Who’s Afraid of Shareholder Power? A Comparative Law Perspective

Jennifer Hill, Vanderbilt University

Available at: https://works.bepress.com/jennifer_hill/3/
Who’s Afraid of Shareholder Power? A Comparative Law Perspective

Jennifer G. Hill

Professor of Corporate Law, University of Sydney Law School; Visiting Professor, Vanderbilt Law School (Spring 2008-2010); Research Associate, European Corporate Governance Institute (ECGI)

Who’s Afraid of Shareholder Power? A Comparative Law Perspective

Jennifer G. Hill*

1. Introduction

“We fear to grant power and are unwilling to recognize it when it exists”. 
Oliver Wendell Holmes¹

Shareholder power is back on the agenda in US corporate law. Although shareholders have traditionally held restricted participatory rights under US corporate law, this paradigm has been challenged in recent times. The shareholder empowerment debate² raised shareholder power as a serious subject for corporate law reform. The Committee on Capital Markets Regulation (“Paulson Committee”) also recommended increased shareholder rights as an alternative regulatory technique to a more stringent rules-based approach.³ Yet, in spite of these calls for stronger shareholder rights, there has been great resistance to adjusting the traditional balance of power between shareholders and the board of directors in the US. The current financial crisis highlights some of the dangers of untrammelled managerial power and under-

* Professor of Corporate Law, University of Sydney; Visiting Professor, Vanderbilt Law School; Research Associate, European Corporate Governance Institute. I am grateful to Bill Carney, Kevin Cramer, Deborah DeMott, Ron Masulis, Randall Thomas, Robert Thompson and Andrew Tuch for helpful comments and suggestions. Thanks also to participants at workshops at Duke University, Emory University, University of Hawaii, University of Hong Kong, Queensland University, and at the following conferences - The Delaware General Corporation Law for the 21st Century (Widener University, 2008) and Shareholder Rights, Shareholder Voting and Corporate Performance (University of Amsterdam, University of Cagliari and Vanderbilt University, 2008). Thanks also Alice Grey for her excellent research assistance. All errors are my own. Funding for this research was provided by the University of Sydney and the Australian Research Council.


2 The debate is played out in a 2006 and 2007 Special Issue of the Harvard Law Review and Virginia Law Review respectively.

regulation - business once again has “a legitimacy problem”. The financial crisis represents an opportunity to reassess whether shareholders should be afforded stronger power, as a check on managerial control. It has been argued, for example, that any regulatory response to the crisis will be "incomplete if it fails to address this basic issue of shareholder rights".

Comparative corporate governance adds an important dimension to the shareholder empowerment debate. The dominant issue in the comparative corporate governance debate at the turn of the decade was whether international corporate laws would converge, or whether differences between common law and civil law jurisdictions would persist. An embedded assumption by all parties to this debate was the existence of a unified and stable Anglo-American model of corporate governance representing the common law side of this divide.

This article critically analyzes the shareholder empowerment debate from a comparative law perspective, challenging the assumption of a cohesive common law governance model in relation to shareholder power. Corporate governance literature


6 This discussion has arisen, for example, in the context of the UK bank bailout. See Kate Burgess, Shareholders Welcome Chance to Help, FIN. TIMES, Oct. 9, 2008, at 04.

7 John Plender, Shut Out, FIN. TIMES, Oct. 18, 2008, at 11. The International Corporate Governance Network (ICGN) has also warned that shareholder rights need to be made integral to reforms associated with the UK bank bailout. See also Kate Burgess, Global Crisis? Blame the Regulators, Says Investors Group, FIN. TIMES, Nov. 10, 2008, at 18.

8 For example, at this time, Professors Hansmann and Kraakman famously stated “[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured…” Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 GEO. L.J. 439, 468 (2001).

9 A voluminous literature on the “convergence-divergence” debate emerged at the turn of the last decade. For a recent synthesis of the issues in that debate, see Jeffrey Gordon & Mark Roe (eds), CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (2004).

10 See, e.g., Gordon & Roe (eds), id, which poses the question “Is the Anglo-American model of shareholder capitalism destined to become standard or will sharp differences persist?”
has paid relatively little attention to legal differences within the common law world. Nonetheless, as this article shows, US shareholders have significantly less power than their counterparts in other common law jurisdictions, such as the UK and Australia. This divergence became more pronounced in the aftermath of international corporate scandals, such as Enron, which prompted a wave of reforms in common law jurisdictions.\footnote{See generally, Jennifer G. Hill, \textit{Regulatory Responses to Global Corporate Scandals}, 23 Wis. INT’L L.J. 367 (2005).} While these reforms tackled similar corporate governance concerns, they demonstrated intriguing differences in relation to shareholder power.\footnote{\textit{Id.} at 392.}

Much regulatory debate has focused on the effect of legal rules in reallocating power. Yet, commercial norms and practices may be equally, or more, important.\footnote{See generally Melvin A. Eisenberg, \textit{Corporate Law and Social Norms}, 99 COLUM. L. REV. 1253 (1999).} The article concludes by discussing a tension, which has emerged in Australia, between legal rules designed to enhance shareholder participation in corporate governance, and commercial attempts to curb such involvement and shift power away from shareholders toward the board of directors. These commercial developments are noteworthy because they demonstrate how some Australian companies have tried to create a \textit{de facto} corporate governance regime, which mimics certain aspects of Delaware law. These developments show that commercial practices may in some instances effectively subvert legal rules and generate their own convergence pressures.

2. Evolving Visions of the Shareholder in Corporate Law

“[I]t is the courts that are relegating shareholders to the questionable role of bystanders”.

Richard M. Buxbaum\footnote{Richard M. Buxbaum, \textit{The Internal Division of Powers in Corporate Governance}, 73 CAL. L. REV. 1671, 1683 (1985).}
“[I]f the principal economic function of the corporate form [is] to amass the funds of investors, \textit{qua} investors, we should not anticipate their demanding or wanting a direct role in the management of the company”.

Henry G. Manne\textsuperscript{15}

A range of visions of the relationship between shareholders and the corporation can be discerned across time and jurisdictions in corporate theory. These images lie on two distinct axes – first, the appropriate level of shareholder participation in corporate governance and secondly, the status of shareholder interests. A number of competing roles for investors are discernible within this schema. The shareholder is variously presented as an owner/principal; beneficiary under a trust; bystander; participant in a political entity; investor; gatekeeper; or managerial partner.\textsuperscript{16}

The level of shareholders’ participatory rights, and the status of their interests, varies considerably across this spectrum of possible images. So, too, does the level of shareholder power. Under the classic nexus of contracts theory of the corporation, for example, the shareholder is viewed as an investor with restricted participatory rights and power, but preeminent interests.\textsuperscript{17} Collectivist theories, such as team production theory, go one step further, by challenging not only strong participatory rights for shareholders, but also any assumed primacy of their interests over the interests of other corporate constituencies.\textsuperscript{18}

The image of shareholders has been reevaluated in recent times, in the light of the spate of international corporate scandals, such as Enron, the demise of the dotcom


\textsuperscript{16} For a detailed analysis of these images underlying corporate law doctrine, see Jennifer G. Hill, \textit{Visions and Revisions of the Shareholder}, 48 AM. J. COMP. L. 39, 42ff (2000).


\textsuperscript{18} Margaret M. Blair \& Lynn A. Stout, \textit{A Team Production Theory of Corporate Law}, 85 VA. L. REV. 247 (1999).
boom, and the onset of the current financial crisis. Ambivalence has emerged concerning the role of shareholders in these events. On one interpretation, boards of directors and gatekeepers bear most responsibility for these events, with shareholders seen as innocent bystanders or victims.

On another interpretation, however, shareholders have been far from blameless. The latter interpretation focuses on the perceived short-term interests of many shareholders, such as hedge funds, viewing them not as victims, but as potential threats to the corporate enterprise. This image is also evident in the cross-border

---


20 Such an image of shareholders is not new. According to Justice Brandeis, for example, “[t]here is no such thing….as an innocent stockholder. He may be innocent in fact, but socially he cannot be held innocent”. Osmond K. Fraenkel, THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS 75 (1965, c 1934).

21 See, e.g., Roberta S. Karmel, Should a Duty to the Corporation be Imposed on Institutional Shareholders?, 60 BUS. LAW. 1, 4-9 (2004) (arguing that institutional investors must take a share of the blame for defective financial analysis and aggressive pursuit of a shareholder primacy norm, which encouraged earnings manipulation and excessive executive pay); Vice Chancellor Leo E. Strine, Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America, 119 HARV. L. REV. 1759, 1764, 1772-1773 (2006) (suggesting, from the perspective of the corporate law traditionalist, that quarter-to-quarter earnings of mutual and pension funds helped to fuel the pre-Enron environment, and noting the failure of institutional investors to detect the “obvious rot” at firms like Enron (at 1766)). See also William W. Bratton, Enron and the Dark Side of Shareholder Value, 76 TUL. L. REV. 1275, 1284 (2002) (condemning the short-termism associated with a commercial norm of shareholder value maximization); Antoine Rebérioux, Shareholder Primacy and Managerial Accountability 2-3, 18-24 (Comparative Research in Law and Political Economy Working Paper No. 1/2007, 2007), available at http://ssrn.com/abstract=961290 (suggesting that a shareholder primacy norm, rather than gatekeeper failure, was the main driving force in the corporate scandals); Patrick Bolton, José A. Scheinkman & Wei Xiong, Executive Compensation and Short-Termist Behavior in Speculative Markets, 73 REV. ECONOMIC STUDIES 577 (2006) (positing a reinterpretation of compensation practices in a bubble market).


23 See generally Vice Chancellor Leo E. Strine, Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America, 119 HARV. L. REV. 1759, 1764 (2006).
context. As the current financial crisis deepens, there is a growing perception that major institutional investors have been deficient monitors, doing little, for example, to counter the immense executive pay packages during boom periods of the last decade. There is also increasing concern about the phenomenon of “empty voting”, involving a disjunction between voting rights and economic interests in the company. Ambivalence about the role of the shareholder is reflected in a shift in much contemporary corporate law scholarship from traditional discourse about protection of investors, to discourse about protection of the corporation from investors.

3. The Great Debate - Shareholder Empowerment and US Corporate Law

24 For example, in January 2008, Takao Kitabata, Vice-Minister of Japan's Ministry of Economy, Trade and Industry described shareholders as "fickle and irresponsible", adding that "[t]hey only take on a limited responsibility, but they greedily demand high dividend payments". The comments were made in the context of pressure exerted by an activist US investment fund, Steel Partners, against management of the Japanese beer company, Sapporo. See Samurai v Shareholders - Activist Investors in Japan, THE ECONOMIST, Feb. 16, 2008, 386.

25 See, e.g., John Plender, Shut Out, FIN. TIMES, Oct. 28, 2008, 11, discussing allocation of blame for the credit crisis and asking the question, "where were the shareholders?". See also Pauline Skypala, Time To Reward Good Corporate Governance, FIN. TIMES, Nov. 17, 2008, 66.

26 See, e.g., Patrick Bolton, José A. Scheinkman & Wei Xiong, Executive Compensation and Short-Termist Behavior in Speculative Markets, 73 REV. ECONOMIC STUDIES 577 (2006).


“There’s a battle outside and it’s ragin’".

Bob Dylan

Ambivalence concerning the role of the shareholder lies at the heart of the shareholder empowerment debate. While some commentators view enhanced shareholder power as a positive corporate governance attribute, others regard it as a potentially dangerous deviation from firmly established principles of US corporate law.

Instigating the controversial shareholder empowerment debate, Professor Bebchuk has advocated readjusting the balance of power between shareholders and the board of directors in some key areas of US corporate law, including the corporate election process (“the corporate election issue”) and amendment of the corporate constitution (“the constitutional amendment issue”).

Shareholder involvement in corporate elections became a live topic when the SEC recommended in its 2003 Staff Report that there should be increased shareholder participation in the US director nomination process, via use of the company’s proxy statement to conduct a contested board election. This was by no means a new debate in US corporate law; the issue has periodically emerged for at least fifty years.

---

29 Bob Dylan, The Times They are A-Changin’ (1964).


33 The issue was first addressed by the SEC in 1942. For a history of the debate, see Lewis J. Sundquist, Comment: Proposal to Allow Shareholder Nomination of Corporate Directors: Overreaction in Times of Corporate Scandal, 30 WM. MITCHELL L. REV. 1471, 1473ff (2004). See also Richard M. Buxbaum, The Internal Division of Powers in Corporate Governance, 73 CAL. L. REV. 1671, 1682-83 (1985), expressing frustration in the mid-1980s with the “jawboning” of the SEC and NYSE, but ultimate lack of progress on the issue at that time.
the debate’s most recent iteration, Bebchuk urged reform on the basis that the supposed power of shareholders to replace directors is illusory under the current corporate election system.\textsuperscript{34} In spite of the SEC’s initial enthusiasm for such reform, the issue of allowing shareholders increased participation in the director nomination process was subsequently described as “moribund”.\textsuperscript{35}

Some later developments, however, breathed further life into the corporate election issue. The Paulson Committee Report, for example, sought to reactivate it,\textsuperscript{36} in conjunction with another contentious reform proposal - the introduction of majority, rather than plurality,\textsuperscript{37} voting for the election of directors.\textsuperscript{38} The SEC also re-entered the fray, with the release of two conflicting proposals. The first had the effect of

\begin{itemize}
\item \textsuperscript{34} See Lucian A. Bebchuk, \textit{The Case for Shareholder Access to the Ballot}, 59 BUS. LAW. 43, 45 (2003); Lucian A. Bebchuk, \textit{The Myth of the Shareholder Franchise}, 93 VA. L. REV. 675 (2007). See also Vice Chancellor Leo E. Strine, \textit{Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America}, 119 HARV. L. REV. 1759, 1782 (2006), arguing that reform of the current “incumbent-biased election process” in the US would accord legitimacy to directors and justify corporate law’s deference to their autonomy and power.
\item \textsuperscript{35} See Vice Chancellor Leo E. Strine, \textit{id.} at 1776-1777.
\item \textsuperscript{36} See Committee on Capital Markets Regulation, \textit{Interim Report of the Committee on Capital Markets Regulation} 33, 106 (Nov. 30, 2006, revised version released Dec. 5, 2006), calling on the SEC to “address and resolve, in its upcoming hearings, appropriate access by shareholders to the director nomination process”.
\item \textsuperscript{37} For a damning description of the plurality voting norm as a “Soviet-style” voting system, see John Plender, \textit{Shut Out}, FIN. TIMES, Oct. 18, 2008, 11.
\end{itemize}
preventing shareholder participation in the director election process.\footnote{SEC, Shareholder Proposals Relating to the Election of Directors: Release No. 34-56161, 27 July 2007, available at \url{http://www.sec.gov/rules/proposed/2007/34-56161.pdf}.} This proposal came in reaction to a federal appeals court decision\footnote{American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc., 462 F.3d 121 (2d Cir. 2006).} which adopted a liberal interpretation of Securities Exchange Act Rule 14a-8(i)(8), potentially providing an indirect method for increased shareholder participation in the director nomination process.\footnote{The court limited the election exclusion under Securities Exchange Act Rule 14a-8(i)(8) to proposals relating to a particular election. The court held that proposals which established the procedural rules governing elections generally (such as a procedure permitting shareholder-nominated candidates to be included on the corporate ballot), would not fall within the scope of the election exclusion. \textit{Id}.} In contrast, the second SEC proposal would have allowed shareholders with five per cent of a company’s voting shares to include in that company’s proxy materials proposals for bylaw amendments regarding the nomination of directors.\footnote{SEC, Shareholder Proposals: Release No. 34-56160, 27 July 2007, available at \url{http://www.sec.gov/rules/proposed/2007/34-56160.pdf}. Some investor groups were highly critical of the proposed five per cent threshold: see Judith Burns, \textit{SEC Proxy Access Proposal Draws Fire from Investors}, WALL ST. J., Jul. 11, 2007, at D2.} Internal disagreement among commissioners at the SEC explains the release of these two separate, yet opposing, proposals.\footnote{Two Democratic commissioners voted in favor of the proposal affording greater participation rights to shareholders. Two Republican commissioners voted in favor of the converse proposal. Rather than supporting one proposal alone, Chairman Christopher Cox voted both ways. See Kara Scannell, \textit{SEC’s Solomon? Cox Splits Vote on Proxy Access – Chairman Backs Change and the Status Quo; Buying Time to Fix Rule}, WALL ST. J., Jul. 26, 2007, at C1; Stephen Labaton, \textit{A Public Airing for Proposals on Shareholders}, N.Y. TIMES, Jul. 26, 2007, at 3.} In late 2007, the SEC voted to maintain the \textit{status quo} and adopt the first proposal, restricting shareholder participation in the director election process.\footnote{See SEC, SEC Votes to Codify Longstanding Policy on Shareholder Proposals on Election Procedures: Release 2007-246, 28 November 2007, available at \url{http://www.sec.gov/news/press/2007/2007-246.htm}.}

Bebchuk’s second set of reform proposals involved increasing US shareholder powers to initiate and effect change to governance structures by, for example, alteration to the corporate charter.\footnote{See Lucian A. Bebchuk, \textit{The Case for Increasing Shareholder Power}, 118 HARV. L. REV. 833 (2005).} The ability of shareholders to effect corporate change through
constitutional amendment is extremely limited in the US. Under both the Delaware General Corporation Law (“Delaware Code”) and the Model Business Corporation Act (“MBCA”), shareholders are precluded from initiating changes to the corporate charter.46

At first sight, the potential for shareholders to achieve corporate governance change via a company’s bylaws appears more promising, as both the Delaware Code and the MBCA grant shareholders power to initiate and to effect changes to the bylaws.47 Since these statutes explicitly permit the bylaws to contain provisions relating to the business of the corporation and the conduct of its affairs, this would appear to give US shareholders significant powers with respect to constitutional change. There is, however, a Catch 22-like twist. It is in the form of the statutory qualification to the effect that no provision in the bylaws can be inconsistent with US state law or with the corporation’s charter.48 The Delaware Code vests power to manage the corporation’s business in the board of directors, except as is otherwise provided by the statute or the certificate of incorporation.49 The absence of any reference to the bylaws in this qualification dilutes the efficacy of bylaw amendment as a tool for reallocation of power between shareholders and management. The recent Delaware Supreme Court decision in CA, Inc. v. AFSCME Employees Pension Plan50 confirms such a restricted role for bylaw amendments.

US corporate law is strikingly different to UK and Australian corporate law in relation to the ability of shareholders to alter the constitution. Under traditional English and

46 See DEL. CODE ANN., tit. 8, § 242(b) (2008); MODEL BUS. CORP. ACT § 10.03 (2008).
47 See DEL. CODE ANN., tit. 8, § 109 (2008); MODEL BUS. CORP. ACT § 10.20 (2008). Under the MBCA provision, shareholders have concurrent power with directors to amend the bylaws, however, under the Delaware provision, directors will only have concurrent power to amend the bylaws if such power is conferred in the company’s certificate of incorporation.
50 See generally CA, Inc. v. AFSCME Employees Pension Plan, No. 329, 2008 (Del. July 17, 2008), holding that shareholders and the board do not possess co-extensive power to adopt and amend bylaws, in view of the “cardinal precept” of managerial authority under DEL. CODE ANN., tit. 8, § 141(a) (2008).
Australian law principles, the constitution\(^{51}\) is freely alterable\(^{52}\) by special resolution of the shareholders.\(^{53}\) The board’s managerial powers are expressly constrained by any powers reserved to the shareholders in general meeting, either by statute or the company’s constitution.\(^{54}\) Any provision attempting to contract out, or deprive, the shareholders of their inherent power to alter the constitution would be invalid under UK or Australian law, as contrary to statute.\(^{55}\) Indeed, it has been suggested that the articles of association, and their ability to be freely altered according to the wishes of members, are the cornerstone of shareholder rights in the UK.\(^{56}\) Shareholders may initiate amendment to the constitution, by proposing a resolution at the annual general meeting or by convening a special shareholders’ meeting. The power of shareholders

---

\(^{51}\) Early UK and Australian corporate law recognized two distinct constitutional documents: the memorandum of association and the articles of association. The division between the memorandum and articles is retained in the recently introduced Companies Act 2006 (UK), however the memorandum is now largely of historical significance and contains only basic information. It will no longer be possible to amend the memorandum of a company formed under the new Act: *Explanatory Notes to Companies Act 2006*, available at [http://www.opsi.gov.uk/ACTS/en2006/2006en46.htm](http://www.opsi.gov.uk/ACTS/en2006/2006en46.htm), paras [33] and [65]. The articles of association are now the sole constitutional document: *id. at para [34]*. Companies may also choose to adopt any or all of the ‘model articles’ as prescribed by the Secretary of State (§ 19). Australian law abolished the requirement for a constitution in 1998, and companies may instead adopt “replaceable rules” under § 135 of the Corporations Act 2001 (Cth).

\(^{52}\) See also *Walker v. London Tramways Co.* (1879) 12 Ch. D. 705; *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656 (especially the comments of Lindley MR at 671); *Peters’ American Delicacy Co. Ltd. v. Heath* (1939) 61 CLR 457.

\(^{53}\) Corporations Act 2001 (Cth) § 136(2); Companies Act 2006 (UK) § 21. Under Corporations Act 2001 (Cth) § 136(3), it is possible, however, for the company’s constitution to provide that a further requirement or condition be met before the alteration is effective. In the UK, § 22 of the Companies Act 2006 (UK) permits members, in more limited circumstances than its Australian counterpart, to ‘entrench’ certain provisions by agreeing to additional conditions that must be met for an amendment to succeed.

\(^{54}\) See, for example, Corporations Act 2001 (Cth) § 198A(2).

\(^{55}\) See, e.g., *Allen v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656, 671; *Peters’ American Delicacy Co. Ltd. v. Heath* (1939) 61 CLR 457, 479. Nonetheless, there are several techniques, such as weighted voting, entrenchment clauses or shareholder agreements, whereby free alterability of the constitution can effectively be reduced or subverted. See, e.g., *Bushell v. Faith* [1970] A.C. 1099; *Russell v. Northern Bank Development Corp. Ltd.* [1992] 3 All E.R. 161.

\(^{56}\) See Richard C. Nolan, *Shareholder Rights in Britain*, 7 EUR. BUS. ORG. L. REV. 549, 554-556 (2006), who views free alterability as reflecting the ability of shareholders to “choose the terms of the arrangements between them”. He describes its effect as “explicitly contractual in nature, even though [it] is mandated by statute rather than by the common law”.

to convene meetings under current Australian law is particularly generous, by international standards.\textsuperscript{57}

The US rules relating to charter alteration, and shareholder voting generally, reflect a governance model in which directors are essentially cast in the role of gatekeeper,\textsuperscript{58} and shareholders in the role of supplicant.\textsuperscript{59} This relationship is alien to traditional UK and Australian principles of corporate law, which until recently did not recognize precatory or advisory resolutions by shareholders.\textsuperscript{60} Rather, UK and Australian principles regarding allocation of power are based on a constitutional model of separate and autonomous spheres of authority for directors and shareholders.\textsuperscript{61}

This paradigm difference between US and UK law, which directly affects the balance of power between shareholders and the board of directors, arguably derives from deep historical differences in the evolution of corporations in these jurisdictions\textsuperscript{62} and

\textsuperscript{57} As discussed in detail later in the paper, shareholders with at least 5\% of votes or 100 members by number may requisition a shareholder meeting (Corporations Act 2001 (Cth) § 249D) or propose a resolution (Corporations Act 2001 (Cth) § 249N). In contrast, the basic rule under UK corporate law is that only shareholders with at least 10\% of voting shares may direct the board to convene a meeting (Companies Act 2006 (UK) § 303(3)).

\textsuperscript{58} See Charles O’Kelley & Robert B. Thompson, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS; CASES AND MATERIALS 145 (5\textsuperscript{th} ed. 2006); Stephen M. Bainbridge, Unocal at 20: Director Primacy in Corporate Takeovers, 31 DEL. J. CORP. L. 769, 771 (2006).

\textsuperscript{59} See, e.g., Continental Securities Co. v. Belmont, 206 N.Y. 7, 16-17; 99 N.E. 138, 141 (1912), stating that any action by shareholders is “necessarily in the form of an assent, request or recommendation”.

\textsuperscript{60} See, e.g., NRMA v. Parker (1986) 6 NSWLR 517, 522; Winthrop Investments Ltd. v. Winns Ltd. [1975] 2 NSWLR 666, 683 (adopting the view that advisory resolutions by shareholders were not recognized in law and could have no effect). The recent introduction of a non-binding shareholder vote in relation to executive pay in the UK and Australia therefore diverges from tradition in these jurisdictions. See infra n133ff.

\textsuperscript{61} See, e.g., John Shaw & Sons (Salford) Ltd. v. Shaw [1935] 2 K.B. 113, 134 stating “[a] company is an entity distinct alike from its shareholders and its directors … [The shareholders] cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders”. See also Automatic Self Cleansing Filter Syndicate Co., Ltd. v. Cuninghame [1906] 2 Ch. 34; Howard Smith Ltd. v. Ampol Petroleum Ltd. (1974) 3 ALR 448, 457.

constitutes an interesting example of path dependence in operation. Whereas US corporate law evolved out of state-based charters, the same was not true of UK companies, whose origins can be traced to joint-stock companies, which were unincorporated partnerships. Historically, these different origins meant that UK company law was more firmly based on partnership law and contractual principles than US corporate law, resulting in greater freedom and flexibility for participants themselves to allocate power within UK companies. It has also been said that “[w]hile the focus in the UK has been on attracting capital, the focus in the US has been on attracting managers”. These divergent origins have significant implications for a wide range of contemporary issues in corporate law, such as shareholder rights and hostile takeovers. The high level of deference accorded to the board of directors under US corporate law (and correspondingly narrow shareholder powers) arguably reflect these distinctive historical roots.

Bebchuk’s constitutional amendment reform proposals would, by allowing shareholders to initiate and make constitutional alterations to the corporate charter, significantly alter the balance of power between shareholders and management under US corporate law. The proposed reforms would shift US law away from its

---


traditional “board as gatekeeper” model and towards the constitutional model favored in the UK and Australia.

Bebchuk has advanced the shareholder empowerment reform proposals on the basis of an efficiency, rather than a shareholder democracy, rationale. The presumed efficiency gains include a reduced need for outside intervention by legislators and regulators, with the mere threat of shareholder participation acting as a disciplinary mechanism for managerial decisions.

Issues relating to the balance of power between shareholders and the board of directors permeate several other US developments. The Paulson Committee Report, for example, argued that the US post-Enron reforms were overly stringent by international standards, resulting in reduced competitiveness of US markets. As a concomitant to this argument, the Committee recommended increased shareholder rights and participation as an alternative regulatory technique. Contrary to the assumption in the influential “law matters” hypothesis that US corporate law provides strong minority shareholder protection, the Paulson Committee Report considered


71 Key proposals of the Committee on Capital Markets Regulation relating to enhancement of shareholder rights included:– (i) the requirement that classified boards gain the approval of shareholders prior to implementing a poison pill (ii) the adoption of majority, rather than plurality, voting for board directors (iii) clarification of the rights of shareholders with respect to gaining access to the company proxy to nominate directors for election (iv) enhancing shareholders’ ability to access alternative means of dispute resolution (Paulson Committee, id. at xii-xiii, 93-114). For subsequent developments concerning these proposals, see Hal S. Scott, What is the United States Doing About the Competitiveness of its Capital Markets, 22(9) J. INT’L BANKING LAW & REGULATION 487, 489-490 (2007).

72 See, e.g., Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Law and Finance, 106 J. POLITICAL ECONOMY 1113, 1128, 1130 [1998]; Rafael La Porta,
that, in fact, “lack of shareholder rights” was affecting the level of investment in US companies.\textsuperscript{73} While an efficiency/firm value justification underpins much of the Paulson Committee’s discussion, there are some statements suggesting that the fundamental power imbalance between management and shareholders is an independent justification for stronger shareholder rights.\textsuperscript{74} The current financial crisis also raises this issue in an acute way. Nonetheless, as the crisis intensifies, the reformatory focus may be shifting away from corporate governance, and toward wholesale restructuring of the US financial regulatory system.\textsuperscript{75}

Few US commentators seem to doubt that there is “ample room for increasing shareholder power” under US corporate law.\textsuperscript{76} Yet, the shareholder empowerment reform proposals have elicited a surprisingly polarized debate\textsuperscript{77} and backlash,\textsuperscript{78} with

\begin{flushright}
\end{flushright}

\begin{flushright}
\end{flushright}

\begin{flushright}
\textsuperscript{74} According to the Paulson Committee, “[w]hen firms have a choice of legal regime, any policy proposal should adopt as a default the option most favorable to shareholders, given the fundamental asymmetry of power between managers and shareholders” (\textit{Interim Report of the Committee on Capital Markets Regulation} 103 (Nov. 30, 2006, revised version released Dec. 5, 2006)).
\end{flushright}

\begin{flushright}
\textsuperscript{75} See The Department of the Treasury (“Treasury”), \textit{Blueprint for a Modernized Financial Regulatory Structure} (“Blueprint Report”, March 2008), available at http://www.treas.gov/press/releases/reports/Blueprint.pdf. In this report, Treasury outlined ways in which it considers existing financial institution regulation to be outdated, fragmented and inefficient, and recommends a regulatory framework paradigm shift. The shift proposed in this report is from the current US “functional” regulatory system (characterized by regulation based on historical industry segmentation, such as banking, insurance, and securities) to “objectives-based” regulation (operating across different financial institutions). The Blueprint Report considers that an objectives-based system represents the optimal regulatory structure. This is due to the fact that it promotes operational synergies and efficiencies in regulation, and focuses on key types of market failure and systemic risk. The report cites Australia and the Netherlands as examples of jurisdictions in which objectives-based regulatory systems operate. \textit{See generally, id.} at 1-14, 21-22, 137-143. Timothy F. Geithner replaced Henry Paulson as Treasury Secretary in January 2009. It remains to be seen whether the Obama Administration will adopt the approach set out in the Blueprint Report.
\end{flushright}

\begin{flushright}
\end{flushright}

\begin{flushright}
many commentators doubting the wisdom of increasing shareholder power at the expense of managerial power. Some aspects of this debate may now need to be reassessed in the light of the current financial crisis.

Criticism of the shareholder empowerment proposals emanates from a variety of perspectives. First, paralleling the famous critique over two decades ago by law and economics scholars against the anti-managerialists, some commentators argue that shareholder disempowerment is not a cause for angst, but rather a positive attribute of US corporate law. Rules according deference to managerial autonomy and severely limiting shareholder participation are seen as a deliberate choice, not a perversion, of corporate law.

Responses to the shareholder empowerment reform proposals by Chancellor Strine, Bainbridge, Stout, and Lipton and Savitt fall within this critical rubric. Bainbridge, for example, does not dispute Bebchuk’s assessment of shareholder disempowerment, but rather welcomes it as providing evidence that US corporate law permits disempowerment.

---


---


Vice Chancellor Strine’s analysis is from the perspective of the “open-minded corporate law ‘traditionalist’”. See Vice Chancellor Leo E. Strine, Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America, 119 HARV. L. REV. 1759, 1759 (2006).


is based on an efficient model of centralized board authority. This line of criticism highlights the distinction between shareholder participation rights and protection of shareholder interests. Reflecting the earlier contractarian critique of anti-managerialism, it stresses the voluntary nature of investment in public companies and rejects the need for greater shareholder power on the basis that shareholder interests are already safeguarded via the market, modern governance pressures, and the ability of shareholders to self-protect through mechanisms such as diversification.

Secondly, commentators have criticized the shareholder empowerment proposals from an evolutionary/efficiency perspective, asking why, if shareholder empowerment is a valuable corporate governance attribute, we do not already see it in the marketplace. While this is an intriguing question with respect to US corporate law, it is a less persuasive argument from a comparative corporate governance perspective, since considerable divergence in the nature and level of shareholder power exists across common law jurisdictions.


86 See Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 HARV. L. REV. 1735, 1746-1747 (2006). As in the earlier debate between contractarians and anti-managerialists, Bainbridge and Bebchuk exhibit different levels of faith in the market as a constraining force on management.


88 Vice Chancellor Leo E. Strine, Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America, 119 HARV. L. REV. 1759, 1764 (2006).


90 This evolutionary/efficiency argument suggests that the dearth of shareholder participatory rights under US corporate law proves that they are neither desired nor valued by investors. See, e.g., Bainbridge, id. at 1737; Lynn A. Stout, The Mythical Benefits of Shareholder
A third line of criticism is of the “be careful what you wish for” variety. It views the idea of shareholder empowerment as essentially pernicious - certainly more dangerous, at least, than shareholder disempowerment. It has been argued, for example, that shareholder empowerment would subvert the most advantageous feature of corporations, centralized board power, and potentially result in board blackmail.91 In the context of the corporate election issue, some commentators have claimed that increased shareholder participation in the director nomination process would promote special interest directors, undermine board collegiality and introduce the risk of “balkanized and dysfunctional boards”.92 A variant of this argument stresses that shareholders are themselves a fragmented and fractured group with disparate interests.93 The “be careful what you wish for” argument suggests that shareholders are likely to abuse participatory powers, engage in opportunism, prefer their private sectional interests to those of the shareholders generally,94 or succumb to the “momentary majority impulse”.95 Under this line of argument, not only does the

---

91 Bainbridge, id. at 1749, 1756.


94 Anabtawi, id. at 598.

company need protection from predatory conduct of its shareholders, but shareholders need protection from each other.96

A fourth type of criticism is based on a futility argument. This argument appears, at first sight, difficult to reconcile with the “be careful what you wish for” argument, though they are often conjoined. While the latter argument predicts dire consequences in altering legal rules to increase shareholder power in corporate governance, the futility argument warns of the opposite result. The futility argument suggests that such changes to legal rules would be wholly ineffective, given collective action problems and rational shareholder apathy.97 The explanation of the paradox between these two arguments appears to lie in the fragmented nature of the shareholder body.98 Thus, it is assumed that although apathy would generally prevail among the majority of shareholders, including institutional investors,99 the groups that would take advantage of enhanced shareholder powers are those considered by Bebchuk’s detractors most likely to abuse them – namely, union and public employee pension funds.100

Fifth, some critics have used a precautionary principle to counter the reform proposals. Building on the “be careful what you wish for” argument, the precautionary principle asserts that, given the “likely and severe negative
consequences\textsuperscript{101} of the proposals, a heavy onus should lie on those in favor of reform to demonstrate that the benefits would outweigh the costs. According to Lipton and Savitt, for example, “the policy considerations in favor of not jeopardizing the economy are so strong that not even a remote risk … is acceptable”.\textsuperscript{102} As the credit crisis has shown, however, systemic risks\textsuperscript{103} to the stability of the financial system clearly existed that were at least commensurate with the danger posed by enhanced shareholder power.

Sixth, the timing of the reform proposals has been criticized via a “wait and see” argument. This argument stresses the fact that significant corporate governance changes, such as the strengthening of the role of independent directors, were introduced relatively recently under the US post-Enron reforms,\textsuperscript{104} and that any rush to adopt additional changes should be deferred until the consequences of those reforms can be known and assessed.\textsuperscript{105} This argument parallels criticism of the Sarbanes-Oxley Act 2002, in which perceived defects of the legislation have been linked to the speed of its passage, and the level of associated deliberation and policy assessment.\textsuperscript{106}

\textsuperscript{101} Lipton & Savitt, \textit{id.} at 734.


Seventh, the shareholder empowerment proposal has been condemned as promoting short-term thinking over long-term sustainability. This critique particularly targets institutional investors, claiming that their incentives, including their compensation structures, encourage short-term goals to be prioritized over long-term wealth creation. This problem was seen as a defining element of Enron and other corporate scandals.

Another strand of the short-term versus long-term analysis relates to corporate theory. Some commentators claim that shareholder empowerment proposals rest on the flawed assumption that the role of directors is to serve the interests of shareholders, rather than stakeholders generally. Bebchuk has explicitly disavowed the idea that his shareholder empowerment reform proposals are based upon corporate democracy or shareholder ownership rights. Nonetheless, an underlying theme in the responses from some of his critics is that the concept of shareholder empowerment is misguided, since it would revive an outmoded and inappropriate image of the shareholder as “owner” of the corporation or principal in a principal-agent relationship.

---


4. Post-Enron Regulation – Shareholder Empowerment versus Shareholder Protection

“Lack of shareholder power did not contribute to Enron’s fall”. \footnote{See, e.g., \textit{Automatic Self Cleansing Filter Syndicate Co, Ltd. v. Cuninghame [1906] 2 Ch. 34.}}

Lynn A. Stout\footnote{Lynn A. Stout, \textit{The Mythical Benefits of Shareholder Control}, 93 VA. L. REV. 789, 808 (2007).}

As discussed in Part 3, US corporate law differs significantly from UK and Australian law in terms of the ability of shareholders to alter the constitution. This is merely one of a panoply of such differences. Shareholders in the UK and Australia have stronger power than their counterparts in Delaware in a range of corporate governance contexts.\footnote{See, e.g., Martin Gelter, \textit{The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance}, HARV. INT. L.J. 129, 134 (2009), stating that US corporate and securities law is “highly unusual in the extent to which disenfranchises shareholders from both explicit and implicit influence”. Areas where shareholders \textit{prima facie} have stronger rights in the UK and Australia than in Delaware include convening special shareholder meetings, appointment and removal of directors, and takeovers. Events surrounding News Corp’s 2004 move from Australia to Delaware provide a good snapshot of these differences. See generally Jennifer G. Hill, \textit{Subverting Shareholder Rights: Lessons from News Corp’s Migration to Delaware} (forthcoming _ ).}

\begin{itemize}
  \item \textit{See, e.g., \textit{Automatic Self Cleansing Filter Syndicate Co, Ltd. v. Cuninghame [1906] 2 Ch. 34.}}
  \item \textit{Lynn A. Stout, \textit{The Mythical Benefits of Shareholder Control}, 93 VA. L. REV. 789, 808 (2007).}
  \item \textit{See, e.g., Martin Gelter, \textit{The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance}, HARV. INT. L.J. 129, 134 (2009), stating that US corporate and securities law is “highly unusual in the extent to which disenfranchises shareholders from both explicit and implicit influence”. Areas where shareholders \textit{prima facie} have stronger rights in the UK and Australia than in Delaware include convening special shareholder meetings, appointment and removal of directors, and takeovers. Events surrounding News Corp’s 2004 move from Australia to Delaware provide a good snapshot of these differences. See generally Jennifer G. Hill, \textit{Subverting Shareholder Rights: Lessons from News Corp's Migration to Delaware} (forthcoming _ ).}
\end{itemize}
Regulatory responses to international corporate scandals such as Enron highlight this divergence in relation to shareholder rights across the common law world. The corporate scandals elicited a range of reforms in common law jurisdictions, including the US, UK, and Australia. Although these reforms tackled similar problems of corporate legitimacy, they varied in terms of focus and structure. The reforms also had a distinctly local flavor, often tracking the contours of national issues and political pressures. While similar motivations underpinned the various reforms, their long-term effects are unlikely to coincide, due to inevitable differences in compliance and enforcement. Also, regulatory stringency can itself engender push-back from the business community. The Paulson Committee Report, which stressed the need to protect shareholders from excessive regulation, is an example of this kind of commercial backlash. This is a backlash, however, which has now been met with counter-backlash. Against the backdrop of the escalating credit crisis, and scandals such as the Bernard Madoff affair, a deregulatory reform agenda no longer appears politically feasible. The era of calls for “kinder, gentler” SEC is over, for some


123 President Obama has, for example, criticized the Bush Administration’s adherence to a deregulatory agenda, and condemned US regulators for having been “asleep at the switch”. He has indicated that major financial regulatory reform will be a priority for his government. See Joanna Chung and Andrew Ward, Obama Signals Change with Choice of Schapiro, FIN. TIMES, Dec. 19, 2008, at 05.
time at least.\textsuperscript{125} As Professor John Coffee has stated, if the credit crisis demonstrates anything, it is “that there are also costs to under-regulation”.\textsuperscript{126}

Shareholder protection was a common goal in the various post-Enron regulatory reforms in common law jurisdictions. Nonetheless, the reforms differ in the way in which they sought to achieve this end, with a dichotomy emerging between strengthening of shareholder participatory rights versus protection of shareholder interests.

In the US, protection of shareholder interests was a clear priority and part of the legislative intent of the post-scandal reforms; enhancement of shareholder participation and power was not.\textsuperscript{127} The preamble to the \textit{Sarbanes-Oxley Act} 2002 confirms this focus.\textsuperscript{128} This approach accords with Professor Bainbridge’s view that there is no need for enhanced participatory rights, when shareholder interests are


\textsuperscript{125} The International Corporate Governance Network (ICGN), for example, has blamed the current global financial crisis on failure by regulators, and said that stricter regulation is inevitable. \textit{See} Kate Burgess, \textit{Global Crisis? Blame the Regulators, Says Investors Group}, \textit{FIN. TIMES}, Nov. 10, 2008, at 18.

\textsuperscript{126} In discussing costs under-regulation, Professor Coffee continues, “Those costs can come all of a sudden and without warning. We need to find the proper balance between over-regulation and under-regulation (both of which are dangerous), and to identify the particular problems that most require a focussed assessment”. \textit{Professor John C. Coffee Jr., Financial Crises 101: What Can We Learn from Scandals and Meltdowns - from Enron to Subprime?}, in RP Austin (ed), \textit{THE CREDIT CRUNCH AND THE LAW} 37 (2008).


\textsuperscript{128} The preamble to the Sarbanes-Oxley Act of 2002 states that it is an Act “[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes”. The Act does not, however, provide any greater opportunities for shareholder involvement in corporate governance. \textit{See generally} Roberta S. Karmel, \textit{Should a Duty to the Corporation be Imposed on Institutional Shareholders?}, 60 BUS. LAW. 1, 2 (2004), arguing that the Sarbanes-Oxley Act reinforces shareholder primacy norms in corporate law. \textit{Cf.} Donald C. Langevoort, \textit{The Social Construction of Sarbanes-Oxley}, 105 MICH. L. REV. 1817, 1828ff (2007), arguing that although the Sarbanes-Oxley Act is, by its terms, about investor protection, the long-term effect of the Act may be less about protection of investor interests than about public accountability.
already protected by the market. Nonetheless, at the time of the reforms, several commentators described the refusal of the Sarbanes-Oxley Act 2002 to grant shareholders greater power in relation to matters such as the director election process, as notable and potentially “the forgotten element” of the US reforms.

The post-Enron reforms in a number of other common law jurisdictions present an interesting contrast to the US approach in this regard. Strengthening shareholder power was an explicit theme in the post-scandal reforms of both Australia and the UK, suggesting that legislators viewed increased shareholder participation in corporate governance as a valuable check on abuse of managerial power and a potential antidote to future corporate collapses. This aspect of the Australian and UK reforms contrasts with Professor Stout’s view that shareholder disempowerment was not a contributing factor in corporate scandals, such as Enron. It appears to be a premise of these reforms that shareholders were victims of the corporate scandals, rather than complicit in creating the conditions that produced them. In Australia, the Explanatory Memorandum to the CLERP 9 Act 2004 contains numerous references to the desirability of improving shareholder participation, increasing shareholder

---


133 Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth). The CLERP 9 Act, Australia’s main legislative response to the international corporate scandals, was passed on 25 June 2004. The majority of the Act’s provisions commenced operation on 1 July 2004.


Shareholders can and should play a key role in promoting good corporate governance practices by influencing the management of corporations through participating at general meetings ... It is sought to increase the practical opportunities for shareholders to assess and influence the
activism, and enabling shareholders to “influence the direction of the companies in which they invest”. 

In the light of these developments, it has been claimed that “enhancing shareholder participation is now undoubtedly a legitimate corporate governance objective” in Australia. The assumption that shareholder engagement enhances corporate performance and accountability has strong traction in current Australian law reform. It is reflected in the 2008 report of the Parliamentary Joint Committee on Corporations and Financial Services (“Parliamentary Joint Committee”), Better Shareholders – Better Company: Shareholder Engagement and Participation in Australia. This report assumes a delegated authority model of corporate governance, under which board members are directly accountable to shareholders. Adopting a shareholder democracy paradigm, the Parliamentary Joint Committee states that shareholders have a right to engagement with company boards and that the main focus of legislative reform should be the removal of impediments to such engagement.

Strong governmental rhetoric concerning the need to encourage greater shareholder democracy and participation also accompanied the post-Enron reforms in the UK.

---

135 See, e.g., id. at para [1.4], stating that “[t]he underlying objective of the reforms is to improve the operation of the market by promoting transparency, accountability and shareholder activism”. See also id. at para [4.71].

136 Id. at para [4.174].


139 Id. at paras [2.2]-[2.3].

140 Id. at para [2.23].

141 Id. at para [2.25].

with the Secretary of State for Trade and Industry applauding a “welcome increase in
the level of shareholder activism on the issue of directors’ remuneration”.

Shareholder engagement was an important subtext in the 2003 Higgs Committee Report,
on which the UK Combined Code on Corporate Governance (2003) was based. The recommendations of the Higgs Committee were designed to strengthen
the position of independent directors and foster a strong relationship and active
dialogue between those directors and major shareholders. The reforms in the UK
Companies Act 2006 went even further in encouraging shareholder participation, by
seeking to enfranchise indirect investors holding shares through a nominee.

It is in the area of remuneration that the most prominent Australian and UK statutory
reforms facilitating greater shareholder participation were introduced. The
Australian CLERP 9 Act 2004, for example, permitted greater shareholder
involvement in remuneration issues by requiring shareholders to pass a non-binding
resolution at the annual general meeting approving the directors’ remuneration
report. An analogous provision was introduced two years earlier in the UK.

143 Department of Trade and Industry (UK), Rewards for Failure, Foreword, 5, cited in Ferran, id. at 28.
144 Derek Higgs (Chair), Review of the Role and Effectiveness of Non-Executive Directors (January 2003), available at http://www.berr.gov.uk/files/file23012.pdf.
147 These reforms enable an indirect investor to receive corporate information, be appointed as proxy or give instructions to the legal owner as to how to vote the shares. See generally UK Companies Act 2006, Part 9.
150 The Directors’ Remuneration Report Regulations 2002, S.I. 2002/1986 (UK). The provision requiring shareholder approval of the directors’ remuneration report is now found in section
Unlike the US, where precatory shareholder voting has a long pedigree, there was no precedent for a non-binding shareholder vote in Australia or the UK. In spite of its non-binding status, the explicit goal of the Australian shareholder remuneration resolution is to facilitate more active shareholder involvement in compensation issues and to permit shareholders to express their opinion collectively. The Explanatory Memorandum to the CLERP 9 Act envisages greater consultation and information flow between directors and shareholders, stating that it is essential for directors to communicate with shareholders to ensure that appropriate remuneration policies are adopted. The reform seeks to constrain excessive remuneration by public censure and “shaming”. Evidence from the early years of the provision’s operation suggests that the non-binding shareholder vote has been a more effective regulatory constraint than critics from the business community predicted at the time of its introduction, and the provision now enjoys strong support from shareholder groups, particularly institutional investors. Significant evidence from the early years of the provision’s operation suggests that the non-binding shareholder vote has been a more effective regulatory constraint than critics from the business community predicted at the time of its introduction, and the provision now enjoys strong support from shareholder groups, particularly institutional investors.


Although traditionally related to social responsibility issues, precatory resolutions in the US have increasingly been used in the area of corporate governance, including executive remuneration. See generally Brian R. Cheffins & Randall S. Thomas, Should Shareholders Have a Greater Say over Executive Pay? Learning from the US Experience, 1 J. CORP. L. STUD. 277 (2001); Lucian Bebchuk & Jesse Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 51-52 (2004).


Id. at para [4.353]. According to the Explanatory Memorandum, although it is normally the board’s function to determine executive remuneration, “[i]n performing their function, boards need to be accountable for their decisions and shareholders need to be in a position to exercise their rights in an active and informed way”. Id. at para [5.413].


For evidence on the early years of the provision’s operation, see Kym Sheehan, Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and
protest votes were registered at many major Australian companies during recent annual shareholder meeting seasons. The Paulson Committee suggested that a vote of this kind should be considered in the US context, but legislation to this effect is yet to come into operation.

Recent reforms to promote greater shareholder engagement in corporate governance have not been limited to these common law jurisdictions. Ensuring more effective shareholder participation and voting in listed companies was the main focus of the 2007 EU Directive on Shareholder Rights (“the EU Directive”), which was also introduced in response to the corporate scandals. The EU Directive is designed to remove existing obstacles to shareholder voting in European capital markets, particularly in a cross-border context. These obstacles include problems concerning proxy rules, the practice of “share blocking”, implementation costs, complexity and

---


The most high profile of these protest votes occurred at the 2007 annual shareholder meetings of Telstra, Australia’s primary telecommunications company, and AGL Energy, where 66% and 62% of votes respectively were cast against the directors’ remuneration report. Id. at 18-20.


legal disincentives to exercising voting rights under various European laws.\textsuperscript{161} Despite the divergent models of corporate governance that exist throughout European Union countries and the widely different roles played by shareholders, the Directive “builds on existing structures by insisting on certain minimum rights for shareholders”\textsuperscript{162}

The EU Directive’s regulatory approach is analogous to that of the Paulson Committee and the Australian Parliamentary Joint Committee in a number of ways.\textsuperscript{163} Like the Paulson Committee Report,\textsuperscript{164} the EU Directive views shareholder rights as an alternative, and superior, regulatory mechanism to more stringent rules-based corporate regulation.\textsuperscript{165} Both the EU Directive and the Australian Parliamentary Joint Committee Report rely on principles of fairness\textsuperscript{166} and shareholder democracy.\textsuperscript{167}


\textsuperscript{164} See id. at xii-xiii, 93-114.


\textsuperscript{167} See, e.g., Parliamentary Joint Committee on Corporations and Financial Services, \textit{Better Shareholders – Better Company: Shareholder Engagement and Participation in Australia} (June 2008), para [2.23]. For a discussion of this aspect of the EU Directive, and the need for greater shareholder democracy in EU countries, see Peter Montagnon, \textit{Shareholder Rights are an Antidote to Company Regulation}, FIN. TIMES, Mar. 9, 2006, at 17. It is worth noting, however, that one key element in the establishment of EU shareholder democracy was
They justify shareholder participation in corporate governance by envisaging shareholders as “owners” of the company, an image often condemned in critiques of Professor Bebchuk’s shareholder empowerment proposal.

These international post-Enron reforms are noteworthy in the light of the shareholder empowerment debate. They raise the puzzle of why, given that US shareholders have traditionally had less power than shareholders in a number of other common law jurisdictions, there has been so much recent resistance to increasing their participatory rights. One possible answer is the paradigm shift in contemporary corporate law from discourse about protection of shareholders to discourse about protection of the corporation from shareholders. The traditional objective of shareholder protection provides the theoretical basis for the post-Enron reforms in the UK, Australia and the 2007 EU Directive. However, it is the paradigm of protecting the corporation from shareholders which underlies many of the recent arguments against shareholder empowerment in the US. This evolving paradigm views the shareholder as predator, and the corporation as victim. It is exemplified by Martin Lipton’s assessment that "[t]oday shareholder activism is ripping through the boardrooms of public corporations and threatening the future of American business".


170 See supra, n28.


5. Shareholder Power and the Tension Between Legal Rules and Commercial Practices

“He was also an adept at breaking rules, or diverting them to ends not intended by those who had framed them”.

Anthony Powell, *A Dance to the Music of Time* 173

Much recent corporate governance debate has focused on the role played by legal rules in enhancing or diminishing shareholder participation. However, although legal rules clearly matter in establishing the balance of power between the board and shareholders, commercial practice may play an equally important role.

A tension has emerged in Australia between legal rules and commercial practice concerning shareholder rights. In spite of the existence of legal rules designed to enhance shareholder power, a number of commercial developments have pulled in the opposite direction. Two developments in particular demonstrate this evolving tension: the successful 2003 amendment to the constitution of Boral Ltd (“the Boral amendment”), and the unsuccessful attempt by several major Australian listed companies to introduce corporate prenuptial agreements for non-executive directors. These two case studies demonstrate the importance of considering not only the terms of laws themselves, but also the commercial responses of parties subject to those laws.

5.1 Reining in Shareholder Power: The Boral Backlash

The Boral amendment is interesting in the context of the shareholder empowerment debate, since it involved not the more familiar scenario of investors seeking stronger rights, but rather a vote by shareholders at Boral Ltd (“Boral”) to curtail their power in the future.

Under Australian law, changes to the corporate constitution may, as previously noted, be initiated by shareholders and can generally be effected by a special resolution, passed by at least 75% of votes cast by shareholders entitled to vote on the resolution.\(^\text{174}\) It is possible, however, for the constitution to provide that the special resolution is not effective to alter the constitution unless a further specified requirement has been satisfied.\(^\text{175}\)

Theoretically at least, amendment of the constitution is a potent shareholder right, since there is no restriction on the content of the alteration. Although, when the constitution vests managerial power in the board,\(^\text{176}\) shareholders are unable to pass a resolution relating to managerial matters, this restriction does not apply to alterations to the constitution reallocating power between the board and shareholders. It is also relatively easy for shareholders to propose changes to the constitution under Australian law. Under the controversial “100 member rule”, 5% of the shareholders, or 100 shareholders by number, may requisition a meeting to alter the company’s constitution\(^\text{177}\) or propose a resolution to that effect where a meeting has already been convened by the company.\(^\text{178}\) This contrasts with the US “board as gatekeeper” paradigm.

Resolution 3 of the notice of meeting for Boral’s 2003 annual shareholder meeting proposed a constitutional amendment, which would reverse the effects of the 100 member rule at Boral. The resolution, which was passed by a special resolution,\(^\text{179}\)


\(^{175}\) See Corporations Act 2001 (Cth) § 136(3).

\(^{176}\) Corporations Act 2001 (Cth) § 198A is a replaceable rule, stating that “[t]he business of a company is to be managed by or under the direction of the directors”. See generally Automatic Self Cleansing Filter Syndicate Co Ltd. v. Cuninghame [1906] 2 Ch. 34; NRMA v. Parker (1986) 11 ACLR 1.

\(^{177}\) Corporations Act 2001 (Cth) § 249D.

\(^{178}\) Corporations Act 2001 (Cth) § 249N(1).

\(^{179}\) Only approximately 6% of votes cast on the resolution were opposed to the constitutional change. See Boral Limited, ASX Announcement – Annual General Meeting – Outcome of Business and Declaration of Polls, 21 October 2003, 2; Stuart Wilson, Boring into Minorities a Big Blue in Boral Board War, THE AUST., Oct. 28, 2003, at 24.
limited the ability of Boral shareholders to requisition a meeting, or propose a resolution, to alter the constitution in the future. It achieved this by inserting further conditions which needed to be met before Boral’s “new constitution” could be altered. Any proposed constitutional amendment would first have to be approved by either the board of directors or shareholders holding at least 5% of voting shares. The Boral amendment therefore subverted both limbs of the 100 member rule in their application to alterations of the company’s constitution.180

At first sight, it seems puzzling that Boral shareholders voted to restrict their power under Australian law. However, this was a matter where there was arguably a schism between large institutional investors and small shareholders.181 There had been several high profile examples of Australian companies in which environmental activists had taken a relatively small stake and utilized the 100 member rule to initiate constitutional changes.182 Boral had itself been the target of shareholder activism by the Transport Workers’ Union (“TWU”),183 reflecting a trend, both in Australia and

180 Whereas previously 100 shareholders acting together could requisition a meeting, or propose a resolution, to alter the constitution, the Boral amendment meant that in future this could only be done by shareholders with $160 million worth of Boral shares (i.e. 5% of Boral’s capital) unless they had the board’s consent. See Stephen Bartholomeusz, Heavy-handed Boral Could Help Strengthen the Hand of Critics, THE AGE, Oct. 23, 2003, at 3. The 100 member rule would still apply to ordinary resolutions and special resolutions not involving an alteration to the constitution.

181 The institutional investors were criticized for their role in the Boral constitutional amendment. While Stephen Conroy, the Labor spokesman for financial services and corporate governance, condemned these investors for “turning a blind eye” to the implications of the Boral amendment, other financial press commentators pointed out that the institutional investors actively supported management’s position on the issue. See Bryan Frith, Right to Clip Board Powers, THE AUST., Dec. 2, 2003, at 20.

182 Environmental activism in major Australian companies included, for example, the requisitioning by shareholders of extraordinary general meetings at North Ltd and Gunns Ltd. See Shelley Bielefeld, Sue Higginson, Jim Jackson & Aidan Ricketts, Directors’ Duties to the Company and Minority Shareholder Environmental Activism, 23 Comp. & Sec. L.J. 28, 43-47 (2004).

183 The TWU used the 100 member rule to propose a number of resolutions at the 2003 annual shareholder meeting relating to safety concerns and corporate governance matters, including executive remuneration. None of the resolutions was passed. For further details of these events, see Michael Rawling, Australian Trade Unions as Shareholder Activists: The Rocky Path Towards Corporate Democracy, 28 SYD. L. REV. 227, 229-233 (2006); Kirsten Anderson & Ian Ramsay, From the Picket Line to the Board Room: Union Shareholder Activism in Australia, 24 Comp. & Sec. L.J. 279, 289-292 (2006).
the US,\textsuperscript{184} for unions to propose corporate governance resolutions at annual shareholder meetings.\textsuperscript{185} Large institutional investors at Boral presumably shared management’s concern that small activist shareholders could use the 100 member rule to further a social agenda.\textsuperscript{186} Thus, the events at Boral reflect Bainbridge’s concern that the conferral of greater shareholder participatory rights could empower classes of shareholders who might misuse those powers\textsuperscript{187} and Justice Strine’s argument that, in certain circumstances, even investors themselves might not favor strong shareholder rights.\textsuperscript{188}

The Boral amendment explicitly relied for its validity on § 136(3) of the Australian \textit{Corporations Act}, permitting a company to stipulate that “a further requirement” is necessary before a special resolution to alter the constitution is effective.\textsuperscript{189} This section envisages the possibility of virtual entrenchment of constitutional provisions,

\begin{itemize}
  \item \textsuperscript{184} See, for e.g., Stewart J. Schwab & Randall S. Thomas, \textit{Realigning Corporate Governance: Shareholder Activism by Labor Unions}, 96 Mich. L. Rev. 1018 (1998).
  \item \textsuperscript{185} For an overview and analysis of recent instances of union shareholder activism in Australia, see Kirsten Anderson & Ian Ramsay, \textit{From the Picket Line to the Board Room: Union Shareholder Activism in Australia}, 24 Comp. & Sec. L.J. 279 (2006). For discussion of the growth of shareholder activism by labor unions in the US, see generally Stewart J. Schwab & Randall S. Thomas, \textit{id}.
  \item \textsuperscript{186} This concern was also expressed by the Corporations and Securities Advisory Committee (now known as the Corporations and Markets Advisory Committee (CAMAC)). In its 2000 Report entitled \textit{Shareholder Participation in the Modern Listed Company}, CASAC criticized the 100 member rule on the basis that the threshold level of shareholder support was too low, was inconsistent with much higher thresholds in other jurisdictions, and could be abused by activist shareholders with a social agenda (CASAC, \textit{Shareholder Participation in the Modern Listed Public Company}, Final Report (July 2000), Recommendation 2, 15). \textit{Cf}, however, Michael Rawling, \textit{Australian Trade Unions as Shareholder Activists: The Rocky Path Towards Corporate Democracy}, 28 Syd. L. Rev. 227, 241-243 (2006). Rawling observes that the interests of such activist groups do not necessarily diverge from more ‘traditional’ shareholder concerns: \textit{id}. at 231-232.
  \item \textsuperscript{187} Stephen M. Bainbridge, \textit{Director Primacy and Shareholder Disempowerment}, 119 Harv. L. Rev. 1735, 1751 (2006).
  \item \textsuperscript{188} Vice Chancellor Leo E. Strine, \textit{Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America}, 119 Harv. L. Rev. 1759, 1759 (2006).
  \item \textsuperscript{189} Corporations Act 2001 (Cth) § 136(3) of the states that “[t]he company’s constitution may provide that the special resolution does not have any effect unless a further requirement specified in the constitution relating to that modification or repeal has been complied with”.
\end{itemize}
depending upon the stringency of the “further requirement”. However, it is not clear that the Boral amendment is validated by this provision, since, rather than stipulating a “further requirement” to a special resolution altering the company’s constitution, the Boral amendment effectively prevents voting at all on the proposed special resolution in certain circumstances.

The Boral amendment has been contentious, and its legitimacy was questioned in Parliamentary Joint Committee hearings on the CLERP 9 Bill 2003. Nonetheless, for some time it appeared that legislative intervention might make it unnecessary for corporate management to seek to circumvent the 100 member rule by such indirect means, since in 2005 the Australian federal government announced its intention to abolish the rule. The announcement appears to have been a response to lobbying by companies which had previously experienced high levels of shareholder activism. The future of the reform proposal became uncertain after state leaders rejected it in 2006, and a change of federal government occurred in 2007. The

---

190 There is no reference in the Corporations Act to the kind of “further requirement” contemplated, however, earlier incarnations of the legislation referred to matters such as a supermajority voting requirement or the need for the approval of a particular person before the amendment would take effect. See, e.g., Corporations Law § 176(3).


192 See Chris Pearce, Parliamentary Secretary to the Treasurer, Press Release: Government Consults on Proposed Corporate Governance Reforms, 7 February 2005; Corporations Amendment Bill (No 2) 2005, Explanatory Memorandum (Exposure Draft). A concession embedded in the reform proposal was that the number of shareholders required to propose a resolution at an annual general meeting was to be lowered from 100 to 20. See Corporations Act 2001 (Cth) § 249N.


194 See Chris Pearce, Parliamentary Secretary to the Treasurer, Press Release: Key Corporate Governance Reforms in Jeopardy, 27 July 2006. The states’ rejection of the reforms was criticized by a number of industry bodies. See Chartered Secretaries Australia, Media Release: Shareholders Caught in Political Shenanigans, 26 July 2006; Leon Gettler, IFSA Censures States over 100 Member Reform, THE SYDNEY MORNING HERALD, Jun. 21, 2006, at 37. Prior to the meeting, several states cast doubt on the supposed detriment caused to Australian companies by the 100 member rule, and expressed concern over the effect of reform on the rights of minority shareholders. See Joseph Kerr, States Resist 100-member Rule Reform, THE AUST., Jun. 14, 2006, at 24.
100 member rule remains on the reform agenda, however, with the Parliamentary Joint Committee on Corporations and Financial Services Report recently reviving calls for its abolition.\footnote{196} Although acknowledging that no significant abuse of the rule by activist shareholders had arisen, the Report considered that it should be jettisoned, in view of its potential for abuse.\footnote{197}

5.2 Background to the Coca-Cola Amatil Prenuptial Agreement - Intra-board Conflict and the NAB Dispute

Another commercial development in Australia, which arguably affected shareholder power was the emergence of the corporate prenuptial agreement. This development occurred in response to a corporate governance dispute between members of the board of directors at the National Australia Bank Limited (“NAB”). The NAB dispute also had interesting implications for what is expected of independent directors and boards.

The dispute stemmed from a foreign exchange trading scandal, revealed by NAB in January 2004,\footnote{198} which prompted resignations of the bank’s CEO and chairman.\footnote{199}

\footnote{195} In a federal election held on 24 November 2007, the Liberal Government, which had proposed abolition of the 100 member rule, was defeated by the Australian Labor Party, with Kevin Rudd replacing John Howard as Prime Minister of Australia.

\footnote{196} Parliamentary Joint Committee on Corporations and Financial Services, Better Shareholders – Better Company: Shareholder Engagement and Participation in Australia (June 2008), Recommendation 7, paras [3.84]-[3.91].

\footnote{197} Id. at para [3.90].


\footnote{199} \textit{See} National Australia Bank, ASX Announcement – John Stewart Appointed the National’s Managing Director & Chief Executive Following the Resignation of Frank Cicutto, 2 February 2004, available at \url{http://www.nabgroup.com/0,,41673,00.html}; National Australia Bank, ASX Announcement – Mr Graham Kraehe Appointed the National’s Chairman Following the Resignation of Mr Charles Allen, 16 February 2004, available at \url{http://www.nabgroup.com/0,,42633,00.html}.}
NAB also announced that it had commissioned PricewaterhouseCoopers (“PwC”) to conduct an investigation and prepare a report into the trading scandal.\(^{200}\)

What ensued was a classic boardroom brawl.\(^{201}\) One of NAB’s non-executive directors, Catherine Walter, challenged the report’s legitimacy in advance, claiming that PwC had significant conflicts of interest which compromised the report and rendered it procedurally flawed.\(^{202}\) The PwC Report, which was released with a probity advice certifying its independence,\(^{203}\) found that four foreign exchange currency traders had exploited weaknesses in the bank’s risk management controls to hide trading losses and protect bonuses.\(^{204}\) The Report was highly critical of aspects


\(^{201}\) For an interesting recent study of such conflicts in the US context, see Anup Agrawal & Mark A. Chen, Boardroom Brawls: An Empirical Analysis of Disputes Involving Directors (EFA 2008 Athens Meetings Paper, 1 July 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1101035. The authors consider issues such as common features of board disputes leading to director departures, characteristics of directors who become involved in board disputes, and subsequent firm performance.

\(^{202}\) Ms Walter argued that, as a result of the close business relationship between NAB and PwC and particularly the fact that PwC had a strategic alliance with NAB to provide internal audit services, the report “lacked legitimacy in serious respects”. See Pamela Williams, The Heretic, AUST. FIN. REV., Aug. 27, 2004, at 74.

\(^{203}\) Blake Dawson Waldron, Probity and Governance Advice: PricewaterhouseCoopers (“PwC”) Report into Foreign Exchange Losses (12 March 2004), available at http://www.nabgroup.com/vgnmedia/downld/bdwreport.pdf. The Blake Dawson Waldron probity advice found that a conflict existed in respect of one aspect of PwC’s investigation only, and that this conflict had been satisfactorily resolved by the separate engagement of a non-conflicted expert.

of NAB’s corporate culture, and considered that ultimate responsibility for the “tone at the top” lay with the board of directors and the CEO.

At the time of the release of the PwC Report, the NAB chair, Graham Kraehe, announced that Walter would be removed from the audit committee. At a subsequent board crisis meeting, Walter was asked to resign as a director. Upon her refusal to do so, the bank announced that it had received a request from the other non-executive directors to convene an extraordinary shareholder meeting to remove Walter from office.

Catherine Walter, in a strategy reminiscent of Samson, announced that she would propose alternative resolutions at a shareholder meeting, seeking the staged removal of the entire NAB board, including herself, and the immediate replacement of Kraehe as chair. Both groups in the NAB dispute vigorously lobbied institutional investors in the lead-up to the proposed shareholder meeting, and it appears that dialogue was a significant factor in determining the outcome.

---

205 Id. at 32. The Australian Prudential Regulatory Authority (“APRA”) also considered that cultural issues in the currency options division were central to the bank’s losses. According to APRA, “[t]he culture … was one in which risk management controls were seen as trip-wires to be negotiated rather than presenting any genuine constraint on risk-taking behaviour”. See APRA, Report into Irregular Currency Options Trading at the National Australia Bank 6 (23 March 2004), available at http://www.nabgroup.com/vgnmedia/downld/APRAreport_24march04.pdf.


209 Ms Walter also proposed several resolutions censuring the board for its role in the foreign exchange scandal, and calling on the directors to forgo more than $1 million in retirement benefits. See National Australia Bank, ASX Announcement – Notices Submitted by Mrs Catherine Walter, 29 March 2004, available at http://www.nabgroup.com/0,,45973,00.html; Stephen Bartholomeusz, Shareholders to Decide Future of Bank’s Board, SYDNEY MORNING HERALD, Apr. 20, 2004, at 21.

with major investors was influential in resolving the dispute. A showdown at the scheduled shareholder meeting was ultimately avoided when, as part of a compromise, several parties to the dispute including Walter, agreed to resign from the NAB board.

Opinion was sharply divided on the NAB corporate governance dispute, paralleling to some degree debate in the US on greater shareholder participation in board nominations. Opponents of Catherine Walter, stressing the need for board harmony, argued that her criticism of the PwC Report was baseless and that her public campaign had seriously damaged the bank’s commercial standing and shareholder interests. Supporters, however, echoing the view of Warren Buffett that there should be more dissent in the boardroom, argued that she had fulfilled admirably the role envisaged for an independent director.

---

211 Cornell & Oldfield, *ibid.*

212 Technically, in fact, three separate shareholder meetings were scheduled to consider the different sets of resolutions proposed. See National Australia Bank, *ASX Announcement – National General Meetings to be Held on 21 May 2004*, 19 May 2004, available at http://www.nabgroup.com/0,,47233,00.html.


217 See, e.g., Alan Kohler, *Take Two on ‘Pre-nups’ For Quiet Departures*, THE AGE, Aug. 11, 2004, at 1. See also Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 Berkeley J. Int’l L. 195, 224 (2004), describing the ideal independent director as “a person who is unrelated to the company’s insiders with regard to family or business ties, who will insist on transparency and accountability from senior managers, and who is capable of openly challenging the chairperson and other members of the board…”.
5.3 The Coca-Cola Amatil Prenuptial Agreement and its Effect on Shareholder Power

The NAB corporate governance dispute sent reverberations through the Australian commercial community, and demonstrated the power of shareholder opinion.\(^{218}\) One commentator predicted that, following the dispute, chairs would become even more conservative in their nomination of directors, to avoid similar intra-board conflicts.\(^{219}\) Yet, some companies, including Coca-Cola Amatil and NAB itself, were already considering the adoption of a commercial device which could prove an even more powerful antidote to board disharmony: the prenuptial agreement.

Coca-Cola Amatil announced that in future, all non-executive directors would be required to sign a contract with the company prior to their appointment to the board. The central undertaking in this contract was that Coca-Cola Amatil would review the director’s performance every two years, and if a majority of the board considered performance unsatisfactory and requested the director to resign, the director agreed to do so.\(^{220}\) NAB and several other Australian companies also considered introducing prenuptial agreements.\(^{221}\)

The concept of prenuptial agreements provoked controversy, and debate about whether they breached the provisions of the Australian Corporations Act. A major concern voiced was that the agreements constituted an illicit transfer of power from


\(^{219}\) See Stephen Bartholomeusz, Zero Tolerance of Board Errors a Lose-lose Trend, SYDNEY MORNING HERALD, May 8, 2004, at 46. See also Andrew Cornell & Stewart Oldfield, Where NAB Went Wrong, ibid, claiming that one of the lessons of NAB was that “major investors will not support mavericks on the board”.


shareholders to the board, which aimed to “erode shareholders’ rights and avoid accountability”.  

The policy debate about prenuptial agreements is an apt one in the light of the shareholder empowerment debate and the emphasis on the role of independent directors in contemporary corporate governance.  On the one hand, prenuptial agreements potentially stifle the lone dissentent voice on the board. However, supporters of prenuptial agreements have argued that they enhance, rather than undermine, board accountability, since it is often practically difficult to remove underperforming directors.  Some skeptical commentators have suggested that the focus on failure to perform under prenuptials “was universally seen as code for ‘toe the line’”.

Two key issues arose in the public debate concerning Coca-Cola Amatil’s prenuptial agreements. First, were the agreements valid and legally binding and secondly, as a normative matter, should agreements of this kind be permitted?

The appointment and removal of directors has traditionally been viewed as a core right of shareholders and the flip-side of centralized managerial control. While shareholders have no power to override managerial decisions of the board, the power of shareholders to remove directors from office reflects the basic corporate

---


224 McConvill articulates the tension between competing corporate governance aims in the debate over prenuptial agreements. He notes that critics of such agreements believed that they would undermine recent advances in corporate governance designed to enhance shareholder participation (id. at 206-209). Supporters of the agreements, however, characterized them as a desirable corporate governance development, which would increase accountability and allow for effective peer review of directors (id. at 209-211). See also Michelle Grattan, Director ‘Prenuptials’ Erode Shareholder Rights, Says ALP, THE AGE, Aug. 2, 2004, at 13.


226 See Automatic Self Cleansing Filter Syndicate Co Ltd. v. Cuninghame [1906] 2 Ch. 34.
constitutional structure, in which shareholders exercise ultimate control.\textsuperscript{227} It also provides an important buffer against managerial entrenchment.\textsuperscript{228}

The provisions under the Australian \textit{Corporations Act} on removal of directors from office reflect this fundamental principle. For proprietary companies, § 203C of the Act provides for the removal of directors by ordinary resolution, namely a resolution passed by simple majority of shareholders present and voting at the meeting, in person or by proxy.\textsuperscript{229} However, § 203C is a replaceable rule only, and can be ousted or modified by the company’s constitution.\textsuperscript{230} For proprietary companies, it is therefore possible to displace this default rule with a provision in the constitution permitting the board to remove a director from office.\textsuperscript{231}

The position is stricter in relation to removal of public company directors. This scenario is covered by § 203D of the Corporations Act, which unlike its proprietary company counterpart,\textsuperscript{232} is a mandatory, rather than a replaceable, rule. Section 203D(1) provides that shareholders in a public company may remove a director from office, despite anything in the company’s constitution or any agreement between the director and the company or members.\textsuperscript{233} Furthermore, § 203E clearly distinguishes

\begin{itemize}
  \item \textsuperscript{228} See \textit{Allied Mining & Processing v. Boldbow Pty Ltd.} [2002] WASC 195, paras [47], [52].
  \item \textsuperscript{229} For a discussion of the historical development of Australia’s system of simple majority voting, and the rejection of a model of absolute majority voting, see I. M. Cameron, \textit{Majority Rule; The Development of General Principle in Cases on Chartered Corporations}, 15 MELB. U. L. REV. 116 (1985).
  \item \textsuperscript{230} Corporations Act 2001 (Cth) § 135(2). Prior to the introduction of § 203C under the Corporate Law Economic Reform Program Act 1999 (Cth), no statutory removal power existed for proprietary companies, which were therefore required to rely upon a constitutional provision, such as Table A reg. 62(1). Table A reg. 62(1) stated that “the company may by resolution remove any director before the expiration of his period of office”.
  \item \textsuperscript{232} Corporations Act 2001 (Cth) § 203C.
  \item \textsuperscript{233} Corporations Act 2001 (Cth) § 203D: “A public company may by resolution remove a director from office despite anything in: (a) the company’s constitution (if any); or (b) an agreement between the company and the director; or
removal of directors in a public company from a proprietary company context, by rendering void any action by the directors of a public company to remove a director, or require the director to leave office.\textsuperscript{234} For public companies, one of the practical effects of § 203D is to prevent the use of staggered boards as an anti-takeover device in Australia.\textsuperscript{235} This contrasts with Delaware law, where directors may be insulated from removal from office through the adoption of a staggered board structure, in conjunction with a norm of removal for cause in the case of a classified board.\textsuperscript{236} In the wake of the global financial crisis, however, the International Corporate Governance Network (ICGN) has called on US regulators to strengthen shareholder rights to dismiss directors from office, "so that boards can be held to account".\textsuperscript{237}

Did the Coca-Cola Amatil prenuptial agreement breach the provisions of § 203D or § 203E? The corporate regulator, the Australian Securities and Investments Commission ("ASIC"), considered that the agreements were in breach of the Corporations Act and thus void. In an Information Release on the issue, ASIC stated “[t]he Corporations Act 2001 says that only shareholders can remove a director of a public company and that attempts by directors to remove another director from office are void”.\textsuperscript{238}

However, the relevant provisions in the Corporations Act are surprisingly ambiguous, and the law concerning removal of a public company director from office is rather less certain than ASIC’s terse statement would suggest. For example, while some

\begin{itemize}
\item[(c)] an agreement between any or all members of the company and the director.”
\end{itemize}

\textsuperscript{234} Corporations Act 2001 (Cth) § 203E: “A resolution, request or notice of any or all of the directors of a public company is void to the extent that it purports to:
\begin{itemize}
\item[(a)] remove a director from their office; or
\item[(b)] require a director to vacate their office.”
\end{itemize}

\textsuperscript{235} An analogous provision, Companies Act 2006 (UK) § 168, also has the effect of preventing the use of staggered boards as an entrenchment and anti-takeover mechanism in the UK context.

\textsuperscript{236} DEL. CODE ANN., tit. 8, § 141(k)(1) (2008).


commentators regard § 203D as providing the exclusive means by which directors of a public company may be removed from office,\(^{239}\) established case law rejected this interpretation.\(^{240}\) The position has been further complicated by a 2008 decision, holding that § 203D constitutes an exclusive removal regime.\(^{241}\) Thus, inconsistent judicial authority on this point now exists in Australia. Nonetheless, the history and wording of § 203D show that it is more focused on ensuring that shareholders have an unerodable,\(^{242}\) rather than an exclusive, right to remove directors from office.\(^{243}\) Also, historically it has been permissible for companies to provide in their constitutions for self-executing disqualifying events that will automatically terminate the office of director.\(^{244}\)

The Coca-Cola Amatil prenuptial agreement did not purport to eliminate the right of shareholders to remove a director from office; rather it provided an additional mechanism for removal. Nonetheless, in the context of a board conflict such as the NAB dispute, the practical effect of the operation of a prenuptial agreement would be


\(^{240}\) See, e.g., Allied Mining and Processing v. Boldbow Pty Ltd. [2002] WASC 195, in which Roberts-Smith J took the view that, although § 203D could never be excluded, it could be supplemented by provisions of the constitution, and was therefore not an exclusive means of removal (id. at [47] and [56]).

\(^{241}\) See Scottish & Colonial Ltd. v. Australian Power and Gas Co Ltd. (2007) 65 ACSR 313; [2007] NSWSC 1266. Bryson AJ held that compliance with §§ 207D(2)-(7) was mandatory, based on a range of factors, including the “emphatic nature of the language used” in § 207D (id. at [21]). Bryson AJ considered that Allied Mining and Processing v. Boldbow Pty Ltd. [2002] WASC 195 had been incorrectly decided (id. at [37]).

\(^{242}\) Yet, even in this respect, the courts have tolerated a range of techniques, including the use of weighted voting provisions in a company’s constitution, which have effectively eroded shareholder power vis-à-vis directors. See generally, Nicholas Bourne, The Removal of Directors, 25 BUS. L. REV. 194 (2004); Christopher L. Ryan, COMPANY DIRECTORS: LIABILITIES, RIGHTS AND DUTIES 325ff (1987).


to shift power to the board, by preempting a decision by shareholders as to whether the director should be removed from office.\footnote{Alan Kohler, \textit{Take Two on ‘Pre-nups’ for Quiet Departures}, \textit{The AGE}, Aug. 11, 2004, at 1.}

There is a stronger argument however, that the proposed prenuptial agreements would breach § 203E of the \textit{Corporations Act}. On a technical reading of § 203E, it could be argued that the director’s vacation of office under a prenuptial agreement would arise not from any act of removal by the board, but simply from performance of the contract by the relevant director.\footnote{Cf James McConvill & Evan Holland, ‘Pre-nuptial Agreements’ for Removing Directors in Australia – Are They a Valid Part of the Marriage Between Shareholders and the Board, J. BUS. L. 204 [2006], who support such an interpretation of § 203E and Stephen Knight, \textit{The Removal of Public Company Directors in Australia: Time for Change?}, 25 COMP. & SEC. L. J. 351, 353-354 (2007).} Yet, such an interpretation is tenuous. The prohibition in section 203E is not restricted to actions of board members which directly remove a director from office. It also includes actions of board members which “require” a director to vacate office.\footnote{Corporations Act 2001 (Cth) § 203E(b).} There seems little reason why this provision should be interpreted narrowly to exclude from its ambit vacation of office pursuant to a contractual obligation triggered by a vote of no confidence by the board.\footnote{The predecessor to § 203E (Corporations Law § 227(12)) explicitly stated that the prohibition on removal from office by the board existed “notwithstanding anything in the constitution or any agreement”. \textit{See generally} Jean J. du Plessis, \textit{Some Peculiarities Regarding the Removal of Company Directors}, 27 AUST. BUS. L. REV. 6 (1999).}

Ultimately, in response to pressure from ASIC\footnote{See ASIC, \textit{Information Release IR 04-40: Removal of Directors of Public Companies}, 17 August 2004.} and opposition by a number of fund managers, Coca-Cola Amatil announced that the proposed prenuptial agreements would not be implemented in their original form.\footnote{Annabel Hepworth, \textit{Coke Cans Pre-nuptials for Directors}, AUST. FIN. REV., Aug. 10, 2004, at 1. NAB also announced that it would not introduce prenuptial agreements at that time.} Rather, directors’ letters of appointment would be amended to provide that, where a majority of the board considered a particular director’s performance to be unsatisfactory, a motion for the director’s removal from office would be put to shareholders at the next annual general
ASIC welcomed this amendment, while stressing the need for shareholders to be provided with full background information to enable informed participation in the removal of directors under this revised model. ASIC’s interpretation of the Australian provisions dealing with removal of public directors from office also appears to have prompted some major companies to alter provisions in their constitution to ensure that they constitute self-executing disqualification of directors, rather than removal by the board.

Australian law on removal of directors from office diverges from UK law in one important respect. In contrast to Australian law, which maintains a clear distinction between removal of directors of public and private companies, UK law makes no such distinction. A statutory power of removal was originally introduced in the UK in 1948 following the Cohen Committee Report, to strengthen shareholder control over management by conferring power on shareholders to remove a director from office by ordinary resolution, irrespective of anything in the company’s articles. The UK statutory removal provision has at all times applied to public and proprietary companies equally.

---

252 See Richard M. Buxbaum, The Internal Division of Powers in Corporate Governance, 73 CAL. L. REV. 1671, 1679 (1985), stating that “[i]nformed participation is as important as participation per se” in corporate governance.
254 See, e.g., Stephen Knight, The Removal of Public Company Directors in Australia: Time for Change?, 25 COMP. & SEC. L. J. 351, 355 (2007), discussing a constitutional amendment passed at the 2004 Annual General Meeting of shareholders of the Commonwealth Bank. The previous article stated that the directors could resolve to remove a director who had been absent from board meetings for at least six months. In the light of ASIC’s comments about the prohibition on the board removing a director from office under § 203E, a shareholder resolution was passed altering the article so that it provided that such an absentee director would automatically cease to hold office, “unless the Directors resolve otherwise”.
255 Companies Act 1948 (UK) § 184(1).
257 See also Companies Bill, Second Reading, 16 November 1961, 2588, 2598-2599.
258 This removal power is now contained within Companies Act 2006 (UK) § 168(1).
UK law also treats the statutory removal power as only one method of removing directors from office, and recognizes removal of directors based upon provisions in the articles as valid both for public and proprietary companies.  There is no restriction equivalent to § 203E of the Australian Corporations Act, prohibiting removal of a director of a public company by the board. In fact, it appears that UK companies routinely include a provision for the removal of a director by the board in their articles, specifically to address the type of situation that arose in the NAB controversy. UK commentators have pointed out that such a provision is particularly common in the case of public companies “to enable directors to deal with conflict within the boardroom” and to permit internecine corporate disputes “to be settled out of the public eye”.

In the US context, recent amendments to the Delaware Code indirectly raise the issue of prenuptial agreements. Thus, for example, an amendment to § 216 of the Delaware Code, while retaining a plurality of votes default rule for the election of directors by shareholders, impliedly permits shareholders to amend the bylaws and substitute a majority vote requirement. The revised section provides that a shareholder-adopted bylaw for the election of directors “shall not be further amended or repealed by the board of directors”. The adoption by shareholders of such a bylaw for the election of directors will increase the likelihood that an existing director’s reelection bid may fail under the more demanding, majority-voting standard.

An intriguing question is whether the tenure of such a director would end automatically upon the failed reelection bid. Section 141(b) states that “[e]ach

260 See, e.g., Lee v. Chou Wen Hsien [1984] 1 WLR 1202, 1205, where the Privy Council states that the provision dates back to the 1902 edition of PALMER’S COMPANY PRECEDENTS.
262 Desmond Wright, RIGHTS AND DUTIES OF DIRECTORS 19 (1987).
263 I am grateful to Deborah DeMott for raising with me the implications of these amendments for the issue of prenuptial agreements.
director shall hold office until such director’s successor is elected and qualified or until the director’s earlier resignation or removal”. Thus, where no successor is appointed, it is arguable that the director would continue to hold office, since there has been no “resignation or removal” for the purposes of § 141(b), merely a reelection failure. Another recent amendment, however, provides a mechanism to permit directors in this situation to fall on their sword. The relevant amendment to § 141(b) states that “[a] resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable”. This amendment essentially permits and legitimizes a prenuptial agreement in the restricted situation of a current director failing in a reelection bid. The restriction of the amendment to § 141(b) to this narrow situation implies that a more general Coca-Cola Amatil style prenuptial agreement would be impermissible under Delaware law. These amendments therefore appear to resolve the issue of removal of directors by the board in Delaware along the lines of Australian law, rather than UK law.

6. Conclusion

Shareholder rights have traditionally been limited in the US, and there has been great resistance to proposals for increasing those rights. The current financial crisis represents an opportunity to reassess whether shareholders should be granted stronger power, as a constraint on managerial control.

This article critically assesses the shareholder empowerment debate through a comparative law lens. It challenges the widely held view that a unified common law model of corporate governance exists in relation to shareholder rights, identifying fundamental differences between US law and that of a number of other common law jurisdictions.

The article also considers an emerging tension in Australia between legal rules designed to enhance shareholder participation in corporate governance, and commercial practices designed to curb shareholder power. This commercial power-shifting is interesting because it demonstrates how some major Australian companies
have artificially created a corporate governance regime, which mimics certain aspects of Delaware law in its restriction of shareholder rights. The complex image of shareholder empowerment across common law countries presented in this article offers important lessons for comparative corporate governance. Ultimately, it highlights the need to consider specific legal rules, and the commercial responses to such rules, rather than resorting to broad generalizations.