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

Jennifer G. Hill
Dear Articles Editor:

I am pleased to submit for publication an Article entitled “Who's Afraid of Shareholder Power? A Comparative Law Perspective”. US corporate law is currently in the midst of a major paradigm shift in relation to shareholder power. The global financial crisis has given regulatory impetus to the shareholder empowerment debate, and an unprecedented array of reforms and proposals to increase shareholder power are now on the table. This Article is the first to assess this paradigm shift in relation to shareholder power through a comparative law lens. There is often an assumption in corporate law scholarship that a unified model of corporate governance exists across the common law world. The Article challenges this widely held tenet, and shows that by international standards, US shareholders have traditionally possessed significantly less power than their counterparts in other common law jurisdictions. By examining some fundamental, but often overlooked, legal differences across common law jurisdictions, the Article provides a richer and more coherent analysis of the shareholder empowerment debate, and the current US reforms to grant shareholders stronger rights, from a theoretical and doctrinal perspective.

The Article builds on themes in earlier articles published in the American Journal of Comparative Law, and special symposium issues of the Wisconsin International Law Journal and the Delaware Journal of Corporate Law. The themes are also linked to an article, entitled Subverting Shareholder Rights: Lessons from News Corp's Migration to Delaware, which is forthcoming in Vanderbilt Law Review in January 2010. I have presented my research for this Article at Workshops at a number of eminent Law Schools, including Duke University, Emory University, Vanderbilt University and University of Hong Kong. I am Professor of Corporate Law at the University of Sydney, and have been a Visiting Professor at several US Law Schools, including Cornell, University of Virginia, University of Texas, and Vanderbilt University, where I hold a continuing visiting appointment. I am a Research Associate of the European Corporate Governance Institute (ECGI) and am ranked in the Top 100 Law Authors on the Social Science Research Network (SSRN). If I may provide you with any further information, please contact me at jennifer.hill@vanderbilt.edu. Thank you very much for your time and consideration.

Yours sincerely,

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SSRN Author page -
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Abstract

US corporate law is undergoing a seismic shift in relation to shareholder power. Although shareholders have traditionally had restricted participatory rights under US corporate law, this paradigm has been challenged in recent times. The shareholder empowerment debate raised shareholder power as a serious subject for corporate law reform. The global financial crisis has given the issue further impetus, and an unprecedented array of reforms and proposals to increase shareholder power are now on the table in the US. There has, however, been great resistance to adjusting the traditional balance of power between shareholders and the board of directors.

This article critically analyzes the US shareholder empowerment debate, and current reformatory zeal in this regard, through a comparative corporate governance lens. There is often an implicit assumption in corporate law scholarship that a unified and stable model of corporate governance exists across the common law world. The article challenges this widely held tenet. It shows that US shareholders have traditionally possessed significantly less power than their counterparts in other common law jurisdictions, and examines particular legal rules that contribute to this divergence.

The article also uses a comparative corporate governance analysis to discuss the possibility of commercial pushback. It examines a tension between legal rules, designed to enhance shareholder power, and commercial practices designed to subvert it. The existence of commercial pushback suggests that, even if US shareholder powers are significantly strengthened, that will by no means be the end of the story.
1. Introduction

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

Oliver Wendell Holmes

US corporate law is undergoing a seismic shift in relation to shareholder power. Although shareholders have traditionally held restricted participatory rights under US corporate law, this paradigm has been challenged in recent times. The shareholder empowerment debate raised shareholder power as a serious subject for corporate law reform, and the Committee on Capital Markets Regulation (“Paulson Committee”) recommended increased shareholder rights as an alternative regulatory technique to a more stringent rules-based approach.

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

The global financial crisis has given further impetus to shareholder empowerment. The crisis highlighted some of the dangers of untrammelled managerial power and under-regulation - business once again has “a legitimacy problem”. The issue of whether shareholders should be afforded stronger powers as a check on managerial control, particularly in the area of executive compensation, has been a major theme in international regulatory responses to the crisis. It has been argued that any response to the crisis will be “incomplete if it fails to address this basic issue of shareholder rights”.

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7 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.

8 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.
It now appears likely that US corporate law will indeed address this issue, and that stronger shareholder rights may soon become a reality. An unprecedented array of reforms and proposals to increase shareholder powers are now on the table in the US. These developments are consistent with the current zeitgeist of international corporate governance.\(^9\) They have, however, provoked fierce controversy and backlash within the US.\(^10\)

This article analyzes the US shareholder empowerment debate from a comparative corporate governance perspective. Comparative corporate governance adds some important dimensions to the debate. The dominant issue in the comparative corporate governance debate at the turn of the decade was whether international corporate laws would converge,\(^11\) or whether differences between common law and civil law


jurisdictions would persist. An embedded assumption by many 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.

The goal of this article is twofold. First, it seeks to consider the shifting boundaries between shareholder and board power within the common law world. In spite of the widespread assumption that a unified common law governance model exists, this article shows that US shareholders have traditionally possessed significantly less power than their counterparts in other common law jurisdictions, such as the UK and Australia. The article analyzes particular legal rules which contribute to this

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).

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).

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?” The influential “law matters” hypothesis contributed to the assumption that a unified common law governance model in relation to shareholder rights existed, by creating a sharp divide between common law and civil law jurisdictions in relation to shareholder protection. See, e.g., Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Law and Finance, 106 J. POL. ECON. 1113 [1998].

This divergence became more pronounced in the post-Enron international regulatory reforms. See generally Jennifer G. Hill, 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. Id. at 392.
divergence. It demonstrates that even if all the controversial US shareholder empowerment reforms are introduced, US investors will still have fewer powers than shareholders in other common law jurisdictions.

Secondly, a comparative corporate governance analysis is used to illustrate the possibility of commercial pushback, by examining a tension between legal rules and commercial practices. Much comparative corporate governance debate has focused on the role of legal rules in reallocating power between shareholders and directors. Yet, commercial norms and practices may be equally, or more, important.15 Recent comparative corporate governance literature has stressed the dynamic operation of legal regulation.16 This dynamism includes the strategic response of regulated parties.17 The article shows how, even in common law countries such as Australia, where legal rules accord shareholders strong participatory rights in corporate governance, commercial pushback may curb such involvement and shift power away


16 “Enforcement intensity” literature, for example, highlights the fact that the efficacy of similar regulations may differ significantly across jurisdictions, as a result of variation in enforcement efforts. See Howell E. Jackson, Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications, 24 YALE J. ON REG. 253, 255 (2007); John C. Coffee, Jr, Law and the Market: The Impact of Enforcement, 156 U. PA. L. REV. 229 (2007).

17 See generally David A. Skeel, Governance in the Ruin, 122 HARV. L. REV. 696, 697 (2008), discussing the approach of Curtis J Milhaupt and Katharina Pistor, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 6 (2008), concerning the need to recognize law’s complex “iterative process of action and strategic reaction”.
from shareholders toward the board of directors. This commercial pushback is noteworthy because it demonstrates how some Australian companies have tried to create a de facto corporate governance regime, which mimics certain aspects of traditional Delaware law, by restricting shareholder rights. These developments show that commercial practices may in some instances effectively subvert legal rules and generate their own convergence pressures. Even if US shareholder powers are significantly strengthened, the prospect of commercial pushback suggests that this will by no means be the end of the story.

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. Buxbaum18

“[I]f the principal economic function of the corporate form [is] to amass the funds of investors, qua investors, we should not anticipate their demanding or wanting a direct role in the management of the company”.

Henry G. Manne19

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

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presented as an owner/principal; beneficiary under a trust; bystander; participant in a political entity; investor; gatekeeper; or managerial partner.20

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.21 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.22

The image of shareholders has been reevaluated in recent times, in the light of international corporate scandals, such as Enron, the demise of the dotcom boom, and the onset of the global financial crisis. Ambivalence has emerged concerning the role of shareholders in these events. On one interpretation, boards of directors and

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


gatekeepers bear most responsibility for these events,\textsuperscript{23} with shareholders seen as innocent bystanders or victims.

On another interpretation, however, shareholders have been far from blameless.\textsuperscript{24} The latter interpretation focuses on the perceived short-term interests of many shareholders,\textsuperscript{25} such as hedge funds,\textsuperscript{26} viewing them not as victims, but as potential

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24 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, \textit{THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS} 75 (1965, c 1934).
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25 See, e.g., Roberta S. Karmel, \textit{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, \textit{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, \textit{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, \textit{Shareholder Primacy and Managerial Accountability} 2-3, 18-24 (Comparative Research in Law and Political Economy
threats to the corporate enterprise.\(^{27}\) This image is also evident in the cross-border context.\(^{28}\) During the global financial crisis, there has been a growing perception that major institutional investors were deficient monitors,\(^{29}\) doing little, for example, to

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\(^{28}\) 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 ECON., Feb. 16, 2008, at 386.

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\(^{29}\) *See, e.g.*, John Plender, *Shut Out*, FIN. TIMES, Oct. 18, 2008, at 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, at 06.
counter the immense executive pay packages during boom periods of the last decade.\textsuperscript{30} There is also increasing concern about the phenomenon of “empty voting”, involving a disjunction between voting rights and economic interests in the company,\textsuperscript{31} and the implications of this phenomenon for the legitimacy of shareholder voting power.\textsuperscript{32} Ambivalence about the role of the shareholder is reflected in a shift in much contemporary corporate law scholarship from traditional discourse about

\textsuperscript{30} See, \textit{e.g.}, Patrick Bolton, José A. Scheinkman & Wei Xiong, \textit{Executive Compensation and Short-Termist Behavior in Speculative Markets}, 73 \textsc{Rev. Econ. Stud.} 577 (2006).


protection of investors, to discourse about protection of the corporation from investors.  

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

“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 advocated readjusting the balance of power between shareholders and the board of

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

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38 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
the debate’s 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. In spite of the SEC’s initial enthusiasm for such reform, it soon stalled, and was subsequently pronounced “moribund”. Some later developments, however, breathed further life into the issue. The Paulson Committee Report sought to reactivate it, in conjunction with another contentious reform proposal - the


See Vice Chancellor Leo E. Strine, *id.* at 1776-1777.

See Committee on Capital Markets Regulation, *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”.

See 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.
introduction of majority, rather than plurality, voting for the election of directors. The SEC also re-entered the fray, with the release of two conflicting proposals. The first had the effect of preventing shareholder participation in the director election process. This proposal came in reaction to a federal appeals court decision 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.\textsuperscript{46} 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.\textsuperscript{47} Internal disagreement among commissioners at the SEC explains the release of these two separate, yet opposing, proposals.\textsuperscript{48} In late 2007, the

\textsuperscript{45} American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc., 462 F.3d 121 (2d Cir. 2006).

\textsuperscript{46} 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}.


SEC voted at that time to maintain the status quo and adopt the first proposal, restricting shareholder participation in the director election process. As discussed further below, however, in May 2009 the SEC executed another volte-face on this issue.

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. 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.

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


50 See below nn 83-84.


52 See generally Robert B. Thompson & Paul H. Edelman, Corporate Voting, 62 VAND. L. REV 129, 130 (2009) (noting the very narrow range of matters on which US shareholders have a binding vote – namely, the election of directors and ratifying basic corporate changes, such as mergers).

53 See DEL. CODE ANN., tit. 8, § 242(b) (2008); MODEL BUS. CORP. ACT § 10.03 (2008).
MBCA grant shareholders power to initiate and to effect changes to the bylaws.\textsuperscript{54} 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.\textsuperscript{55} 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.\textsuperscript{56} 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 Delaware Supreme Court decision in \textit{CA, Inc. v. AFSCME Employees Pension Plan}\textsuperscript{57} confirms such a restricted role for bylaw amendments.\textsuperscript{58}

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\item \textsuperscript{54} See \textsc{Del. Code Ann.}, tit. 8, § 109 (2008); \textsc{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.
\item \textsuperscript{55} See \textsc{Del. Code Ann.}, tit. 8, § 109(b) (2008); \textsc{Model Bus. Corp. Act} § 10.20 (2008).
\item \textsuperscript{56} \textsc{Del. Code Ann.}, tit. 8, § 141(a) (2008). See also \textsc{Model Bus. Corp. Act} § 8.01 (2008).
\item \textsuperscript{57} See generally \textit{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 \textsc{Del. Code Ann.}, tit. 8, § 141(a) (2008).
\item \textsuperscript{58} See Robert B. Thompson & Paul H. Edelman, \textit{Corporate Voting}, 62 \textsc{Vand. L. Rev} 129, 142 (2009), discussing how shareholder power to amend bylaws has been “stunted” by doubts concerning the interrelation of shareholder power to amend the bylaws and the principle of centralized managerial power.
\end{itemize}
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 Australian law principles, the constitution\textsuperscript{59} is freely alterable\textsuperscript{60} by special resolution of the shareholders.\textsuperscript{61} The board’s managerial powers are expressly constrained by any powers reserved to the shareholders in general meeting, either by statute or the

\textsuperscript{59} 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: \textit{Explanatory Notes to Companies Act 2006, available at http://www.opsi.gov.uk/ACTS/en2006/2006en46.htm}, paras [33] and [65]. The articles of association are now the sole constitutional document: \textit{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).

\textsuperscript{60} \textit{See also Walker v. London Tramways Co.} (1879) 12 Ch. D. 705; \textit{Allen v. Gold Reefs of West Africa Ltd.} [1900] 1 Ch. 656 (especially the comments of Lindley MR at 671); \textit{Peters’ American Delicacy Co. Ltd. v. Heath} (1939) 61 CLR 457.

\textsuperscript{61} 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.
company’s constitution.\textsuperscript{62} 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.\textsuperscript{63} 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.\textsuperscript{64} 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 to convene meetings under current Australian law is particularly generous by international standards.\textsuperscript{65}

\textsuperscript{62} See, for example, Corporations Act 2001 (Cth) § 198A(2).

\textsuperscript{63} 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.

\textsuperscript{64} 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”.

\textsuperscript{65} 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)).
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, and shareholders in the role of supplicant. 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. 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.


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”.

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 n162ff.

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.
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 and 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

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71 See generally Mark J. Roe, Path Dependence, Political Options and Governance Systems, in Klaus J. Hopt & Eddy Wymeersch (eds), COMPARATIVE CORPORATE GOVERNANCE: ESSAYS AND MATERIALS 165 (1997).


and hostile takeovers. The traditional 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. Reforms of this kind would shift US law away from its traditional “board as gatekeeper” model and towards the constitutional model favored in the UK and Australia.

Bebchuk advanced the shareholder empowerment reform proposals on the basis of an efficiency, rather than a shareholder democracy, rationale. The presumed efficiency

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76 Lucian A. Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675, 678 (2007). James McConvill considers it ironic that advocates from both sides of the shareholder empowerment debate adopt the same view regarding the place of shareholder participation, perceiving it as a means to enhance corporate performance rather than as an end in itself. See James McConvill, Shareholder Empowerment as an End in Itself: A New Perspective on
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.\textsuperscript{77}

The Paulson Committee Report also addressed balance of power between shareholders and the board of directors. It argued that the US post-Enron reforms were overly stringent by international standards, resulting in reduced competitiveness of US markets.\textsuperscript{78} As a concomitant to this argument, the Committee recommended increased shareholder rights and participation as an alternative regulatory technique.\textsuperscript{79}


\textsuperscript{79} 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, \textit{id.} at xii-xiii, 93-114). For subsequent developments concerning these proposals, see Hal S. Scott, \textit{What is the United States Doing About the Competitiveness of its Capital Markets}, 22(9) J. INT’L BANK. L. & REG. 487, 489-490 (2007).
Contrary to the assumption in the influential “law matters” hypothesis that US corporate law provides strong minority shareholder protection, the Paulson Committee Report considered that, in fact, “lack of shareholder rights” was affecting the level of investment in US companies. 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.

The global financial crisis has added tinder to the shareholder empowerment debate in a range of different contexts. In spite of the SEC’s earlier prevarication on the corporate election issue, shareholder proxy access now appears to be inevitable. On May 20, 2009, SEC commissioners voted, in a 3-2 split along party lines, to propose

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82 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” (Interim Report of the Committee on Capital Markets Regulation 103 (Nov. 30, 2006, revised version released Dec. 5, 2006)).

SEC Rule 14a-11, granting shareholders access to the company’s proxy materials to nominate directors.84

Enhanced shareholder participation in the director nomination process is also a theme in the Shareholder Bill of Rights, which was introduced by US Democrat Senators, Charles Schumer and Maria Cantwell, on May 19, 2009. The Shareholder Bill of Rights is aimed at increasing shareholder powers as an antidote to excessive risk-taking and executive compensation.85 In this respect, it is a direct response to the global financial crisis. The Shareholder Bill of Rights includes an instruction to the SEC to issue rules permitting shareholders wishing to nominate a director to have access to the company’s proxy in certain circumstances.86 It also affects the balance of power between shareholders and the board, and corporate governance practices


generally, in several other important ways. For example, the Shareholder Bill of Rights would require: a mandatory annual non-binding shareholder vote on executive compensation in public companies; elimination of staggered boards; separation of the position of CEO and Chairman in public company boards and the presence of a risk committee for public company boards.  

Few US commentators seem to doubt that there is “ample room for increasing shareholder power” under US corporate law. Yet, the issue of shareholder empowerment has elicited a surprisingly polarized debate and backlash, with

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many commentators doubting the wisdom of increasing shareholder power at the expense of managerial power. The current US reform developments have merely exacerbated this existing controversy.

Criticism of shareholder empowerment 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.

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92 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).
Bainbridge, for example, does not dispute Bebchuk’s assessment of shareholder disempowerment, but rather welcomes it as providing evidence that US corporate law 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,\textsuperscript{98} modern governance pressures,\textsuperscript{99} and the ability of shareholders to self-protect through mechanisms such as diversification.\textsuperscript{100}

Secondly, commentators have criticized shareholder empowerment 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.\textsuperscript{101} Although this is an intriguing question with respect to the historical development of 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.\textsuperscript{102}

\textsuperscript{98} See Stephen M. Bainbridge, \textit{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.


\textsuperscript{100} 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, 1764 (2006).


\textsuperscript{102} 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, \textit{id.} at 1737; Lynn A. Stout, \textit{The Mythical Benefits of Shareholder Control}, 93 VA. L. REV. 789, 801-803 (2007). Background events concerning the migration
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.\textsuperscript{103} In the context of the corporate election issue, some commentators have opposed increased shareholder participation in the director nomination process on the basis that it would promote special interest directors, undermine board collegiality and introduce the risk of “balkanized and dysfunctional boards”\textsuperscript{104} A variant of this argument stresses that shareholders are themselves a fragmented and fractured group with disparate interests.\textsuperscript{105} The “be careful what you wish for” argument suggests that

\begin{itemize}
\item of News Corporation (“News Corp”) from Australia to a Delaware in 2004 tell another story, however, highlighting the fact that both shareholder rights, and the extent to which they are valued, differ across the common law world. \textit{See, e.g.}, Jennifer G. Hill, \textit{Subverting Shareholder Rights: Lessons from News Corp’s Migration to Delaware} (forthcoming \textit{VAND. L. REV}, 2010).
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\item Bainbridge, \textit{id.} at 1749, 1756.
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\item \textit{See} Iman Anabtawi, \textit{Some Skepticism About Increasing Shareholder Power}, 53 \textit{UCLA L. REV.} 561, 564-565, 578ff (2006); Vice Chancellor Leo E. Strine, \textit{Toward a True Corporate
shareholders are likely to abuse participatory powers, engage in opportunism, prefer their private sectional interests to those of the shareholders generally,\textsuperscript{106} or succumb to the “momentary majority impulse”.\textsuperscript{107} Under this line of argument, not only does the company need protection from predatory conduct of its shareholders, but shareholders need protection from each other.\textsuperscript{108}

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

\textsuperscript{106} Anabtawi, \textit{id.} at 598.


action problems and rational shareholder apathy.\textsuperscript{109} The explanation of the paradox between these two arguments appears to lie in the fragmented nature of the shareholder body.\textsuperscript{110} Thus, it is assumed that although apathy would generally prevail among the majority of shareholders, including institutional investors,\textsuperscript{111} 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.\textsuperscript{112}

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{113} 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{114} As the global credit crisis has shown, however, systemic risks\textsuperscript{115} 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{116} and that any rush to adopt additional changes should be deferred until the consequences of those

\textsuperscript{113} Lipton & Savitt, \textit{id.} at 734.


reforms can be known and assessed. 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.

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.


118 See Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521, 1528 (2005), describing the Sarbanes-Oxley Act as “emergency legislation”. Cf J. Robert Brown, Criticizing the Critics: Sarbanes-Oxley and Quack Corporate Governance, 90 MARQ. L. REV. 309 (2006), who, while acknowledging that the Sarbanes-Oxley Act came into force quickly due to political pressures, argues that it nonetheless delivered real benefits and improvements in the corporate governance process.


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.\textsuperscript{121} Bebchuk explicitly disavowed the idea that his shareholder empowerment reform proposals were based upon corporate democracy or shareholder ownership rights.\textsuperscript{122} Nonetheless, an underlying theme in the responses from some of his critics has been that the concept of shareholder empowerment is misguided, since it would revive an outmoded and inappropriate image of the shareholder as “owner”\textsuperscript{123} of the corporation\textsuperscript{124} or principal in a principal-agent relationship.


\textsuperscript{124} See, e.g., Martin Lipton & Steven A. Rosenblum, \textit{Election Contests in the Company’s Proxy: An Idea Whose Time Has Not Come}, 59 BUS. LAW. 67, 68, 70 (2003). See also Roberta S.
relationship with directors. It is worth noting, however, that although shareholders are accorded significant participatory rights in corporate governance under UK law, the courts have firmly rejected a view of shareholders as corporate owners or principals.

4. From Enron to the Global Financial Crisis: Shareholder Empowerment or Shareholder Protection?

“Lack of shareholder power did not contribute to Enron’s fall”.

Lynn A. Stout

“In sum, the separation of ownership and control did not cause the financial crisis of 2008. Efforts to reduce the degree to which ownership and control are separated by empowering shareholders will not help prevent future crises.”

Stephen M. Bainbridge


See, e.g., Automatic Self Cleansing Filter Syndicate Co, Ltd. v. Cuninghame [1906] 2 Ch. 34.

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.129

Regulatory responses to international corporate scandals such as Enron highlighted 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.130 Although these reforms tackled similar problems of


129 See, e.g., Martin Gelter, The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance, 50 HARV. INT’L L.J. 129, 134 (2009), stating that US corporate and securities law is “highly unusual in the extent to which it disenfranchises shareholders from both explicit and implicit influence”. Areas where shareholders 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, Subverting Shareholder Rights: Lessons from News Corp’s Migration to Delaware (forthcoming VAND. L. REV, 2010).

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 of the kind exhibited by the Sarbanes-Oxley Act 2002 can itself engender pushback 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 credit crisis, and scandals such as the Bernard Madoff affair, a

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deregulatory reform agenda no longer appears politically feasible. The era of calls for “kinder, gentler” SEC is over, for some time at least. As Professor John Coffee has stated, if the credit crisis demonstrates anything, it is “that there are also costs to under-regulation”.

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136 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. See also Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?* 108 (Yale Law & Economics Research Paper No. 385, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1404967, discussing the limits of regulatory rollback in the current political environment.


138 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. See Kate Burgess, *Global Crisis? Blame the Regulators, Says Investors Group*, FIN. TIMES, Nov. 10, 2008, at 18.

139 In discussing the costs of 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”. Professor John C. Coffee Jnr., *Financial*
Shareholder protection was a common goal in the various post-Enron regulatory reforms in common law jurisdictions. Nonetheless, the reforms differed 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-Enron reforms; enhancement of shareholder participation and power was not. The preamble to the Sarbanes-Oxley Act 2002 confirms this focus. This approach accords with Professor Bainbridge’s view that there is no need for enhanced participatory rights, when shareholder interests are already

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Crises 101: What Can We Learn from Scandals and Meltdowns - from Enron to Subprime?, in


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. See generally Roberta S. Karmel, 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. Cf. Donald C. Langevoort, 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.
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 presented 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

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145 Lynn A. Stout, The Mythical Benefits of Shareholder Control, 93 VA. L. REV. 789, 808 (2007). Professor Stout characterizes the idea of using shareholder empowerment as an antidote to corporate collapse as a corporate governance “fad”, akin to that of stock options in the 1990s, and likely to do more harm than good. Id.
Explanatory Memorandum to the CLERP 9 Act 2004 contains numerous references to the desirability of improving shareholder participation, increasing shareholder 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

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146 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.

147 See, e.g., Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, Explanatory Memorandum, paras [4.271]-[4.280], “Shareholder Participation and Information”. According to the Explanatory Memorandum:-

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 performance of the board by effectively participating in general meetings of corporations” (Id. at paras [4.271] - [4.272]).

148 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].

149 Id. at para [4.174].
The assumption that shareholder engagement enhances corporate performance and accountability also has strong traction in more recent 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.

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151 Parliamentary Joint Committee on Corporations and Financial Services, Better Shareholders – Better Company: Shareholder Engagement and Participation in Australia (June 2008).

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

153 Id. at para [2.23].

154 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.

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160 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 Companies Act 2006 (UK), Part 9.
It was in the area of remuneration that the most prominent Australian and UK post-
Enron reforms facilitating greater shareholder participation were introduced.\textsuperscript{161} 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.\textsuperscript{162} An analogous provision was introduced two years earlier in the UK.\textsuperscript{163}

\textsuperscript{161} Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill
\textit{Regulating Executive Remuneration: International Developments in the Post-Scandal Era}, 3

\textsuperscript{162} \textit{See} Corporations Act 2001 (Cth), § 250R(2) and 249L. \textit{See generally} Larelle Chapple &
Blake Christensen, \textit{The Non-Binding Vote on Executive Pay: A Review of the CLERP 9

requiring shareholder approval of the directors’ remuneration report is now found in section
439 of the recently enacted Companies Act 2006 (UK). \textit{See generally} Eilis Ferran, \textit{Company
available at http://ssrn.com/abstract=644203. Evidence from the first three years of operation
of the non-binding vote in the UK suggests that it has had an effect on remuneration practices
and excessive compensation. \textit{See} Kym Sheehan, \textit{Is the Outrage Constraint an Effective
Constraint on Executive Remuneration? Evidence from the UK and Preliminary Results from
Unlike the US, where precatory shareholder voting has a long pedigree,\textsuperscript{164} 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 was to facilitate more active shareholder involvement in compensation issues and to permit shareholders to express their opinion collectively.\textsuperscript{165} The Explanatory Memorandum to the CLERP 9 Act envisaged 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.\textsuperscript{166} The reform sought to constrain excessive remuneration by public censure and “shaming”.\textsuperscript{167} 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.

\textsuperscript{164} 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. \textit{See generally} Brian R. Cheffins & Randall S. Thomas, \textit{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, \textit{Pay Without Performance: The Unfulfilled Promise of Executive Compensation} 51-52 (2004).

\textsuperscript{165} Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, \textit{Explanatory Memorandum}, paras [5.434]-[5.435].

\textsuperscript{166} \textit{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”. \textit{Id.} at para [5.413].

predicted at the time of its introduction,\textsuperscript{168} and the provision now enjoys strong support from shareholder groups, particularly institutional investors.\textsuperscript{169} Significant protest votes were registered at many major Australian companies during recent annual shareholder meeting seasons.\textsuperscript{170} Although protest votes were previously far less common in the UK, this has changed as a result of the global financial crisis. At the annual shareholders meeting of the Royal Bank of Scotland in April 2009, for example, an unprecedented 90.42\% of votes were cast against the directors’ remuneration report.\textsuperscript{171}


\textsuperscript{170} 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. Sheehan, \textit{id.} at 18-20.

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"),\(^{172}\) which was also introduced in response to the corporate scandals.\(^{173}\) 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 legal disincentives to exercising voting rights under various European laws.\(^{174}\) 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{175}

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{176} Like the Paulson Committee Report,\textsuperscript{177} the EU Directive views shareholder rights as an alternative, and superior, regulatory mechanism to more stringent rules-based corporate regulation.\textsuperscript{178} Both the EU Directive and the Australian Parliamentary Joint Committee Report rely on principles of fairness\textsuperscript{179} and shareholder democracy.\textsuperscript{180}

\textsuperscript{175} See Richard C. Nolan, Shareholder Rights in Britain, 7 EUR. BUS. ORG. L. REV. 549, 551 (2006), commenting on a draft version of the Directive.


\textsuperscript{177} See id. at xii-xiii, 93-114.


They justify shareholder participation in corporate governance by envisaging shareholders as “owners” of the company, an image often condemned in the critiques of scholars who oppose shareholder empowerment.

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

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180 See, e.g., Parliamentary Joint Committee on Corporations and Financial Services, 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, 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 ultimately jettisoned, when the Commission decided not to pursue its controversial “one share, one vote” proposal. See Andrew Bounds & Kate Burgess, EU Scraps Plans for ‘One Share, One Vote’ Reform, FIN. TIMES, Oct. 4, 2007, at 1.


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 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".

Interestingly, however, the most recent financial crisis seems to have pushed US lawmakers and regulators from a strategy aimed at protection of shareholder interests, to one concerned with the promotion of shareholder rights. One of most obvious examples of this attitudinal shift is the non-binding shareholder vote on executive pay,

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183 See supra, n33.


which appears in several recent US reforms and reform proposals. “Say on pay” has, indeed, become emblematic of public backlash against excessive pay during the global financial crisis. The operation of a “say on pay” provision was originally restricted to financial institutions receiving TARP funding, under the American Recovery and Reinvestment Act of 2009, which was introduced in February 2009.

The US origins of current reforms relating to “say on pay” date back several years. The Paulson Committee suggested that a shareholder vote of this kind should be considered in the US. See Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation* 109 (Nov. 30, 2006, revised version released Dec. 5, 2006). An Act to this effect, the *Shareholder Vote on Executive Compensation Act* (HR 1257) (2007) was subsequently passed by the House of Representatives in April 2007. See Kara Scannell & Siobhan Hughes, *House Clears an Executive-Pay Measure*, WALL ST. J., Apr. 21, 2007, A3. However, the Bill’s passage stalled in the Senate, due to opposition by the Bush Administration at that time. Scannell & Hughes, *id*. “Say on pay” has been controversial in the US. Several commentators opposed its introduction of a “say on pay” provision on the basis that it would encroach on managerial discretion and promote a narrow “one size fits all” remuneration model.

Although several commentators have strongly opposed greater shareholder involvement in executive compensation in the US context, it now appears that a “say on pay” requirement will spread beyond institutions receiving government funding. A “say on pay” provision appears in both the Shareholder Bill of Rights, and in a more recent Bill, the proposed Corporate and Financial Institution Compensation Fairness Act of 2009. Thus, we now see the US echoing the reforms made elsewhere in the common law world during the post-Enron period, raising the question as to whether greater convergence on the issue of shareholder participation will, in fact, occur.

See, e.g., Stephen M. Bainbridge, Remarks on Say on Pay: An Unjustified Incursion on Director Authority (UCLA School of Law, Law & Economics Research Paper No. 08-06, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1101688 (disputing the view that there is a crisis in executive remuneration that justifies any federal regulatory intervention in this regard); See Jeffrey N. Gordon, "Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-in, 46 HARV. J. ON LEGIS. 323 (2009). Gordon also expresses concern that such a provision would introduce a gatekeeper role for a small number of proxy advisers. Id.

US House, 111th Congress, “H.R. 3269, Corporate and Financial Institution Compensation Fairness Act of 2009”. The Bill was passed by the House of Representatives on July 31, 2009, and has been referred to the Senate Committee on Banking, Housing and Urban Affairs. The Bill proposes to amend the Securities Exchange Act of 1934 to allow an annual, non-binding shareholder vote on executive compensation, and a similar non-binding vote on “golden parachute” compensation. Other reforms are also contained within the Bill, including a proposal to require financial institutions to disclose information on their pay structures, and how these structures relate to risk. For further information, see Edward Luce and Sarah O’Connor, Control of Executive Pay is Handed to Regulators, FIN. TIMES, Aug. 1, 2009, at 06. For commentary on the Bill, see Lucian Bebchuk, Regulate Financial Pay to Reduce Risk-taking, FIN. TIMES, Aug. 4, 2009, at 07.
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*190

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. Regulation is neither static, nor a one way street. Recent comparative corporate governance literature has stressed the dynamic operation of legal regulation,191 a dynamism which includes the strategic response of regulated parties.192


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. It constitutes a clear example of commercial pushback.

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.\(^{193}\) 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.\(^{194}\)

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\(^{193}\) See Corporations Act 2001 (Cth) § 136(2). “Special resolution” is defined in Corporations Act 2001 (Cth) § 9.

\(^{194}\) See Corporations Act 2001 (Cth) § 136(3).
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, 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 or propose a resolution to that effect where a meeting has already been convened by the company. This contrasts with the traditional 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, 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

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195 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.

196 Corporations Act 2001 (Cth) § 249D.

197 Corporations Act 2001 (Cth) § 249N(1).

198 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.
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.\textsuperscript{199}

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.\textsuperscript{200} 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.\textsuperscript{201} Boral had itself been the target of shareholder activism by

\textsuperscript{199} 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. \textit{See} Stephen Bartholomeusz, \textit{Heavy-handed Boral Could Help Strengthen the Hand of Critics}, \textit{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.

\textsuperscript{200} 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. \textit{See} Bryan Frith, \textit{Right to Clip Board Powers}, \textit{THE AUST.}, Dec. 2, 2003, at 20.

\textsuperscript{201} Environmental activism in major Australian companies included, for example, the requisitioning by shareholders of extraordinary general meetings at North Ltd and Gunns Ltd. \textit{See} Shelley Bielefeld, Sue Higginson, Jim Jackson & Aidan Ricketts, \textit{Directors’ Duties to the
the Transport Workers’ Union (“TWU”), \(^{202}\) reflecting a trend, both in Australia and the US, \(^{203}\) for unions to propose corporate governance resolutions at annual shareholder meetings. \(^{204}\) 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. \(^{205}\) Thus, the events at Boral reflect Bainbridge’s concern

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\(^{202}\) 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).


\(^{204}\) For an overview and analysis of recent instances of union shareholder activism in Australia, see Kirsten Anderson & Ian Ramsay, *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, *id.*

\(^{205}\) 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 *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
that the conferral of greater shareholder participatory rights could empower classes of shareholders who might misuse those powers and Justice Strine’s argument that, in certain circumstances, even investors themselves might not favor strong shareholder rights.

The Boral amendment explicitly relied for its validity on § 136(3) of the Australian Corporations Act, permitting a company to stipulate that “a further requirement” is necessary before a special resolution to alter the constitution is effective. This section envisages the possibility of virtual entrenchment of constitutional provisions, depending upon the stringency of the “further requirement”. However, it is not


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”.

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
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 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).


211 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.
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 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. Although acknowledging that no significant abuse of the rule


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.

by activist shareholders had arisen, the Report considered that it should be jettisoned, in view of its potential for abuse.\textsuperscript{216}

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,\textsuperscript{217} which prompted resignations of the bank’s CEO and chairman.\textsuperscript{218}

\textsuperscript{216} Id. at para [3.90].


\textsuperscript{218} 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 http://www.nabgroup.com/0,,41673,00.html; National Australia Bank, ASX Announcement – Mr Graham Kraehe Appointed the National’s Chairman
NAB also announced that it had commissioned PricewaterhouseCoopers (“PwC”) to conduct an investigation and prepare a report into the trading scandal.\textsuperscript{219}

What ensued was a classic boardroom brawl.\textsuperscript{220} 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.\textsuperscript{221} The PwC Report, which was released with a

\textit{Following the Resignation of Mr Charles Allen, 16 February 2004, available at http://www.nabgroup.com/0,,42633,00.html.}


\textsuperscript{220} For an interesting recent study of such conflicts in the US context, see Anup Agrawal & Mark A. Chen, \textit{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.

\textsuperscript{221} 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, \textit{The Heretic, AUST. FIN. REV.}, Aug. 27, 2004, at 74.
probity advice certifying its independence,\(^\text{222}\) found that four foreign exchange currency traders had exploited weaknesses in the bank’s risk management controls to hide trading losses and protect bonuses.\(^\text{223}\) The Report was highly critical of aspects of NAB’s corporate culture,\(^\text{224}\) and considered that ultimate responsibility for the “tone at the top” lay with the board of directors and the CEO.\(^\text{225}\)

\(^{222}\) 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.


\(^{224}\) 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.

At the time of the release of the PwC Report, the NAB chairman 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 the chairman. Both groups in the NAB dispute vigorously lobbied institutional investors in the lead-up to the proposed shareholder meeting, and it appears that

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226 The NAB chairman was Graham Kraehe. See National Australia Bank, ASX Announcement – Board Changes at the National, 12 March 2004, available at http://www.nabgroup.com/0,,44475,00.html.


228 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.

229 In early May 2004, NAB’s major shareholders, AMP, Perpetual and the Australian Council of Super Investors announced their somewhat reluctant support of NAB chair, Graham Kraehe. See Andrew Cornell & Stewart Oldfield, Where NAB Went Wrong, AUST. FIN. REV., May 8, 2004, at 20. Corporate Governance International, however, advised its clients to vote in favor
dialogue with major investors was influential in resolving the dispute.\textsuperscript{230} A showdown at the scheduled shareholder meeting\textsuperscript{231} was ultimately avoided when, as part of a compromise, several parties to the dispute including Walter, agreed to resign from the NAB board.\textsuperscript{232}

\textsuperscript{230} Cornell & Oldfield, \textit{id.}

\textsuperscript{231} Technically, in fact, three separate shareholder meetings were scheduled to consider the different sets of resolutions proposed. \textit{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.}

\textsuperscript{232} Graham Kraehe announced that he would retire after overseeing a board reconstruction and that two of NAB’s longest serving directors, Ken Moss and Ed Tweddell, would retire in three months. \textit{See National Australia Bank, ASX Announcement – Statement by Seven Non-executive Directors of the National, 5 May 2004, available at http://www.nabgroup.com/0,,48073,00.html.} Catherine Walter announced her resignation the following day. \textit{See National Australia Bank, Statement by Catherine Walter, National Australia Bank Ltd Director, 6 May 2004, available at http://www.nabgroup.com/vgnmedia/downld/CWalter_statement_060504.pdf.}
Opinion was sharply divided on the NAB corporate governance dispute, paralleling US debate on greater shareholder participation in board nominations.233 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.234 Supporters, however, echoing the view of Warren Buffett that there should be more dissent in the boardroom,235 argued that she had fulfilled admirably the role envisaged for an independent director.236

5.3 The Coca-Cola Amatil Prenuptial Agreement and its Effect on Shareholder Power


236 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…”.
The NAB corporate governance dispute sent reverberations through the Australian commercial community, and demonstrated the power of shareholder opinion.\textsuperscript{237} One commentator predicted that, following the dispute, chairs would become even more conservative in their nomination of directors, to avoid similar intra-board conflicts.\textsuperscript{238} 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.\textsuperscript{239} NAB and several other Australian companies also considered introducing prenuptial agreements.\textsuperscript{240}


\textsuperscript{238} See Stephen Bartholomeusz, \textit{Zero Tolerance of Board Errors a Lose-lose Trend}, \textsc{Sydney Morning Herald}, May 8, 2004, at 46. See also Andrew Cornell & Stewart Oldfield, \textit{Where NAB Went Wrong}, \textit{id}, claiming that one of the lessons of NAB was that “major investors will not support mavericks on the board”.

\textsuperscript{239} See generally Stewart Oldfield, \textit{Boards Seek Power to Sack Directors}, \textsc{Aust. Fin. Rev.}, Jul. 20, 2004, at 1; Katherine Jimenez, ‘Pre-nuptial Deal’ Torn Up as Coke Bows to Investor Pressure, \textsc{The Aust.}, Aug. 10, 2004, at 19.

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 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 dissentient 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


243 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.
focus on failure to perform under prenuptials “was universally seen as code for ‘toe the line’”. 244

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, 245 the power of shareholders to remove directors from office reflects the basic corporate constitutional structure, in which shareholders exercise ultimate control. 246 It also provides an important buffer against managerial entrenchment. 247 The significance of the removal power in the US context has recently been highlighted by Professors Thompson and Edelman, who advocate increased shareholder voice in relation to removal of directors. 248

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245 See Automatic Self Cleansing Filter Syndicate Co Ltd v. Cuninghame [1906] 2 Ch. 34.


247 See Allied Mining & Processing v. Boldbow Pty Ltd. [2002] WASC 195, paras [47], [52].

248 Adopting an error-correction rationale for shareholder voting, Professors Thompson and Edelman advocate increased shareholder voice for removal of directors and mergers. They are less convinced of the need for increased shareholder participatory rights in the context of
The provisions under the Australian *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.\(^{249}\) However, § 203C is a replaceable rule only, and can be ousted or modified by the company’s constitution.\(^{250}\) 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.\(^{251}\)


\(^{250}\) 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”.

company counterpart,\textsuperscript{252} 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{253} Furthermore, § 203E clearly distinguishes 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{254} 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{255} 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{256} In the wake of the global financial crisis, however, the International Corporate

\textsuperscript{252} Corporations Act 2001 (Cth) § 203C.

\textsuperscript{253} 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

(c) an agreement between any or all members of the company and the director.”

\textsuperscript{254} 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:

(a) remove a director from their office; or

(b) require a director to vacate their office.”

\textsuperscript{255} 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.

Governance Network (ICGN) called on US regulators to strengthen shareholder rights to dismiss directors from office, "so that boards can be held to account".\footnote{See Global Crisis? Blame the Regulators, Says Investors Group, FIN. TIMES, Nov. 10, 2008, at 18.} The recent Shareholder Bill of Rights includes a provision which would require the elimination of staggered boards in US public corporations.\footnote{See US Senate, 111\textsuperscript{th} Congress, “S. 1074, A Bill to Provide Shareholders with Enhanced Authority over the Nomination, Election and Compensation of Public Company Executives”, available at http://law.du.edu/documents/corporate-governance/legislation/bill-text-shareholders-bill-of-rights-act-of-2009.pdf. Also, in the last few years, there has been an increase in the number of US corporations that have removed their classified board structure due to institutional investor pressure. See Robert B. Thompson & Paul H. Edelman, Corporate Voting, 62 VAND. L. REV 129, 169 (2009).}

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”.\footnote{ASIC, Information Release IR 04-4: Removal of Directors of Public Companies, 17 August 2004.}

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 commentators regard § 203D as providing the exclusive means by which directors of
a public company may be removed from office,\textsuperscript{260} established case law rejected this interpretation.\textsuperscript{261} The position has been further complicated by a 2008 decision, holding that § 203D constitutes an exclusive removal regime.\textsuperscript{262} 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,\textsuperscript{263} rather than an exclusive, right to remove directors from office.\textsuperscript{264} Also,

\begin{itemize}
\item \textsuperscript{261} 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 (\textit{id.} at [47] and [56]).
\item \textsuperscript{262} 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 (\textit{id.} at [21]). Bryson AJ considered that Allied Mining and Processing v. Boldbow Pty Ltd. [2002] WASC 195 had been incorrectly decided (\textit{id.} at [37]).
\item \textsuperscript{263} 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).
\end{itemize}
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.\textsuperscript{265}

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 to shift power to the board, by preempting a decision by shareholders as to whether the director should be removed from office.\textsuperscript{266}

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.\textsuperscript{267} 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.\textsuperscript{268} 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.\textsuperscript{269}

Ultimately, in response to pressure from ASIC\textsuperscript{270} 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.\textsuperscript{271} 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 meeting.\textsuperscript{272} ASIC welcomed this amendment, while stressing the need for

\begin{footnotesize}
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\item \textsuperscript{268} Corporations Act 2001 (Cth) § 203E(b).
\item \textsuperscript{269} 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”. See generally Jean J. du Plessis, Some Peculiarities Regarding the Removal of Company Directors, 27 AUST. BUS. L. REV. 6 (1999).
\item \textsuperscript{270} See ASIC, Information Release IR 04-40: Removal of Directors of Public Companies, 17 August 2004.
\item \textsuperscript{271} Annabel Hepworth, 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.
\item \textsuperscript{272} See Alan Kohler, Take Two on ‘Pre-nups’ for Quiet Departures, THE AGE, Aug. 11, 2004, at 1.
\end{enumerate}
\end{footnotesize}
shareholders to be provided with full background information to enable informed participation\textsuperscript{273} in the removal of directors under this revised model.\textsuperscript{274} 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.\textsuperscript{275}

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\textsuperscript{276} following the Cohen Committee Report,\textsuperscript{277} to strengthen shareholder control

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\textsuperscript{273} See Richard M. Buxbaum, \textit{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.


\textsuperscript{275} See, e.g., Stephen Knight, \textit{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”.

\textsuperscript{276} Companies Act 1948 (UK) § 184(1).

\textsuperscript{277} \textit{Report of the Committee on Company Law Amendment}, Cmd 6659 (HMSO, 1945).
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.

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.”

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278 See also Companies Bill, Second Reading, 16 November 1961, 2588, 2598-2599.

279 This removal power is now contained within Companies Act 2006 (UK) § 168(1).


281 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.


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 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.

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284 I am grateful to Deborah DeMott for raising with me the implications of these amendments for the issue of prenuptial agreements.

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 has provided an opportunity to reassess whether shareholders should be granted stronger power as a constraint on managerial control, and it appears that a major paradigm shift in this regard is now underway in the US.

This article critically assesses the issue of shareholder empowerment, and current regulatory developments in the US concerning shareholder rights, 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. It shows that US shareholders have traditionally possessed significantly fewer participatory rights than their counterparts in other common law jurisdictions, and examines particular legal rules that contribute to this divergence.

The article also considers the regulatory implications of commercial pushback. It discusses 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 shows how some major Australian companies have artificially created a corporate governance regime, which mimics certain aspects of Delaware law in its traditional 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.