliberate attempt to avoid reaching the 10% EWR reporting threshold, with disclosures about the swaps being made only at the time of its take-over bid.[178] Furthermore, they contended that Brookfield did not adhere to the prevailing take-over bid regulations. Specifically, Form 62-104F1 mandates that the offeror disclose details of any significant agreements, commitments, or understandings related to the bid.[179] This disclosure requirement extends to "any material facts concerning the securities of the offeree issuer," along with any other information not widely known but "that would reasonably be expected to influence the decision of the security holders of the offeree issuer to accept or reject the offer."[180]

---

173 *Ibid* at para 353.

174 *Ibid* at para 365.

175 *Ibid* at para 364.

176 *Ibid* at para 365.

177 *Ibid* at paras 390–394.

178 *Ibid* at paras 390–394.

179 *Form 62-104F1: Take-Over Bid Circular*, OSC Form 62-104F1, 39 OSCB (Supp-1) 93 at Items 15, 16 [Form 62-104F1].

180 *Ibid* at Item 23.

At the ASC hearing, Brookfield did not present direct evidence from BMO, its swap dealer.[181] Instead, Brookfield's managing partner relayed second-hand information about his conversation with the BMO representative.[182] He explained his understanding that BMO had hedged a portion of its position through subsequent transactions with undisclosed swap dealers.[183] Additionally, he conveyed his understanding that BMO operates based on its commercial interests and that it neither votes nor tenders the hedged shares at the direction or under the influence of Brookfield or any affiliated parties.[184]

The ASC ruled that Brookfield was not required under the securities laws to include its economic interests in shares held via swaps with its counterparty, BMO, within its early warning report.[185] This decision was grounded in the interpretation that the EWR rules do not generally require swaps to be included in the 10% reporting threshold.[186] Specifically, section 3.1 of NP 62-203, which provides policy guidance on take-over bid rules, posits that a swap investor could be deemed to have beneficial ownership of referenced securities if they possess the ability to obtain the referenced securities or to direct the voting of them. Given that Brookfield lacked a contractual right to control or influence the voting of shares held by BMO, it was concluded that Brookfield was not obligated to disclose its economic interest in these swap shares in its early warning report.[187]

However, the ASC determined that the intricacies of the IPL swaps and Brookfield's relationship with BMO constituted material information that should have been disclosed to the IPL shareholders.[188] This conclusion stemmed from a complex pre-existing relationship between the parties, which included BMO's ownership of shares in Brookfield's entities and its various lending and investment dealings with Brookfield.[189] A significant aspect of this relationship involved Brookfield appointing BMO as a financial advisor for the IPL acquisition, coupled with an agreement on a completion fee contingent upon the deal's success.[190] This multifaceted relationship created a conflict of interest, incentivizing BMO to act in a manner consistent with Brookfield's interests.[191] Specifically, the

---

181 *Bison, supra* note 42 at para 373.
182 *Ibid* at para 373.
183 *Ibid*.
184 *Ibid*.
185 *Ibid* at para 408.
186 *Ibid* at para 408.
187 *Ibid* at paras 409, 411.
188 *Ibid* at para 437.
189 *Ibid* at para 393.
190 *Ibid* at para 432.
191 *Ibid* at para 434.

completion fee arrangement gave BMO a vested interest in supporting Brookfield's offer for IPL or opposing the Pembina Arrangement.[192] Brookfield's communication strategy further compounded this issue by not distinguishing between its beneficial ownership and economic interest in IPL shares. The ASC held that this tactic misled IPL shareholders into believing Brookfield controlled nearly 20% of IPL shares (the "Brookfield Block"), enhancing the perceived likelihood of Brookfield's offer's success.[193] Consequently, IPL shareholders were more inclined to accept Brookfield's bid, while potential competitors were deterred from making offers, under the impression that Brookfield had essentially secured control.[194]

Overall, the ASC was of the view that while Brookfield had complied with the Early Warning requirements, its non-disclosure regarding its nearly 20% economic interest in IPL including omitting details about the swaps, BMO's role as the swap dealer, and the underlying completion fee agreement—was deemed abusive towards the Alberta capital markets and IPL shareholders.[195] This finding was primarily rooted in the content requirements of a take-over bid circular and the broad principle that a bidder must disclose any matter that "would reasonably be expected to affect the decision of the security holders of the offeree issuer to accept or reject the offer."[196] Consequently, the ASC held that that the inadequate disclosure of swaps contravened the take-over bid regulation, arguing that the details about the swaps were important to IPL shareholders in deciding whether to tender their shares.[197]

It is intriguing to consider how different circumstances might have influenced the outcome in *Bison*. Specifically, had Brookfield presented concrete evidence from BMO supporting its independent hedging strategies and voting policies, the case's resolution might have diverged. Likewise, *Bison* could have been resolved differently if the swap counterparty differed from the financial advisor involved in the acquisition, or if Brookfield had more clearly separated its economic interest from the beneficial ownership of the shares, rather than merging them into the so-called "Brookfield block." It is therefore plausible that swap counterparties in Canada may now be motivated to sidestep a *Bison*-like ruling by not repeating Brookfield's missteps.

---

192 *Ibid* at para 432.

193 *Ibid* at para 425.

194 *Ibid* at para 450.

195 *Ibid* at paras 416–420, 432.

196 *Bison, supra note* 42 at para 416–418; Form 62-104F1, *supra* note 179 at Item 23

197 *Bison, supra* note 42 at paras 417–420.

A more fundamental issue with *Bison*, however, is the difficulty in establishing how information about the swaps and BMO's relationship with Brookfield would materially influence IPL shareholders' decisions to tender their shares. Generally, shareholders base their decisions on the price offered by the acquirer, so in this case, they would tender their shares if they believed Brookfield's offer was favourable. The potential influence of Brookfield's relationship with BMO on their decision is likely minimal, if any. This argument gains further weight considering the reformed mechanics of the take-over bid regime in Canada. Under the current rules, Brookfield was required to keep the bid open for 105 days and could not acquire any shares until more than 50% of the IPL shares had been tendered.[198] Furthermore, once more than 50% of the shares were tendered, Brookfield had to extend the bid for another 10 days (the "mandatory extension period"). [199] This extended period allowed IPL shareholders ample time to assess the merits of the offer. Even if they chose not to tender during the initial deposit period, they had a second chance to tender if they later deemed the offer favourable. Therefore, there appears to be a disconnect between the ASC's analysis of materiality and the contemporary rules governing the take-over regime.

The *Bison* decision also raises broader questions about how regulators operationalize section 3.1 of NP 62-203. Curiously, the ASC expressly said that it was "satisfied" that Brookfield did not need to include its interest in the swap shares in its early warning report, reasoning that Brookfield did not have the ability to obtain the swap shares or to direct the voting of them [200]. However, the decision simultaneously underscores specific characteristics of the relationship between Brookfield and BMO that point to the Brookfield's informal ability to direct the voting of the shares held by its swap counterparty.[201] This concern was serious enough for the ASC to raise the minimum tender condition from the statutory threshold of 50% to 55%, effectively excluding the swap shares from the count toward approval of Brookfield's offer.[202]

It is difficult to reconcile this unusual remedy with the earlier finding that Brookfield was not required to disclose the swap shares in its early warning reports. If the underlying issue is the ability to influence the voting of the swap shares, then logically, those shares should also be included in the early warning threshold. The tension in the *Bison* findings highlights the ambiguities in the current regulatory regime, leaving

198 *NI 62-104*, *supra* note 39 at s 2.28.1, 2.29.1(c).
199 *Ibid* at s 2.31.1.
200 *Bison, supra* note 42 at para 411.
201 *Ibid* at paras 419–420
202 *Ibid* at para 517

market participants uncertain about how regulators will assess future uses of swaps.

7. Revisiting the Canadian Approach to Hidden Ownership: How Different is Canada from the United States?

As I previously explained, despite acknowledging the issues surrounding hidden ownership, the Canadian securities regulators have yet to introduce an overhaul of the relevant laws. Notably, the CSA has abstained from adopting the mandatory disclosure of equity equivalent derivatives as part of the early warning requirements. Given the SEC's recent initiative to modernize beneficial ownership reporting, it is pertinent to compare Canada's approach to swaps disclosure with that of the United States.

The SEC originally proposed that holders of cash-settled derivatives would be deemed beneficial owners of an issuer's shares if they held the derivatives with "the purpose or effect of changing or influencing the control of the issuer." The agency reasoned that beneficial ownership reporting rules needed modernization to reflect the "economic realities" faced by derivative counterparties. [203] It noted that even without explicit voting rights, holders of cash-settled derivatives could strategically position themselves to effect a change in control of a company. [204] This influence is possible because derivative holders can amplify their effective voting power by reducing the total number of shares available to vote against their proposals. Furthermore, even if the derivative contract stipulates cash settlement, holders of such derivatives might still obtain any underlying securities that their counterparty has purchased for hedging purposes.[205] As investments in cash-settled derivatives can be morphed into direct ownership of referenced shares, holders can use their economic interests as leverage in negotiations with the target company or its shareholders.[206]

However, following public consultation, the SEC decided not to proceed with the original proposal.[207] Instead, it opted to provide guidance

---

203 88 FR, *supra* note 31 at 76926.

204 *Ibid*; see also Maria L Passador, "The Woeful Inadequacy of Section 13(d): Time for a Paradigm Shift?", (2019) 13:2 Virginia L & Bus Rev at 296–299 ("[I]n the recent past, cash-settled equity derivatives—mainly call and security-based options—were frequently used not only with a speculative and hedging purpose, but also with the immediate, explicit, and specific aim of silently accumulating a leading (or even control) position in public companies."); T Mervis et al, *Beneficial Ownership of Equity Derivatives and Short Positions—A Modest Proposal to Bring the 13D Reporting System into the 21st Century*, (Watchell, Lipton, Rosen & Katz, 2008).

205 88 FR, *supra* note 31 at 76927.

206 *Ibid*.

207 *Ibid* at 76928.

on a more limited set of circumstances in which holders of cash-settled derivatives can be deemed beneficial owners of the issuer's securities for the purpose of disclosure under Rule 13d-3.[208] In its Final Guidance issued in 2023, the SEC outlines three such situations where holders of cash-settled derivatives are considered beneficial owners of reference securities:

1) the derivatives, through contractual terms or otherwise, provide their holders with voting or investment power over the issuer's reference securities;

2) the derivatives are acquired with the purpose of evading the reporting requirements; and

3) the holder has the right to acquire the reference securities within 60 days, or acquires the right to obtain beneficial ownership of the reference securities with a control purpose, regardless of when the right is exercisable.[209]

The SEC's withdrawal of its initial proposal underscores the challenges of adapting the concept of beneficial ownership to the realm of cash-settled derivatives. As the law currently stands, cash-settled derivatives typically fall outside the scope of beneficial ownership, as holding a derivative entitles the holder only to economic exposure to the reference securities, which is insufficient to constitute beneficial ownership.[210] Two sources support this interpretation. Firstly, the standardized documentation of derivatives contracts, which clearly delineates the rights and obligations of the involved parties, emphasizes that holding such instruments does not equate to ownership or control. Secondly, judicial rulings, which have scrutinized the application of swaps in take-over contexts, have affirmed that mere economic interest, as conferred by cash-settled derivatives, does not constitute beneficial ownership or control.

Further illustrating this point, the International Swaps and Derivatives Association standard documentation specifies that when a counterparty to a derivative hedges its position, the other party gains no direct economic, legal, or beneficial ownership of the hedged securities. Additionally, the decision to hedge is solely at the discretion of each party, with neither party able to influence the approach or technique the other uses to initiate, adjust, or close their hedge positions.[211] Consequently,

---

208 *Ibid*.

209 *Ibid* at 76928–76929.

210 *Ibid* at 76928.

211 International Swaps and Derivatives Association, Inc., *2006 ISDA Fund Derivatives Definitions*, (New York: 2006) at s 13.2.

investors in derivatives have formally no say in the timing or method of how counterparties manage their risk exposure. Moreover, swap dealers typically maintain internal controls and policies that prohibit discussions about the potential voting of reference shares and generally do not disclose their voting policies for hedged shares.[212] Similar principles have been observed by courts in the United States and New Zealand.

In *CSX Corp*, the hedge fund defendants The Children's Investment Fund ("TCI") and 3G Capital Partners, collectively owning 8.7% of CSX Corporation's ("CSX") shares, held an undeclared economic interest of nearly 14% via total return equity swaps.[213] Initially, the district court deemed TCI a beneficial owner under Rule 13d–3(b), attributing this status to their strategic use of swaps to circumvent the beneficial ownership reporting mandated by Section 13(d).[214] The district court's reasoning was heavily influenced by the practical realities in the market.[215] It noted that the swap dealers were inevitably going to hedge their positions by purchasing CSX securities, and TCI knew this well.[216] Embracing an expansive view of beneficial ownership, the district court came to the conclusion that TCI had the ability to either cause or, at minimum, influence the swap dealers' decisions to buy or sell the referenced securities.[217] Furthermore, TCI was in a position to unwind the swaps at any time and receive the CSX securities instead of cash; this option afforded TCI with considerable leverage against CSX.[218]

However, the circuit court vacated the district court's injunction and remanded the case.[219] Further, it narrowed the focus of the remand to whether an alleged group violation had occurred in respect of the shares owned outright by the defendants, rather than the swaps bestowing beneficial share ownership.[220] In a concurring opinion, Winter J, found that "cash-settled total-return equity swaps do not, without more, render the long party a "beneficial owner" of such shares with a potential disclosure

---

212 United States, Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association, *Comments on Modernization of Beneficial Ownership Reporting* (Securities and Exchange Commission, 2022) at 12–13, online <https://tinyurl.com/59cb8z5d> [perma.cc/KG2G-MGVL]; *Ithaca (Custodians)*, *supra* note 62 at para 183.

213 *CSX Corp*, *supra* note 24 at 526–527.

214 *Ibid* at 552; see also 17 CFR, *supra* note 33 at s 240.13d-3; 15 USC at s 78m(d)(1).

215 *Ibid* at 547.

216 *Ibid* at 542.

217 *Ibid* at 546.

218 *Ibid* at 542.

219 *CSX Corp v Children's Inv Fund Management (UK) LLP*, 654 F.3d 276, at 279 (2d Cir 2011)[*CSX II*].

220 *Ibid* at 279.

obligation under Section 13(d)."[221] He criticized the district court's flawed reasoning, which overlooked the statutory language and relevant case law.[222] He emphasized that the economic interest stemming from the swaps did not constitute beneficial ownership. This interpretation hinges on the fact that the swap agreements did not compel the short parties to engage in specific actions such as purchasing shares as a hedge, selling shares at a designated time or to the long party, or voting the shares in accordance with the long party's wishes.[223] Subsequent American court decisions have aligned with Judge Winter's rationale, asserting that mere economic exposure from cash-settled derivatives does not translate to the beneficial ownership of the underlying securities.[224]

The court decisions are also vital for understanding "arrangement" and "understanding" concerning the securities of an issuer which are key to early warning requirements. These terms imply a degree of commitment that transcends mere mutual expectations, yet they remain less formal than a binding contractual agreement. As such, they demand more than simple mutual expectations shaped by the derivatives market, which notably influenced the trial decision in *CSX Corp*.[225] This distinction is crucial in grasping why the circuit court, with Judge Winter, at the forefront, contested the district court's interpretation that deemed the swap counterparty as the beneficial owner of the CSX securities.

Similarly, this logic corresponds with the conclusions of the New Zealand Court of Appeal in *Ithaca (Custodians)*, [226] where the court differentiated between the market reality the shares would be available for purchase post-unwinding of the swap positions and having de facto control over those shares.[227] In fact, the Court of Appeal went to find that it was almost certain the hedged shares would be available for purchase by the long party upon terminating the swaps. However, this market expectation was not "indicative of the existence of a side arrangement

---

221 *Ibid* at 288.

222 *Ibid* at 289–297.

223 *Ibid* at 297.

224 *In re Bear Stearns Companies, Inc Sec, Derivative, & ERISA Litig*, 995 F Supp 2d 291, at 304 (SDNY 2014); citing Winter J's, concurrence in *CSX Corp, supra* note 24 at 307; *Galopy Corp. Int'l N.V. v. Deutsche Bank, AG*, 2016 NY Slip Op 31576 at 5-6 (NY Sup Ct 2016). This finding is corroborated by the SEC's own recognition in its proposed amendments to Regulation 13D which state that cash-settled derivatives typically do not endow their holders with rights to acquire the referenced securities; see 88 FR, *supra* note 31 at 76928.

225 *CSX Corp*, *supra* note 24 at 560–561.

226 *Ithaca (Custodians)*, *supra* note 62.

227 *Ibid* at paras 183–187.

or understanding," since it failed to confer any actual control to the long party over the shares held by the banks.[228]

Thus, the EWRs in both the U.S. and Canada are based on the notion of beneficial ownership, with both jurisdictions agreeing that cash-settled derivatives are not generally subject to mandatory disclosure. Additionally, there is a similar stance on deemed beneficial ownership; both the CSA and the SEC require that derivatives be included in the early warning reporting threshold if they give the holder the ability to acquire or vote the reference shares.[229] However, the SEC's recent guidance takes a step further by mandating the disclosure of cash-settled derivatives if they are used as part of a plan or scheme to evade disclosure requirements.[230]

Despite this additional stipulation, the regulatory approaches in the U.S. and Canada do not appear to be significantly different. Both *Sears* and *Bison* confirm that "a deliberate attempt to avoid reporting obligations" in the take-over bid context are considered as abusive to capital markets.[231] *Bison* further illustrates that Canadian securities regulators retain significant discretion to intervene when swaps are used in take-over bids. They are prepared to scrutinize the intricacies of relationships between swap counterparties, extending their analysis beyond the formal language of the swap agreements. Yet, the challenge lies in the lack of clear operational guidance on when the use of swaps is deemed "abusive" and the precise metrics regulators apply in making that determination.

8. Courts and Empty Voting: Why the Reluctance to Intervene?

Similar to the issue of hidden ownership, the CSA proposed expanding the scope of EWR to include securities lending arrangements but ultimately decided against proceeding with such amendments. Consequently, in the absence of specific regulatory actions addressing empty voting, courts continue to serve as the primary arbiters for disputes concerning shareholder voting rights. Since the right to vote is a key attribute of share ownership under corporate statutes, courts must navigate the complexities inherent in cases where the alignment between voting rights and economic interests is disrupted. TELUS stands out as a prominent example where both trial and appellate courts engaged directly with empty voting.

---

228 *Ibid* at para 207.

229 88 FR, *supra* note 31 at 76928.

230 *Ibid*, at 76928–76929.

231 *Bison*, *supra* note 42 at paras 447–450; *Sears*, *supra* note 41 at paras 110–111.

Analyzing the TELUS saga in its entirety, it becomes clear that while courts were reluctant to strip a shareholder of rights granted by corporate statutes, there was a unanimous recognition across all judicial levels of the potential problems posed by empty voting. The British Columbia Court of Appeal, for example, recognized the Delaware jurisprudence on empty voting, especially in *Crown EMAK Partners, LLC v Kurz,*[232] which highlighted the detrimental impact of separating voting rights from financial interests on the efficacy of voting as a decision-making tool.[233] Despite this recognition, the explicit wording of section 167 of the *BCBCA* afforded the court scant leverage to deny a shareholder the right to call for a meeting, particularly when the stipulated voting threshold had been achieved. Mason's argument, aimed at preserving the historical premium on TELUS common shares in any share conversion scenario, articulated a credible viewpoint, one that any common shareholder might plausibly assert. This perspective was therefore regarded as a legitimate commercial interest, warranting the convening of a meeting, even though it was proposed by a shareholder actively engaging in empty voting.[234]

However, as Mason's opposition intensified and its motives for obstructing TELUS's proposal became more evident, the courts' willingness to endorse Mason's arbitrage strategy waned, especially when it conflicted with the broader interests of the company and the majority of shareholders. The courts' extensive jurisdiction in determining whether the plan of arrangement was fair and reasonable facilitated a thorough consideration of various aspects, including an examination of Mason's reasons for resisting the plan and a recognition of how its objectives diverged from those of other common shareholders. This approach aligned with the principles established by the Supreme Court of Canada in *BCE Inc v 1976 Debentureholders*, Canada's seminal authority on plans of arrangements.[235]

According to *BCE*, a court's endorsement of a plan of arrangement as fair and reasonable depends on satisfying a two-pronged test:

1) the arrangement serves a valid business purpose, and

2) the objections of those whose legal rights are affected are addressed in a fair and balanced manner.[236]

---

232 *Crown EMAK Partners, LLC v Kurz*, 992 A.2d 377, at 387–388 (Del Super. 2010).

233 *TELUS (Re)*, *supra* note 17 at paras 73–74.

234 *Ibid* at paras 80–81.

235 *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69 [*BCE*].

236 *Ibid* at para 138.

The first prong of the test requires the court to focus on the best interest of the company as opposed catering to the needs of a singular investor.[237] TELUS's proposed plan met this criterion as transitioning to a single share class structure would provide long-term benefits, such as improved access to capital, increased liquidity, and the potential for a New York Stock Exchange listing.[238] The second criterion accommodates adverse effects on interest of specific individuals or groups, provided their objections are resolved in a fair and balanced manner.[239] This was achieved through following a rigorous and independent process to consider the interest of all stakeholders, coupled with the overwhelming shareholder approval of the arrangement, excluding Mason.[240] Although Mason's vote was not dismissed, the court delved deeper than Mason's mere opposition to uncover the underlying reasons for its vote against the plan of arrangement.[241] This exploration was informed by Mason's status as an empty voter and its distinctive arbitrage strategy, which bore no relation to the long-term interests of the company or those of its broader shareholder base.

In summary, due to the absence of any direct legislative or regulatory guidance, courts appear less inclined to invoke inherent jurisdiction to address empty voting abuses. Therefore, their interventions will be contingent upon the extent of authority granted by statutory provisions. As the BC Court of Appeal's reasoning in *TELUS Corp* indicates, it is unlikely that a court will inhibit an empty voter from requisitioning a meeting if the statutory criteria are fulfilled.[242] Conversely, when statutory provisions embed principles of fairness and reasonableness—as within the context of plans of arrangement—courts have more leeway for intervention.[243] This broader discretion allows the courts to not only oversee the procedures of shareholder voting and meetings, but also evaluate their substantive impact on the corporation's long-term interests.

9. Conclusion

Canada has been reluctant to implement legislative or regulatory reforms in response to concerns about hidden ownership and empty voting. This hesitation may stem from the belief that decoupling strategies are less problematic in Canada than in other jurisdictions. However, actual market practices in Canada paint a different picture. Decoupling strategies are

237 *Ibid* at para 148.
238 *TELUS (Re)*, *supra* note 17 at para 420.
239 *BCE*, *supra* note 235 at para 157.
240 *TELUS (Re)*, *supra* note 17 at paras 435–436.
241 *Ibid* at para 437.
242 *TELUS Corp*, *supra* note 40 at paras 74–81.
243 *TELUS (Re)*, *supra* note 17 at paras 429–438.

not only prevalent among Canadian investors, but they have also raised significant public policy concerns, as demonstrated by the case studies discussed.

The absence of specific legislative or regulatory guidance does not signify total indifference from courts and regulators; rather, it constrains their ability to address these issues directly. This is consistent with the cases studied in this article, where different concepts or frameworks were leveraged to address empty voting. In the TELUS case, it was the reframing of the proposal and the adjustment of applicable voting thresholds that ultimately allowed the company to defeat Mason's attempt to block the deal. As the appellate decision confirmed, had the TELUS proposal continued to require an amendment to the articles and a special resolution of common shares, Mason would have been able to block the proposal, regardless of its status as an empty voter. However, it remains unclear whether such ad hoc solutions can successfully address empty voting in the long term.

A similar line of inquiry applies to hidden ownership. Since the disclosure regimes in the U.S. and Canada remain grounded in beneficial ownership, cash-settled derivatives generally do not need to be included in the applicable beneficial ownership thresholds. As a result, regulators can only intervene when the lack of disclosure breaches other standards or is deemed abusive. Notably, in *Bison* the ASC approached Brookfield's hidden ownership primarily from a materiality perspective, holding that the details about the swaps were material to the target shareholders. However, it is debatable whether materiality is the appropriate benchmark to address the disclosure of swaps. Indeed, one might ask whether the issue of swaps was material to target shareholders who are primarily concerned with the price they receive for their shares. In other words, shareholders will tender their shares if they consider the offer favourable and refuse if they do not. This may explain why Brookfield ultimately succeeded in completing the acquisition.

Further, relying on the public interest as a secondary means to address hidden ownership concerns is problematic and can lead to inconsistent outcomes. For example, in the Sears case, the OSC did not consider Pershing's use of swaps to be abusive, even though evidence suggested that Pershing intended to unwind the swaps and purchase the underlying shares from its counterparty to defeat Sears Holdings' bid, highlighting a lack of clarity on whether, and under what conditions, regulators will intervene. In the Bison case, submissions occurred six months after Brookfield had announced its bid, disclosing both its ownership and its economic interest in IPL through swaps. The existence of the IPL swaps was therefore in the public domain for a considerable time and was repeatedly disclosed

before the ASC deemed their lack of disclosure to be abusive. Hearings before the commissions can take months, and such significant delays can jeopardize time-sensitive acquisitions. Regulatory intervention can, and usually will, cause delay and uncertainty in public acquisitions, potentially undermining the interests of target shareholders, whom the take-over bid regime is designed to protect in the first place.

Ultimately, while Canadian jurisprudence has acknowledged the problems associated with empty voting and hidden ownership, these issues have not been systematically addressed by securities regulators or courts. The current piecemeal approach offers flexibility in tailoring responses to individual cases but comes at the expense of overall consistency and coherence. Furthermore, it risks overextending existing legal frameworks, which may not be adequately equipped to address the distinct challenges presented by decoupling. It is conceivable that courts and regulators could chart a clearer path as more cases on empty voting or hidden ownership emerge. However, a direct legislative approach might prove more effective and operational in addressing the evolving challenges of empty voting and hidden ownership within the Canadian context. A future article will explore what such a legislative framework might look like and how it could respond effectively to the issues raised here.