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The Rising Tension between Shareholder and Director Power in the Common Law World

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Abstract

This article explores the rising tension between shareholder and director power in the common law world. First the article analyzes key arguments in the shareholder empowerment debate, and current US reform proposals to grant shareholders stronger rights, from a comparative corporate law perspective, examining how traditional US legal rules diverge from other common law jurisdictions. Secondly, the article discusses power shifts in the opposite direction – namely toward the board – in some parts of the common law world.

The article shows that US shareholders have traditionally had unusually restricted rights compared to their counterparts in common law jurisdictions, such as the United Kingdom and Australia. It challenges a number of arguments supporting the traditional US approach, by showing that the arguments are often US-specific, and are less persuasive from a comparative corporate governance perspective. The article also identifies an important tension between legal rules designed to enhance shareholder power, and commercial practices designed to subvert it. It shows how strategic commercial responses to regulation can affect the operation of legal rules. The existence of commercial pushback of this kind suggests that, even if US shareholder powers are significantly strengthened, that will by no means be the end of the story.

Keywords: corporate governance, comparative corporate governance, "law matters" hypothesis, shareholders, shareholder empowerment, institutional investors, directors, corporate charter amendment, appointment of directors, removal of directors, corporate prenuptial agreements, entrenchment mechanisms

JEL Classifications: D70, G30, G32, G34, G38, K22, K33, K40, K42, M14

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THE RISING TENSION BETWEEN SHAREHOLDER AND DIRECTOR POWER IN THE COMMON LAW WORLD

Jennifer G. Hill*

INTRODUCTION

> "We fear to grant power and are unwilling to recognize it when it exists".
>
> Oliver Wendell Holmes (*Tyson & Bro.-United Theatre Ticket Offices v. Banton*, 1927:445)

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 (Paulson Committee, 2006).

The global financial crisis has given further impetus to shareholder empowerment (Bratton & Wachter, 2009; Bainbridge, 2009). The crisis highlighted some of the dangers of untrammelled managerial power and under-regulation (Coffee, 2008:37; Burgess, 2008a); business once again has "a legitimacy problem"

(Plender, 2008a). The issue of whether shareholders should be afforded stronger powers as a check on managerial control has been a major theme in international regulatory responses to the crisis (Burgess, 2008b). It has been argued that any response to the crisis will be "incomplete if it fails to address this basic issue of shareholder rights" (Plender, 2008b). The International Corporate Governance Network (ICGN) also warned that shareholder rights need to be made integral to reforms associated with the UK bank bailout (Burgess, 2008a).

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 (Nathan, 2009); they are, nonetheless, extremely controversial in the US.

Although shareholder protection has traditionally been a mantra of US corporate law, shareholder empowerment has not (Chandler & Strine, 2003:973; Hill, 2008:825). Yet, empowerment is an important aspect of investor protection, providing shareholders with a corporate governance self-help mechanism. Shareholder power is also closely correlated with investor activism (Bainbridge, 2008), which ranges across a broad spectrum of possible conduct (Gillan & Starks, 2007), and may, or may not, be publicly observable (Becht, Franks, Mayer & Rossi, 2008; Black & Coffee, 1994). The relationship between shareholder empowerment and activism is of growing importance in a range of corporate governance areas, such as executive compensation (Balachandran, Ferri & Maber, 2007). Some scholars have argued that the rise of shareholder power should be coupled with the introduction of fiduciary duties for activist shareholders, akin to those traditionally imposed upon directors and officers (Anabtawi & Stout, 2008; Plender, 2008c).

As this article demonstrates, there are a number of important differences in the balance of power between shareholders and directors in the US and UK, which have arguably produced different levels of shareholder activism in these countries. It has been suggested, for example that the willingness of UK companies to engage privately with institutional investors is due to the "potent threat" that investors may convene an extraordinary shareholders' meeting (Becht et al., 2008). It has also been argued that a higher level of shareholder power was responsible for greater investor activism in shaping takeover rules in the UK than was possible in the US, where a pro-managerial takeover regime prevails (Armour & Skeel, 2007: 1771, 1794).

The influential "law matters" hypothesis identified important corporate governance differences between common law and civil law jurisdictions, yet tended to obscure interesting differences regarding shareholder rights within the common law world itself (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998). A recurring criticism of the study is that it assessed "law on the books", rather than law in action (Skeel, 2004:1543; Enriques, 2002:769*ff*). This theme is continued in recent scholarship that emphasizes the relevance of enforcement intensity in assessing the quality of legal protection (Coffee, 2007; Jackson, 2007). Another methodological criticism of the "law matters" study asserts that it overlooked the fact that context also matters in corporate governance. According to this critique, the impact of even "law on the books" may vary depending on the applicable underlying corporate ownership structures (Bebchuk & Hamdani, 2009; Hopt, 2009)

The goal of this article is to explore the rising tension between shareholder and director power in the common law world. This tension can result in the strengthening of power in either direction. First, the article examines current proposals in the US to increase shareholder rights. It critically analyzes the US shareholder empowerment debate, and current reformatory zeal in this regard, through a comparative corporate governance lens. The article highlights specific ways in which US shareholders have traditionally possessed significantly less power than their counterparts in other common law jurisdictions, examining particular legal rules that have contributed to this divergence.

Secondly, the article discusses power shifts in the opposite direction - namely toward the board - in some other parts of the common law world. Recent enforcement literature has stressed the dynamic operation of legal regulation (Coffee, 2007; Jackson, 2007), a dynamism which includes the strategic response of regulated parties (Skeel, 2008:697; Milhaupt & Pistor, 2008). The article considers the effect of such strategic responses in the form of commercial pushback to regulation. It examines the potential friction between legal rules designed to enhance shareholder power, and commercial practices designed to subvert it. Much comparative corporate governance debate has focused on the role of legal rules in increasing shareholder rights. Yet, as this discussion demonstrates, commercial norms and practices may be equally, or more, important (Eisenberg, 1999), and may operate to shift power away from shareholders, towards the board of directors.

The article shows how, even in common law countries such as Australia, where legal rules accord shareholders strong participatory rights in corporate governance, the strategic response of regulated parties may curb such involvement. This form of 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. This suggests that, even if, as now appears likely on the basis of current reform proposals, US shareholder powers are significantly strengthened, that will by no means be the end of the story.

The structure of the article is as follows. First, it considers, from a theoretical perspective, a range of evolving, and sometimes conflicting, images of the shareholder in corporate governance. These varying images have significant implications for the appropriate allocation of power between shareholders and the board of directors. The article then examines current US developments, including the shareholder empowerment debate and reform proposals to strengthen shareholder rights vis-à-vis the board. It identifies legal rules that have contributed to the divergence of shareholder rights across jurisdictions, discussing why US shareholders have traditionally possessed less power than their counterparts in other common law countries. The article then examines the role of commercial practice in potentially shifting power toward the board of directors in some other common law jurisdictions. It uses two case studies from Australia to demonstrate how commercial practice can potentially subvert the operation of legal rules designed to grant rights to shareholders. The article concludes by considering some of the implications of the discussion for law reform and comparative corporate governance studies generally.

EVOLVING VISIONS OF THE SHAREHOLDER IN CORPORATE LAW

> "[I]t is the courts that are relegating shareholders to the questionable role of bystanders". (Buxbaum, 1985:1683)

> "[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". (Manne, 1967:261)

A range of visions of the relationship between shareholders and the corporation can be discerned across time and jurisdictions in corporate theory, which potentially affects the allocation of power between shareholders and the board. These images lie on two distinct axes – first, the appropriate level of shareholder participation in corporate governance and secondly, the status of shareholder interests. A number of competing roles for investors are discernible within this schema. The shareholder is variously presented as an owner/principal; beneficiary under a trust; bystander; participant in a political entity; investor; gatekeeper; or managerial partner (Hill, 2000).

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 (Macey, 1991; Bratton, 1989:427*ff*; Millon, 1990:229-231). 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 (Blair & Stout, 1999).

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 global financial crisis. Ambivalence has emerged concerning the role of shareholders in these events. On one interpretation, boards of directors and gatekeepers bear most responsibility for these events (Coffee, 2002; Coffee, 2004; Gordon, 2002), with shareholders seen as victims, together with taxpayers who have funded recent government bail-outs (Bratton & Wachter, 2009:4; Walker Review, 2009a:90)).

On another interpretation, however, shareholders have been far from blameless. Such an image of shareholders is not new. Justice Brandeis once stated "[t]here is no such thing….as an innocent stockholder. He may be innocent in fact, but socially he cannot be held innocent" (Brandeis, 1934:75). The latter interpretation focuses on the perceived short-term interests of many shareholders (Karmel, 2004:4-9; Strine, 2006:1772-3; Bratton, 2002:1284; Bolton, Scheinkman & Xiong, 2006), such as hedge funds (Anabtawi, 2006:582-4; Raaijmakers & Maatman, 2006), viewing them not as victims, but as potential threats to the corporate enterprise (Strine, 2006:1764). There has been a growing perception that major institutional investors were deficient monitors over the last decade (Plender, 2008b), doing little, for example, to counter the immense executive pay packages during boom periods (Bolton et al., 2006). There is also increasing concern about the phenomenon of "empty voting", involving a disjunction between voting rights and economic interests in the company (Hu & Black, 2006; Kahan & Rock, 2007), and the implications of this phenomenon for the legitimacy of shareholder voting power (Karmel, 2010; Thompson & Edelman, 2009:153*ff*). Ambivalence about the role of the shareholder is reflected in a shift in much contemporary corporate law scholarship from traditional discourse about protection *of* investors, to discourse about protection of the corporation *from* investors (Clark, 2006).

CONTEMPORARY US DEVELOPMENTS: THE SHAREHOLDER EMPOWERMENT DEBATE AND LAW REFORM AGENDA

“There’s a battle outside and it’s ragin’”. (Dylan, 1964)

Shareholder Empowerment and its Proponents

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 directors in some key areas of US corporate law, including the corporate election process (“the corporate election issue”) (Bebchuk, 2007:696-7; Bebchuk, 2003) and amendment of the corporate constitution (“the constitutional amendment issue”) (Bebchuk, 2006; Bebchuk, 2005).

Shareholder involvement in corporate elections became a live topic when the SEC recommended in its 2003 Staff Report (SEC, 2003b; SEC 2003a; Solomon, 2003) 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 hardly a new debate in US corporate law; the issue has periodically emerged, to the frustration of some, for at least fifty years (Sundquist, 2004; Buxbaum, 1985:1682-3). In 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 (Bebchuk, 2003; Bebchuk, 2007; Strine, 2006:1782).

In spite of the SEC's initial enthusiasm for such reform, it soon stalled, and was subsequently pronounced "moribund" (Strine, 2006:1776-7). Later developments, however, breathed further life into the issue. The Paulson Committee Report sought to reactivate it (Paulson Committee, 2006:106), in conjunction with another contentious reform proposal - the introduction of majority, rather than plurality, voting for the election of directors (Paulson Committee, 2006:33, 105; Scott, 2007:490; Bebchuk, 2007:702-4; Plender, 2008b). 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 (SEC, 2007a). This proposal came in reaction to a federal appeals court decision, *American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.* (2006), which adopted a liberal interpretation of Securities Exchange Act Rule 14a-8(i)(8), potentially providing an indirect method for increased shareholder participation in the director nomination process. In contrast, the second SEC proposal would have allowed shareholders with 5% of a company's voting shares to include in that company's proxy materials proposals for bylaw amendments regarding the nomination of directors (SEC, 2007b). Internal disagreement among commissioners at the SEC explained the release of these two separate, yet opposing, proposals (Scannell, 2007; Labaton, 2007). In late 2007, the SEC voted at that time to maintain the *status quo* and adopt the first proposal, restricting shareholder participation in the director election process (SEC, 2007c). As discussed further below, however, in 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 (Bebchuk, 2005). The ability of shareholders to effect corporate change through constitutional amendment is extremely limited in the US (Thompson & Edelman, 2009). Under both § 242(b) of the Delaware General Corporation Law ("Delaware Code") and § 10.03 of 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 MBCA grant shareholders power to initiate and to effect changes to the bylaws, under § 109 and § 10.20 respectively. 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 in § 109(b) of the Delaware Code and § 10.20 of the MBCA, to the effect that no provision in the bylaws can be inconsistent with US state law or with the corporation's charter. Section § 141(a) of the Delaware Code and § 8.01 of the MBCA vest 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. 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 *CA, Inc. v. AFSCME Employees Pension Plan* (2008) confirmed such a restricted role for bylaw amendments, in view of the "cardinal precept" of managerial authority under Delaware corporate law (Thompson & Edelman, 2009:142).

Shareholder Rights Within the Common Law World

US corporate law is strikingly different to that in other common law jurisdictions, such as the UK and Australia, in terms of the ability of shareholders to alter the constitution. Under traditional English and Australian law principles, the constitution is freely alterable by special resolution of the shareholders (*Walker v. London Tramways Co.* (1879), *Allen v. Gold Reefs of West Africa Ltd.* (1900:671), and *Peters' American Delicacy Co. Ltd. v. Heath* (1939)). Free alterability is embedded in § 136(2) of the Australian Corporations Act 2001 (Cth) ("Corporations Act") and § 21 of the Companies Act 2006 (UK) ("Companies Act"). Under § 136(3) of the Corporations Act it is possible, however, for the company's constitution to provide that a further requirement or condition be met before the alteration is effective. Entrenchment of certain constitutional provisions is also possible under § 22 of the UK legislation, though in more limited circumstances than its Australian counterpart.

Under § 198A of the Australian Corporations Act, the board's managerial powers are expressly constrained by any powers reserved to the shareholders in general meeting, either by statute or the company's constitution. 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 (*Allen v. Gold Reefs of West Africa Ltd.* (1900:671) and *Peters' American Delicacy*

Co. Ltd. v. Heath (1939:479)). 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 (Nolan, 2006:554-6). 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.

Canadian corporate law also tracks these general principles, with some minor variations. Under §§ 175 and 176 of the Canada Business Corporations Act 1985 ("CBCA"), shareholders or directors may make a proposal to amend the articles, and such amendment will be effected upon approval by special resolution of classes of shareholder. The CBCA contains a range of thresholds for different shareholder proposals, including a threshold of 5% of shares of a voting class for nomination of directors. (Nicholls, 2005:266).

The US rules relating to charter alteration, and shareholder voting generally, diverge from the approach taken in other common law jurisdictions, such as the UK and Australia. The US rules reflect a governance model in which directors are essentially cast in the role of gatekeeper (O'Kelley & Thompson, 2006:145; Bainbridge, 2006a:771), 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 (*NRMA v. Parker* (1986:522); *Winthrop Investments Ltd. v. Winns Ltd.* (1975:683)). 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 (*John Shaw & Sons (Salford) Ltd. v. Shaw* (1935:134); *Automatic*

Self Cleansing Filter Syndicate Co, Ltd. v. Cuninghame (1906); *Howard Smith Ltd. v. Ampol Petroleum Ltd.* (1974:457)).

The 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 (Gower, 1956) and constitutes an interesting example of path dependence in operation (Roe, 1997). 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 (Gower, 1956:1371-2; Nolan, 2006:554-6). 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" (Rickford, 2003). These divergent origins have significant implications for a wide range of contemporary issues in corporate law, such as shareholder rights and hostile takeovers (Armour & Skeel, 2007; Davies & Hopt, 2004:172). The traditional high level of deference accorded to the board of directors under US corporate law, and correspondingly narrow shareholder powers (Gelter, 2009:134), 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.

Policy Rationales for Shareholder Empowerment and the US Law Reform Agenda

Bebchuk advanced the shareholder empowerment reform proposals on the basis of an efficiency, rather than a shareholder democracy, rationale (Bebchuk, 2007:678; McConvill, 2007:1031-2). The presumed efficiency gains include a reduced need for outside intervention by legislators and regulators, with the mere threat of shareholder participation acting as a disciplinary mechanism for managerial decisions (Bebchuk, 2005).

The Paulson Committee Report also addressed the 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 (Paulson Committee, 2006; McKinsey& Company, 2007). As a concomitant to this argument, the Committee recommended increased shareholder rights and participation as an alternative regulatory technique (Paulson Committee, 2006: xii-xiii, 93-114; Scott, 2007:489-90). Contrary to the assumption in the influential "law matters" hypothesis that US corporate law provides strong minority shareholder protection (La Porta et al., 1998:1128, 1130; La Porta, Lopez-de-Silanes & Shleifer, 1999) the Paulson Committee Report considered that, in fact, "lack of shareholder rights" was affecting the level of investment in US companies (Scott, 2007:489). 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 (Paulson Committee, 2006:103).

It should be noted, however, that shareholder rights are only one possible method of empowerment. Enforcement is also an important aspect of the regulatory ecosystem. Historically, *ex post* protection through shareholder litigation was less constrained, and far more common, in the US than in other common law jurisdictions (DeMott, 1986). However, this picture may now be changing in the light of developments such as the rise of class actions in Australia and increasing checks on shareholder litigation in the US (von Nessen, 2008).

The current global financial crisis has added tinder to the shareholder empowerment debate in a range of different contexts. It has sorely tested the market's ability to act as a managerial constraint, and shown that efficiency is not the only goal of corporate governance; accountability and legitimacy matter too. The global financial crisis has also introduced a new policy rationale for shareholder empowerment, namely the need to restore market trust (Bratton & Wachter, 2009:3-4).

A broad law reform agenda relating to shareholder power is now underway in the US, including the revival of the corporate election issue, which has recently been described as a "knockdown, drag out political brawl" (Grundfest, 2009:16). In spite of the SEC's earlier prevarication, on May 20, 2009, SEC commissioners voted, in a 3-2 split along party lines, to propose SEC Rule 14a-11, to grant shareholders access to the company's proxy materials to nominate directors (SEC, 2009; Bennett, 2009; Lynch, 2009a; Nathan, 2009). Although a final decision on the proposed rule was initially scheduled for November 2009, it was later deferred until early 2010 (Lynch, 2009b). Debate continues on the question of whether current proxy access rules should be reformed, and whether the applicable proxy access regime should be mandatory or grant shareholders an opt-in/opt-out discretion (Bebchuk & Hirst, 2009; Grundfest, 2009; Paredes, 2009).

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 (Schumer, 2009). In this respect, it is a direct response to the global financial crisis, broadening the scope of earlier reforms directed at financial institutions receiving emergency federal funding assistance (Hill, 2009:106-7; Bratton & Wachter, 2009:4-5). 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 (Shareholder Bill of Rights, 2009). 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.

Shareholder Empowerment and its Opponents

Few US commentators seem to doubt that there is “ample room for increasing shareholder power” under US corporate law (Anabtawi, 2006:569; Stout, 2007:789-90; *cf* Lipton & Savitt, 2007:734). Yet, the issue of shareholder empowerment has elicited a surprisingly polarized debate in academic literature (Economist, 2006:378), with many commentators seriously doubting the wisdom of legislative amendments to increase shareholder power at the expense of managerial power.

The current US reform developments have exacerbated this existing controversy (Bratton & Wachter, 2009; Bainbridge, 2009), provoking fierce controversy and backlash within the US (Lipton, Lorsch & Mirvis, 2009; Mitchell, 2009). Many of the reform proposals have been criticized as continuing a trend of federal encroachment into the traditional state-based corporate arena (Paredes, 2009; Veasey, 2009). Some US commentators have also argued that lack of shareholder power caused neither Enron nor the global financial crisis (Stout, 2007:808; Bainbridge, 2009:20), and that enhancing shareholder power will not prevent, and may even provoke, future crises (Bratton & Wachter, 2009:3-5;50-55).

One distinctive feature of the global financial crisis is that the major culprits were banks, rather than non-financial corporations. Banks have a different capital structure to non-financial corporations, which could arguably make them less responsive to shareholder interests. Comparative corporate governance has, however, typically focused predominantly on non-financial corporations. It is interesting to note that one recent UK review, dealing exclusively with the role of banks and financial institutions in the global financial crisis, has advocated greater activism and engagement by institutional investors as a protective mechanism (Walker Review, 2009b:17-19). The Walker Review recommends, for example, the adoption of a Stewardship Code “to enhance the quality of the dialogue of institutional investors to help improve long-term returns to shareholders, reduce the risk of catastrophic outcomes due to bad strategic decisions, and help with the efficient exercise of governance responsibilities" (Walker Review, 2009b:153). Principle 4 of the Stewardship Code provides that institutional investors "should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value", by interventionary techniques such as submitting resolutions at shareholder meetings, or convening extraordinary general meetings to remove the board of directors (Walker Review, 2009b:156).

In contrast to the Walker Review's encouragement of greater shareholder engagement in corporate governance, criticism of shareholder empowerment by some US commentators has been trenchant, emanating from a variety of perspectives. First, paralleling the famous critique over two decades ago by contractarian scholars against the anti-managerialists (Winter, 1977; Easterbrook & Fischel, 1983), 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 commentators such as Chancellor Strine, whose analysis is from the perspective of the "open-minded corporate law 'traditionalist'" (2006), Bainbridge (2006b), Stout (2007), Lipton (2005), and Lipton and Savitt (2007) fall within this critical rubric. Bainbridge, for example, does not dispute Bebchuk's assessment of shareholder disempowerment, but rather welcomes it as providing evidence that US corporate law is based on an efficient model of centralized board authority (2006b:1735-6; Lipton & Savitt, 2007:740; Strine, 2006:1763; Lipton, 2005:1377). 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 (Stout, 2007:801; *cf* Strine, 2007:4) and rejects the need for greater shareholder power on the basis that shareholder *interests* are already safeguarded via the market (Bainbridge, 2006b:1746-7), modern governance pressures (Lipton & Savitt, 2007:752-3), and the ability of shareholders to self-protect through mechanisms such as diversification (Strine, 2006:1764). 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.

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 (Bainbridge, 2006b:1736-7; Strine, 2006:1774; Lipton & Savitt, 2007:743-4). 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. Considerable divergence in the nature and level of shareholder power exists across common law jurisdictions, and there is some evidence to suggest that strong shareholder rights are highly valued (Hill, 2010).

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 (Bainbridge, 2006b:1749, 1756). 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" (Lipton & Savitt, 2007:748-9; Lipton & Rosenblum, 2003; McKinnell, 2003; Business Roundtable, 2003; Sundquist, 2004). A variant of this argument stresses that shareholders are themselves a fragmented and fractured group with disparate interests (Anabtawi, 2006:564-5, 578*ff*; Strine, 2006:1765-6; Lipton & Savitt, 756-7; Skypala, 2008). The "be careful what you wish for" argument suggests that shareholders are likely to abuse participatory powers, engage in opportunism, prefer their private sectional interests to those of the shareholders generally (Anabtawi, 2006:598), or succumb to the "momentary majority impulse" (Strine, 2006:1763; Lipton & Savitt, 2007:733; Lipton, 2005:1377). 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 (Stout, 2007:794; Strine, 2007:8; Mitchell, 2009).

A fourth type of criticism is based on a futility argument. This argument appears, at first sight, difficult to reconcile with the "be careful what you wish for" argument, though they are often conjoined. While the latter argument predicts dire consequences in altering legal rules to increase shareholder power in corporate governance, the futility argument warns of the opposite result. The futility argument suggests that such changes to legal rules would be wholly ineffective, given collective action problems and rational shareholder apathy (Bainbridge, 2006b:1745, 1751-3; Listokin, 2009). The explanation of the paradox between these two arguments appears to lie in the fragmented nature of the shareholder body (Anabtawi, 2006). Thus, it is assumed that although apathy would generally prevail among the majority of shareholders, including institutional investors (Bainbridge, 2006b:1751-2), 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 (Grundfest, 2009:4, 17*ff*; Bainbridge, 2006b:1751; Strine, 2006:1765; Lipton & Savitt, 2007:744-5; Thomas & Martin, 1998).

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" (Lipton & Savitt, 2007:734) 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 this approach, "the policy considerations in favor of not jeopardizing the economy are so strong that not even a remote risk … is acceptable" (Lipton & Savitt, 2007:747; Lipton, 1979; Stout, 2007:808). As the global credit crisis has again shown, however, systemic risks (Schwarcz, 2008) 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 US post-Enron reforms, and that any rush to adopt additional changes should be deferred until the consequences of those reforms can be known and assessed (Bainbridge, 2006b:1741). This argument parallels criticism of the Sarbanes-Oxley Act of 2002, in which perceived defects of the legislation have been linked to the speed of its passage, the low level of associated deliberation and policy assessment, and its perceived status as "emergency legislation" (Romano, 2005:1528; *cf* Brown, 2006). Some commentators suggest that the case for increased shareholder power has simply been deprived of any urgency (Bratton & Wachter, 2009: 7, 26-27), due to recent commercial developments, such as the move to board independence, which have effectively constrained managerial power (Kahan & Rock, 2009).

Seventh, the shareholder empowerment proposal has been condemned as promoting short-term thinking over long-term sustainability. (Lipton & Savitt, 2007:745-7; Bratton & Wachter, 2009:29). 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 (Bainbridge, 2006b:1764-5). Vice Chancellor Strine's traditionalist analysis is also critical of institutional investors for fixating on "ideas du jour with no proven relationship to creating sustainable wealth" (Strine, 2006:1766, 1771). This issue of sustainability has also proven immensely important in current regulatory debate concerning the structure of executive pay (Walker Review, 2009a:90).

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 (Anabtawi, 2006:571; Strine, 2006:1769; Strine, 2007). Bebchuk explicitly disavowed the idea that his shareholder empowerment reform proposals were based upon corporate democracy or shareholder ownership rights (Bebchuk, 2007:678). 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" (Mason, 1959:5; Stout, 2007:804-5; Lipton & Savitt, 2007:754-5; Lipton, 2005:1377) of the corporation (Lipton & Rosenblum, 2003:68, 70; Karmel, 2003:3; Sundquist, 2004:1489*ff*) or principal in a principal-agent relationship with directors (Stout, 2007:804; Bratton & Wachter, 2009:8). 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 (*Automatic Self Cleansing Filter Syndicate Co, Ltd. v. Cuninghame* (1906)).

THE ROLE OF COMMERCIAL PRACTICE IN SHIFTING POWER TOWARD THE BOARD OF DIRECTORS: TWO AUSTRALIAN CASE STUDIES

> "He was also an adept at breaking rules, or diverting them to ends not intended by those who had framed them" (Powell, 1997:8)

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 (Jackson, 2007: 255; Coffee, 2007), a dynamism which includes the strategic response of regulated parties (Skeel, 2008:697; Milhaupt and Pistor, 2008).

A friction 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.

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 under §136(2) of the Corporations Act by a special resolution, passed by at least 75% of votes cast by shareholders entitled to vote on the resolution. It is possible under § 136(3) of the Act, 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.

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" enshrined in §§ 249D and 249N(1) of the Corporations Act, 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 large majority easily satisfying the requirement of a special resolution (Boral Ltd, 2003; Wilson, 2003), limited the ability of Boral shareholders to requisition a meeting, or propose a resolution, to alter the constitution in the future. It achieved this by inserting further conditions which needed to be met before Boral's "new constitution" could be altered. Any proposed constitutional amendment would first have to be approved by either the board of directors or shareholders holding at least 5% of voting shares. The Boral amendment therefore subverted both limbs of the 100 member rule in their application to alterations of the company's constitution. 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 (namely, 5% of Boral's capital) unless they had the board's consent (Bartholomeusz, 2003).

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, who were criticized for turning a blind eye to the governance implications of the constitutional amendment (Frith, 2003) and small shareholders. 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 (Bielefeld, Higginson, Jackson & Ricketts, 2004:43-47). Boral had itself been the target of shareholder activism by the Transport Workers' Union ("TWU") (Rawling, 2006:229-33; Anderson and Ramsay, 2006:289-93), reflecting a trend, both in Australia and the US (Schwab & Thomas, 1998), for unions to propose corporate governance resolutions at annual shareholder meetings (Anderson & Ramsay, 2006; Schwab & Thomas, 1998). 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. The Corporations and Securities Advisory Committee ("CAMAC" - now known as CAMAC) had also previously expressed this concern (CASAC, 2000:15; *cf* Rawling, 2006:241-3). Thus, the events at Boral reflect Bainbridge's concern that the conferral of greater shareholder participatory rights could empower classes of shareholders who might misuse those powers (Bainbridge, 2006b:1751) and Justice Strine's argument that, in certain circumstances, even investors themselves might not favor strong shareholder rights (Strine, 2006:1759).

The Boral amendment explicitly relied for its validity on § 136(3) of the Australian Corporations Act, which 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". This section envisages the possibility of virtual entrenchment of constitutional provisions, depending upon the stringency of the "further requirement". However, it is not clear that the Boral amendment was in fact validated by this provision, since, rather than stipulating a "further requirement" to a special resolution altering the company's constitution, the 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 (Joint Committee on Corporations and Financial Services, 2004:12-13). 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 (Pearce, 2005). The announcement appears to have been a response to lobbying by companies which had previously experienced high levels of shareholder activism (Lampe, 2002; Milne & Wakefield Evans, 2003:286-7). The future of the reform proposal became uncertain after state leaders rejected it in 2006 (Kerr, 2006; Pearce, 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 (Parliamentary Joint Committee, 2008:[3.84]-[3.91]). Although acknowledging that no significant abuse of the rule by activist shareholders had arisen, the Report considered that it should be jettisoned, in view of its potential for abuse.

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 (NAB, 2004a). Within two weeks, the estimate of loss had escalated to A$360 million (NAB, 2004b; Cornell & Oldfield, 2004; Williams, 2004), prompting resignations of the bank's CEO and chairman (NAB, 2004c; NAB, 2004d). NAB also announced that it had commissioned PricewaterhouseCoopers ("PwC") to conduct an investigation and prepare a report into the trading scandal (NAB, 2004e).

What ensued was a classic boardroom brawl (Agrawal & Chen, 2008). One of NAB's non-executive directors, Catherine Walter, challenged the report's legitimacy in advance, claiming that PwC had significant conflicts of interest, as a result of its business relationship with NAB, which compromised the report and rendered it procedurally flawed (Williams, 2004). The PwC Report, which was released with a probity advice certifying its independence (Blake Dawson Waldron, 2004), found that four foreign exchange currency traders had exploited weaknesses in the bank's risk management controls to hide trading losses and protect bonuses (PWC, 2004:3, 17, 21-8; Miletic, 2006). The Report was highly critical of aspects of NAB's corporate culture (PWC, 2004:32; APRA, 2004:6), and considered that ultimate responsibility for the "tone at the top" lay with the board of directors and the CEO (PWC, 2004:3-4, 31-2).

At the time of the release of the PwC Report, the NAB chairman announced that Walter would be removed from the audit committee (NAB, 2004f). 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 (NAB, 2004g; Williams, 2004).

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. She 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 (NAB, 2004h; Bartholomeusz, 2004a). Both groups in the NAB dispute vigorously lobbied institutional investors in the lead-up to the proposed shareholder meeting (Oldfield, 2004a), and it appears that dialogue with major investors was influential in resolving the dispute (Cornell & Oldfield, 2004). A showdown at the scheduled shareholder meeting was ultimately avoided when, as part of a compromise, several parties to the dispute including Walter, agreed to resign from the NAB board (NAB, 2004i; Walter, 2004).

Opinion was sharply divided on the NAB corporate governance dispute, paralleling US debate on greater shareholder participation in board nominations (Lipton & Savitt, 2007:748-9), where some commentators have warned of the dangers of “balkanized and dysfunctional boards” (Lipton & Rosenblum, 2003). 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 (Bartholomeusz, 2004a, 2004b). Supporters, however, echoing the view of Warren Buffett that there should be more dissent in the boardroom (Financial Times, 2003), argued that she had fulfilled admirably the role envisaged for an independent director (Kohler, 2004a) namely as a fearless champion of transparency and accountability (Licht, 2004:224).

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

The NAB corporate governance dispute sent reverberations through the Australian commercial community, and demonstrated the power of shareholder opinion (Cornell & Oldfield, 2004). Commentator predicted that, following the dispute, chairs would become even more conservative in their nomination of directors, to avoid similar intra-board conflicts (Bartholomeusz, 2004b), and that institutional investors would not tolerate the presence of mavericks on boards (Cornell & Oldfield, 2004). 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 (Oldfield, 2004b; Jimenez, 2004). NAB and several other Australian companies also considered introducing prenuptial agreements (McConvill, 2005:198-9).

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" (Grattan, 2004).

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 (McConvill, 2005; Knight, 2007). 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 (McConvill, 2005:209-11). Some skeptical commentators have suggested that the focus on failure to perform under prenuptials "was universally seen as code for 'toe the line'" (Kohler, 2004b).

Removal of Directors from Office – Did the Coca-Cola Amatil Prenuptial Agreement Breach Australian Corporate Law?

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

The appointment and removal of directors has traditionally been viewed as a core right of shareholders and the flip-side of centralized managerial control. While shareholders have no power to override managerial decisions of the board, the power of shareholders to remove directors from office reflects the basic corporate constitutional structure, in which shareholders exercise ultimate control (Buxbaum, 1985:1696; Cartoon, 1980:17-8). It also provides an important buffer against managerial entrenchment. 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 (Thompson & Edelman, 2009:166*ff*).

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. However, § 203C is a replaceable rule only, and can be ousted or modified by the company's constitution. 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 (Knight, 2007:353).

The position is stricter in relation to removal of public company directors. This scenario is covered by § 203D of the Corporations Act, which unlike its proprietary company counterpart in § 203C, 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. 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. 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. An analogous provision, § 168 of the Companies Act has the same effect in the context of UK corporate law. This contrasts with § 141(k)(1) of the Delaware Code, whereby 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. In the wake of the global financial crisis, however, the International Corporate Governance Network (ICGN) called on US regulators to strengthen shareholder rights to dismiss directors from office, "so that boards can be held to account" (Burgess, 2008a). The recent US Shareholder Bill of Rights includes a provision which would require the elimination of staggered boards in US public corporations (Shareholder Bill of Rights, 2009). 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 (Thompson & Edelman, 2009:169).

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" (ASIC, 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 (du Plessis & McConvill, 2003:256, 264; *cf* McConvill, 2005:226-7)), established case law (reflected in the decision of *Allied Mining and Processing v. Boldbow Pty Ltd.* (2002:[47],[56])) rejected this interpretation. The position has been further complicated by the decision of *Scottish & Colonial Ltd. v. Australian Power and Gas Co Ltd.* (2007:[21],[37]), which held that § 203D constitutes an exclusive removal regime, and argued that earlier contrary case law had been wrongly decided. 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 (Bourne, 2004; Ryan, 1997:325*ff*)), rather than exclusive, right to remove directors from office. This interpretation is also supported by cases, such as *Shanahan v. Pivot Pty Ltd.* (1998), *Link Agricultural Pty Ltd. v. Shanahan* (1998), and *Holmes v. Life Funds of Australia Ltd* (1971). In addition, 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 (Knight, 2007:355).

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 (Kohler, 2004a).

There is a stronger argument however, that the proposed prenuptial agreements would breach § 203E of the 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 (McConvill & Holland, 2006; *cf* Knight, 2007:353-4). Yet, such an interpretation is questionable. The prohibition in § 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. 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 (du Plessis, 1999).

Ultimately, in response to pressure from ASIC (ASIC, 2004) and opposition by a number of fund managers, Coca-Cola Amatil (and also NAB) announced that the proposed prenuptial agreements would not be implemented in their original form (Hepworth, 2004). 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 (Kohler, 2004a). ASIC welcomed this amendment, while stressing the need for shareholders to be provided with full background information to enable informed participation in the removal of directors under this revised model (Hepworth, 2004). 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. The Commonwealth Bank, for example, amended an article, which previously permitted the directors to resolve to remove a director who had been absent from board meetings for at least six months. The revised article provided that such an absentee director would automatically cease to hold office, "unless the Directors resolve otherwise" (Knight, 2006:355).

Removal of Directors from Office – Some Comparative Law Perspectives

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 under § 184(1) of the Companies Act 1948 (UK) following the Cohen Committee Report (Cohen Committee, 1945), to strengthen shareholder control over management by conferring power on shareholders to remove a director from office by ordinary resolution, irrespective of anything in the company's articles. The UK statutory removal provision, now found in § 168(1) of the Companies Act 2006 (UK), 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 (Bourne, 2004). 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. For example, in the UK case, *Lee v. Chou Wen Hsien* (1984:1205), the Privy Council stated that such provisions date back to the 1902 edition of *Palmer's Company Precedents*. Commentators have pointed out that they are particularly common in UK public companies "to enable directors to deal with conflict within the boardroom" (Ryan, 1987:56) and to permit internecine corporate disputes "to be settled out of the public eye" (Wright, 1987:19). The Canadian statutory power of removal is found in § 109 of the CBCA, which provides that the company's shareholders may remove a director from office by ordinary resolution. Like its Australian equivalent, § 109 is ambiguous concerning whether it constitutes the exclusive means by which directors of a public company may be removed from office.

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.

CONCLUSION

This article examines the rising tension between shareholder and director power in the common law world, a tension which can result in the strengthening of power in either direction. First, the article examines current developments in the US, which suggest a power shift towards shareholders may be imminent. 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, reflected in a raft of recent reforms and reform proposals 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 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. Indeed, the current reform proposals to enhance shareholder rights, despite being the subject of great controversy in the US, fall far short of rights already held by shareholders in other common law jurisdictions, such as the UK and Australia.

Secondly, the article considers power shifts in the opposite direction – toward the board – in other parts of the common law world. It discusses the possible friction between legal rules designed to enhance shareholder participation in corporate governance, and commercial practices designed to curb shareholder power, using two Australian case studies. The commercial power-shifting evident in these case studies is interesting because it shows how some major Australian companies have artificially attempted to create 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.

The existence of commercial responses to regulation also suggests that, even if US shareholder powers are significantly strengthened by legislation, that will by no means be the end of the story.

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