Seattle University Law Review, Vol. 33, No. 4, pp. 1005-1023, 2010

The University of Sydney Law School
Legal Studies Research Paper No. 10/58

Vanderbilt University Law School
Law & Economics Research Paper No. 10-17

European Corporate Governance Institute
Law Working Paper No. 163/2010

Then and Now: Professor Berle and the Unpredictable Shareholder

Jennifer G. Hill

University of Sydney - Faculty of Law; Vanderbilt Law School and ECGI

Then and Now: Professor Berle and the Unpredictable Shareholder

Law Working Paper N°.163/2010
September 2010

Jennifer G. Hill
University of Sydney, Vanderbilt University and ECGI

ECGI Working Paper Series in Law

Then and Now: Professor Berle and the Unpredictable Shareholder

Working Paper N°.163/2010
September 2010

Jennifer G. Hill

Abstract

This article is published in a special symposium edition on the work of Adolf Berle, which includes papers from a conference, In Berle's Footsteps, held in November 2009 to celebrate the launch of the Adolf A. Berle, Jr. Center on Corporations, Law and Society.

Shareholders, and the relationship between shareholders and management, lay at the heart of Professor Berle's scholarship. The goal of this Article is to compare the image of shareholders emerging from The Modern Corporation and Private Property and the Berle/Dodd debate with a range of contemporary visions of the shareholder that underpin some international regulatory responses to recent financial debacles, from Enron to the current global financial crisis. As the Article discusses, these recent developments in the era of financial crises, including the US shareholder empowerment debate, have prompted a re-evaluation of the traditional image of the shareholder and the role of the shareholder in the modern corporation that emerged in Professor Berle's work.

Keywords: The Modern Corporation and Private Property, Berle-Dodd debate, shareholder protection, shareholder empowerment, shareholder primacy, corporate governance, corporate theory, Enron, corporate scandals, global financial crisis, executive remuneration

JEL Classifications: D70, G01, G30, G32, G34, G38, K20, K22, K33, N20, M14

Jennifer G. Hill
University of Sydney - Faculty of Law
Faculty of Law Building, F10
The University of Sydney
Sydney, NSW 2006
Australia
phone: +61 2 9351 0280, fax: +61 2 9351 0200
e-mail: jennifer.hill@sydney.edu.au

Then and Now: Professor Berle and the Unpredictable Shareholder

Jennifer G. Hill†

INTRODUCTION

If it is true that all roads once led to Rome, it is equally true that in corporate law, all paths radiate from Adolf A. Berle, Jr. Professor Berle's scholarship was also riveting in his own era. His seminal work with economist Gardiner Means, *The Modern Corporation and Private Property*,[1] was truly radical at the time of publication in 1932. Its interdisciplinary nature was ahead of the times,[2] with one contemporaneous reviewer describing the book as "epoque shattering."[3]

It is difficult to overstate the influence of Professor Berle's work. In 1984, more than fifty years after *The Modern Corporation and Private Property*'s publication, Roberta Romano claimed that it was the last major work of original scholarship in corporate law in terms of its power "to rechannel public discourse."[4] She also noted that the book invariably provided the starting point for all corporate law debate.[5]

Other scholarship by Professor Berle proved to be similarly influential. His famous debate with E. Merrick Dodd on the nature of directors'

---

† Professor of Corporate Law, University of Sydney; Visiting Professor, Vanderbilt Law School; Research Associate, European Corporate Governance Institute. I am grateful to Cornelius Bader for helpful references and to Alice Grey for her excellent research assistance in relation to sections of this paper. All errors are my own. Funding for this research was provided by the University of Sydney and the Australian Research Council.

1. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

2. Robert Hessen, *The Modern Corporation and Private Property: A Reappraisal*, 26 J.L. & ECON. 273, 274 (1983).

3. Stuart Chase, *Ticker Tapeworms*, THE NEW REPUBLIC, Jan. 25, 1933, at 299 (cited in Hessen, *supra* note 2, at 273).

4. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923 (1984).

5. *Id*. It seems that little has changed in this regard since 1984. For example, see Herbert Hovenkamp, *Neoclassicism and the Separation of Ownership and Control*, 4 VA. L. & BUS. REV. 373 (2009).

duties provided the groundwork for most major theories of the corporation since the 1930s. For example, Richard Buxbaum, writing at the same time as Romano, proposed a modern version of Berle's formulation of "enterprise law"[6] to capture the complex relationship between the corporation, its stakeholders, and society.

Shareholders, and the relationship between shareholders and management, lay at the heart of Professor Berle's scholarship. The goal of this Article is to compare the image of shareholders emerging from *The Modern Corporation and Private Property* and the Berle/Dodd debate with a range of contemporary visions of the shareholder that underpin some international regulatory responses to recent financial debacles, from Enron to the current global financial crisis. As the Article discusses, these recent developments in the era of financial crises have prompted a reevaluation of the traditional image of the shareholder—and the role of the shareholder in the modern corporation—that emerged in Professor Berle's work.

I. IMAGE OF THE SHAREHOLDER IN PROFESSOR BERLE'S SCHOLARSHIP

A. *The Modern Corporation and Private Property*

According to the ancient Greek poet Archilochus,[7] "The fox knows many things, but the hedgehog knows one big thing."[8] On its face, Berle and Means's work, *The Modern Corporation and Private Property*, is a quintessential example of the latter category of legal thought. In highlighting the division between ownership and control, Berle and Means' text presented one very large idea, which constituted a new prism through which future discourse would be refracted. Yet, over-familiarity with this famous message can obscure the more ambiguous, nuanced, and radical nature of the text as a whole.[9] In *The Modern Corporation and Private Property*, and in Professor Berle's later 1967 Preface to the

6. The concept of "enterprise law" derives from Professor Berle's 1947 article dealing with the problem of affiliated enterprises under corporate law. *See* Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343 (1947).

7. As retold by Isaiah Berlin. *See* ISAIAH BERLIN, THE HEDGEHOG AND THE FOX: AN ESSAY ON TOLSTOY'S VIEW OF HISTORY (1953).

8. *Id*.

9. *See, e.g.*, Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179, 180 (2005) (noting that this message has obscured the fact that the issue of corporate power was a major theme in *The Modern Corporation and Private Property*).

text,[10] the reader finds surprising riffs, comparing the board's concentration of power with that of communist regimes[11] and medieval churches;[12] descriptions of corporate leaders as "dictators of capital";[13] philosophical discussions about social ethics;[14] and astute predictions about the future of corporate law.[15] Many of these comments provide a basis for contemporary corporate law theories and developments. For example, the statement that shareholders "have surrendered the right to have the corporation operated in their sole interest,"[16] is arguably consonant with modern team production theory.[17] Berle and Means also made the prophetic observation that "the American state is an investor in almost every substantial enterprise,"[18] an increasingly important aspect of the current debate concerning government regulation of the financial industry sector.[19] Finally, the issue of wealth distribution, which was of great concern to Professor Berle,[20] is as relevant today as it was in the gilded era that launched the modern industrial economy.[21]

---

10. Adolf A. Berle, Jr., *Property, Production and Revolution: A Preface to the Revised Edition*, *in* ADOLF A. BERLE, JR. & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Columbia Law School 1967).

11. *See* BERLE & MEANS, *supra* note 1, at 245.

12. *Id*. at 309.

13. *See, e.g.*, *id*. at 306—07.

14. *Id.* at xxxv.

15. For example, Martin Lipton credits Professor Berle with predicting "the third stage of capitalism," in which practical control of major corporations would be held by professional investors. *See* Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 114 n.45 (1979).

16. BERLE & MEANS, *supra* note 1, at 312.

17. Professors Blair and Stout advocate a team production model of the modern corporation. They argue that teamwork problems associated with the various corporate stakeholders can be solved by rational individuals seeking to profit from team production adopting a "mediating hierarchy" governance mechanism. The "mediating hierarchy" approach involves team members renouncing certain property rights over the team's joint output in favor of the corporation itself. The board of directors constitutes the apex of the internal corporate hierarchy and has the task of coordinating team members and allocating team assets. A team production model of the corporation views shareholders as having voluntarily ceded control of the corporation to the board of directors to attract the firm-specific investment of other stakeholder groups, such as executives, employees and creditors. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 250–51 (1999); Lynn Stout, *The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667 (2003).

18. BERLE & MEANS, *supra* note 1, at xxviii.

19. *See, e.g.*, Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2010). In the U.K. context, the Walker Review also raises this issue, noting that the taxpayer has provided U.K. banks with nearly £1.3 trillion in funding. *See* SIR DAVID WALKER, WALKER REVIEW: A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES ¶ 7.1 (2009).

20. *See* BERLE & MEANS, *supra* note 1, at xxxv-xxxvi.

21. *See*, *e.g.*, EMMANUEL SAEZ, STRIKING IT RICHER: THE EVOLUTION OF TOP INCOMES IN THE UNITED STATES (UPDATE WITH 2007 ESTIMATES) 2 (2009) (noting that concentration of wealth has

The Modern Corporation and Private Property presented a new image of shareholders. This image was closely tied to a fundamental transformation in the nature of property itself: it was the corporate entity, not the shareholders, that became the "legal owner" of the collectivized capital and had complete decision-making power over it. Under this transformation, shareholders became essentially dispossessed owners or passive wealth-holders,[22] increasingly dissociated from active management. This model of private property reflected a commercial world in which "[o]wners don't manage, and managers don't own."[23] *The Modern Corporation and Private Property* contains many descriptions about what shareholders cannot do; specifically, shareholders cannot make demands of management with any expectation that those demands will be met.[24] According to Berle and Means, "the individual interest of the shareholder is definitely made subservient to the will of a controlling group of managers."[25] Quoting Walther Rathenau, the industrialist who was instrumental in implementing co-determination in Germany, Berle and Means state that "[o]wnership has been depersonalized."[26]

For Berle and Means, shareholder participation in corporate governance was impossible in this transformed system.[27] They viewed the right to vote as a matter of diminishing importance,[28] and Professor Berle would later dismiss the shareholders' meeting as a "kind of ancient, meaningless ritual like some of the ceremonies that go with the mace in the House of Lords."[29] In *The Modern Corporation and Private Property*, Berle and Means thus sought alternative legal techniques to protect shareholder interests and to control managerial power.[30]

---

increased dramatically in the United States in recent decades and by 2007, rivalled that existing in 1928 at the pre-Depression stock market peak).

22. *See, e.g.*, BERLE & MEANS, *supra* note 1, at xxxiv.

23. *Id.* at xxii.

24. *Id.* at 244.

25. *Id*.

26. *Id*. at 309.

27. Contractarian scholars writing approximately fifty years after Berle and Means would view shareholder participation not so much as impossible, but as unnecessary or positively undesirable. *See, e.g.*, Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV., Summer 1989, at 99; Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983).

28. BERLE & MEANS, *supra* note 1, at xxxii.

29. ADOLF A. BERLE, ECONOMIC POWER AND THE FREE SOCIETY (1957), *noted in* Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 659 n.1 (Del. Ch. 1988) (quoting R. FRANKLIN BALOTTI ET AL., MEETINGS OF SHAREHOLDERS 2 (1987)).

30. *See, e.g.*, BERLE & MEANS, *supra* note 1, at 247.

B. The Berle/Dodd Debate

The issue of managerial power and the protection of shareholder interests[31] was also a central issue in Professor Berle's debate with Professor Dodd.[32] The trust concept was the main regulatory technique advocated in this debate.[33] Professors Berle and Dodd reached quite different conclusions to the famous question of "for whom are corporate managers trustees?"[34] They also disagreed on the issue of whether management was the problem in corporate law or the solution.[35] While Professor Dodd's approach granted directors broad discretion to consider other constituencies such as employees, creditors, and consumers, Professor Berle adopted a far narrower "minimalist version"[36] of directors' duties, under which shareholder interests were paramount. Professor Berle's model was clearly designed as a constraint on managerial power.

Professor Berle's "minimalist version"[37] of directors' duties was interesting both in its choice of the trust as the appropriate legal concept to capture the relationship between shareholders and directors, and also in its selection of the shareholder as *cestui que trust*, or beneficiary.[38] An alternative possible legal relationship might have been agency. Although some scholars have argued that agency and trust operate as functional

---

31. *Id*. at 310.

32. *See* A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1073 (1931); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147 (1932); Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932). *See also* William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99, 124 (2008) (describing the Berle–Dodd debate as a "clash between the different visions of corporatism").

33. The trust concept also appears in similar terms in Chapter VII of Book II of *The Modern Corporation and Private Property*.

34. Whereas Professor Berle identified the shareholder as *cestui que trust*, Professor Dodd adopted a broader view of fiduciary powers that granted the directors discretion to consider the interests of a range of other constituencies associated with the corporation, such as employees, creditors, and consumers. The differences between Professors Berle and Dodd on the issue of to whom directors owe duties reflected a more fundamental disagreement between them on the nature of the corporation itself. *See generally* Jennifer Hill, *At the Frontiers of Labour Law and Corporate Law: Enterprise Bargaining, Corporations and Employees*, 23 FED. L. REV. 204, 210–11 (1995). However, the divide between Berle and Dodd was less than clear-cut, compounded by the fact that both men later appeared to swap positions. *See* Joseph L. Weiner, *The Berle–Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458, 1463 (1964); Bratton & Wachter, *supra* note 32, at 103–04, 132–34.

35. Bratton & Wachter, *supra* note 32, at 127.

36. *See* Gunther Teubner, *Corporate Fiduciary Duties and Their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility*, *in* CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES: LEGAL, ECONOMIC AND SOCIOLOGICAL ANALYSES ON CORPORATE SOCIAL RESPONSIBILITY 149 (Klaus J. Hopt & Gunther Teubner eds., 1984).

37. *Id.*

38. *See* Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 44–47 (2000).

equivalents in attempting to legitimate bureaucratic control,[39] these legal relationships differ fundamentally in terms of the balance of power between the trustee and the *cestui que trust* and between the principal and the agent. One of the features of true agency is that the agent is under the continuous control of the principal.[40] Professor Berle's selection of the trust relationship was therefore a revealing one. It again signalled that shareholders had become dispossessed, passive, and vulnerable under the new economic order, and it sought to control managerial powers via judicial enforcement of more stringent duties applicable to trustees.[41]

II. REEVALUATING THE ROLE OF SHAREHOLDERS IN THE ERA OF FINANCIAL CRISES

A range of different conceptions of the shareholder's role in the corporation have prevailed at different times in corporate law. In addition to Professor Berle's image of shareholders as beneficiaries under a trust, other conceptions of the shareholder have included that of owner/principal; bystander;[42] participant in a political entity;[43] investor;[44] and gatekeeper.[45] The status of shareholder interests and the level of shareholder participatory rights vary significantly across these different paradigms. Whereas Professor Berle's image of shareholders as beneficiaries under a trust elevated shareholder interests, it deflated shareholder participation. Recent corporate governance and financial developments have again prompted a reevaluation of the role of shareholders in the corporation, in terms of the status of their interests and level of participatory rights.

---

39. *See, e.g.*, Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1277, 1305 (1984).

40. *See* Lynne L. Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REFORM 19, 34–35 n.42 (1988); Arthur Pinto, *Corporate Governance: Monitoring the Board of Directors in American Corporations*, 46 AM. J. COMP. L. 317, 324, 327 (1998).

41. *See* A. I. Ogus, *The Trust as Governance Structure*, 36 U. TORONTO L.J. 186, 194 (1986). Nonetheless, it has been argued that given the difficulties of enforcement of duties, shareholders would in practice still be "virtually helpless." *See* Weiner, *supra* note 34, at 1459 n.8.

42. *See, e.g.*, Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CAL. L. REV. 1671, 1683 (1985).

43. *See, e.g.*, STEPHEN BOTTOMLEY, THE CONSTITUTIONAL CORPORATION: RETHINKING CORPORATE GOVERNANCE (2007); Edward S. Mason, *Introduction*, *in* THE CORPORATION IN MODERN SOCIETY 1, 6–7 (Edward S. Mason ed., 1960); GARETH MORGAN, IMAGES OF ORGANIZATION 149 (1986); Earl Latham, *The Body Politic of the Corporation*, *in* THE CORPORATION IN MODERN SOCIETY 218 (E. S. Mason ed., 1960); Kingman Brewster, Jr. *The Corporation and Economic Federalism*, *in* THE CORPORATION IN MODERN SOCIETY 72 (E. S. Mason ed., 1960).

44. *See, e.g.*, Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 260–61 (1967).

45. For a detailed discussion of all these visions of the shareholder, *see generally* Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39 (2000).

In the 1990s, recognition of the implications of the rise of institutional investors[46] opened the door to a range of new possible roles for shareholders. Growing institutional investor influence raised the possibility of greater shareholder participation in corporate governance and investor activism.[47] Some commentators welcomed the ascent of institutional investors as heralding a new age in which such shareholders might become full-scale partners with management in corporate decision-making, thereby bridging the historical divide between ownership and control.[48] Others, however, were skeptical about this prospect.[49] These critics were concerned either that a shared power model contained embedded conflicts of interest[50] or that such a model could be used to entrench management.[51] It has recently been suggested that the modern role of the institutional investor is more akin to that of financial trader than to either owner or joint manager.[52]

Another contemporary development that tested traditional thinking about shareholders involves the recent corporate and financial scandals. At the beginning of this decade, international corporate scandals, including the Enron and WorldCom scandals in the United States, raised two interesting shareholder-related questions. The first question concerned the role of shareholders in these scandals. Historically, theories of the corporation that la-

---

46. *See, e.g.*, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990); Mark J. Roe, *A Political Theory of American Corporate Finance,* 91 COLUM. L. REV. 10 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L. J. 445 (1991).

47. *See, e.g.*, Stuart Gillan, & Laura Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55 (2007); Marco Becht et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 REV. FIN. STUD. 3093 (2009); Bernard S. Black, & John C. Coffee, Jr., *Hail Brittania?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994).

48. *See, e.g.*, John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003 (1993); John Pound, *The Promise of the Governed Corporation*, 73 HARV. BUS. REV. 89 (1995).

49. *See*, *e.g.*, Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009 (1994); Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance*, 85 CAL. L. REV. 1 (1997).

50. *See, e.g.*, Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987 (1994); Fisch, *supra* note 49, at 1036, 1038; Deborah A. DeMott, *Agency Principles and Large Block Shareholders*, 19 CARDOZO L. REV. 321 (1997); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

51. *See* Alfred F. Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J.L. REFORM 117, 119 (1988). *See also*, Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH U. L.Q. 367, 377 (1996) (noting that managers of institutional investors are generally subject to less stringent market and governance constraints than corporate managers).

52. *See*, *e.g.*, John Hendry et al., *Owners or Traders? Conceptions of Institutional Investors and Their Relationship with Corporate Managers*, 59 HUM. REL. 1101 (2010).

mented the "bystander"[53] status increasingly accorded to investors tended to view shareholders as not only passive and vulnerable, but also "innocent."[54] One notable exception to this trend was Justice Louis D. Brandeis, who once stated that "[t]here is no such thing . . . as an innocent stockholder."[55]

In the aftermath of Enron, WorldCom, and the global financial crisis, Justice Brandeis's view has gained considerable traction.[56] Although some reform initiatives proceeded on the basis that shareholders were victims of these corporate catastrophes,[57] a growing number of scholars dispute this assessment. These scholars focus on the perceived short-term interests of many shareholders,[58] viewing them not as victims, but as threats to the corporate enterprise.[59] Such an image is also evident in

53. Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CAL. L. REV. 1671, 1683 (1985).

54. *See generally*, Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 50–51 (2000); Lawrence E. Mitchell, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 243 (2009).

55. Justice Brandeis continued, saying that the shareholder "may be innocent in fact, but socially he cannot be held innocent. He accepts the benefits of a system. It is his business and his obligation to see that those who represent him carry out a policy which is consistent with the public welfare." *See* THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS 75 (Osmond K. Fraenkel ed., 1934).

56. *See, e.g.*, Lawrence Mitchell, *Protect Industry from Predatory Speculators*, FIN. TIMES, July 9, 2009, at 9.

57. Taxpayers who have funded recent government bailouts have also been perceived as victims of the global financial crisis. *See*, *e.g.*, William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010); SIR DAVID WALKER, *supra* note 19, at 90.

58. *See, e.g.*, Roberta S. Karmel, *Should a Duty to the Corporation be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 4–9 (2004) (arguing that institutional investors must take a share of the blame for defective financial analysis and aggressive pursuit of a shareholder primacy norm, which encouraged earnings manipulation and excessive executive pay); Vice Chancellor Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764, 1772–73, 1776 (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). *See also* William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1284 (2002) (condemning the short-termism associated with a commercial norm of shareholder value maximization); Antoine Rebérioux, *Shareholder Primacy and Managerial Accountability* 2–3, 18–24 (Comparative Research in Law and Political Economy Working Paper No. 1/2007, 2007), *available at* http://ssrn.com/abstract=961290 (suggesting that a shareholder primacy norm, rather than gatekeeper failure, was the main driving force in the corporate scandals); Patrick Bolton, José A. Scheinkman & Wei Xiong, *Executive Compensation and Short-Termist Behavior in Speculative Markets*, 73 REV. ECON. STUD. 577 (2006) (positing a reinterpretation of compensation practices in a bubble market). *Cf.* George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 100 (2010) (arguing that the charge that most investors are short-term oriented is a myth).

59. *See generally* Vice Chancellor Strine, *supra* note 58, at 1764.

the cross-border context, where protectionism is on the rise.[60] These developments constitute an interesting twist on the traditional focus of corporate law. Although, since the time of Professor Berle, a key goal of corporate law has been the protection of shareholders,[61] a pivotal theme in much contemporary U.S. corporate law scholarship is the need to protect the corporation from its shareholders[62] and also protect shareholders from fellow shareholders with divergent interests.[63] Paralleling Professor Berle's proposal to rein in managerial power by subjecting directors to trustee duties, recently some scholars have suggested that corporate law

60. 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 U.S. investment fund, Steel Partners, against management of the Japanese beer company, Sapporo. *See Samurai v. Shareholders—Activist Investors in Japan*, THE ECONOMIST, Feb. 16, 2008, at 386. In Germany, too, hedge funds and foreign investors were described as "swarms of locusts" following the 2005 ouster of Werner G. Seifert from his position as chief executive of the German Stock Exchange. *See* Peter Gumbel, *The Day of the Locusts*, TIME, May 15, 2005; Mark Lander & Heather Timmons, *Poison Ink Aimed at 'Locusts'*, N.Y. TIMES, Mar. 31, 2006, at C8.

61. Such a paradigm, for example, underlies and explains the famous anti-managerialist lament by Professor Cary that amendments to Delaware law had "watered the rights of shareholders vis-à-vis management down to a thin gruel." *See* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663, 666 (1974). The subsequent critique of the anti-managerialist position by contractarian scholars did not deny the importance of shareholder protection in corporate law, but instead challenged the view that corporate law provided inadequate protection. *See, e.g.*, Gregory A. Mark, *Some Observations on Writing the Legal History of the Corporation in the Age of Theory*, *in* PROGRESSIVE CORPORATE LAW 67, 71 (Lawrence E. Mitchell ed., 1996) (stating that, according to contractarians, "[t]he putative abuse of shareholders . . . is largely mythical"). For further discussion of this critique, *see generally* Jennifer G. Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 57–59 (2000).

62. Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1749, 1756 (2006); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 734, 748–49 (2007); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 598 (2006); Vice Chancellor Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1763 (2006).

63. *See generally* Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, CORP. GOV. (forthcoming 2010). *See also* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564–65, 578*ff* (2006); Vice Chancellor Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1765–66 (2006); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 756–57 (2007). *Cf.* George W. Dent, *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97 (2010) (claiming that objections to shareholder power in the United States, including the charge that different shareholders have conflicting goals, are greatly exaggerated or wrong).

should impose fiduciary duties on activist shareholders[64] in order to promote greater responsibility and accountability.

Another question to emerge from recent financial scandals and crises is whether there was a causal connection between the lack of shareholder power and these events. Some U.S. scholars have vehemently rejected the existence of any such link. Professor Stout states simply that the "[l]ack of shareholder power did not contribute to Enron's fall."[65] Professor Bainbridge has also denied that the division between ownership and control caused the global financial crisis.[66] These and other scholars assert that reform efforts to empower shareholders will not prevent future crises and may even provoke them.[67]

III. SHAREHOLDER PROTECTION AND SHAREHOLDER PARTICIPATION UNDER RECENT REGULATORY RESPONSES TO FINANCIAL CRISES: SOME COMPARATIVE PERSPECTIVES

Enron, WorldCom, and other contemporaneous international corporate scandals elicited a range of reforms in common law jurisdictions including the United States, the United Kingdom, and Australia.[68] Although these reforms tackled similar problems of corporate legitimacy, they varied in terms of focus and structure,[69] often tracking the contours of national issues and political pressures.[70] Despite the view expressed by U.S. scholars that a lack of shareholder power was not a factor in the scandals, many reforms and reform proposals appear to assume the contrary. The reform responses across several common law jurisdictions suggest interesting variations in attitudes to shareholders and in regulatory approach.

---

64. *See, e.g.*, Iman Anabtawi, & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV., 1255 (2008); John Plender, *Shareholder Activism Raises Questions of Responsibility*, FIN. TIMES, Feb. 27, 2008, at 26.

65. Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 808 (2007).

66. *See* Stephen M. Bainbridge, *Shareholder Activism in the Obama Era*, 20 (UCLA School of Law, Law–Econ Research Paper No. 09-14, 2009), *available at* http://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1437791.

67. *See, e.g.*, Bratton & Wachter, *supra* note 57.

68. *See generally*, Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367 (2005).

69. *See* Jennifer G. Hill, *Evolving 'Rules of the Game' in Corporate Governance Reform*, *in* PRIVATE EQUITY, CORPORATE GOVERNANCE AND THE DYNAMICS OF CAPITAL MARKET REGULATION 29 (Justin O'Brien ed., 2007).

70. *See* Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes–Oxley Act of 2002*, 28 J. CORP. L. 1 (2002); Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367 (2005); Eilis Ferran, *Company Law Reform in the UK: A Progress Report* 25 (ECGI Working Paper No. 27/2005, 2005), *available at* http://ssrn.com/abstract=644203.

While similar motivations underpinned these various reforms, their long-term effects are unlikely to coincide because of inevitable differences in compliance and enforcement intensity.[71] Regulation is a dynamic process that includes the strategic responses of regulated parties themselves[72] and political reaction.[73] Thus, regulatory stringency of the kind exhibited by the Sarbanes–Oxley Act of 2002 can itself engender reaction from the business community.[74] The 2006 Committee on Capital Markets Regulation ("Paulson Committee"), which stressed the need to protect shareholders *from* excessive regulation, exemplifies this kind of regulatory backlash.[75] It has, nonetheless, now met with counter-backlash. Against the backdrop of the global credit crisis and scandals like the Madoff affair,[76] a deregulatory reform agenda no longer appears politically feasible.[77] The era of calls for a "kinder, gentler" SEC[78] is

71. *See, e.g.*, Donald C. Langevoort, *The Social Construction of Sarbanes–Oxley*, 105 MICH. L. REV. 1817 (2007) (arguing that there is a gap between motivations and long-term effects, which depend on compliance and enforcement decisions, in relation to the Sarbanes–Oxley Act of 2002). On the significance of enforcement, *see* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement,* 156 U. PA. L. REV. 229 (2007); Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253 (2007).

72. *See, e.g.*, David A. Skeel, Jr., *Governance in the Ruin*, 122 HARV. L. REV, 696, 697 (2008); CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD (2008).

73. For discussion of the influence of politics on rule-making and allocation of power in corporate law, see, for example, David Charny, *The Politics of Corporate Convergence*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 296 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); Tracy A. Thompson & Gerald F. Davis, *The Politics of Corporate Control and the Future of Shareholder Activism in the United States*, 5 CORP. GOV. 152 (1997).

74. *See, e.g.*, Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, CORP. GOV. (forthcoming 2010).

75. COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION xi (Nov. 30, 2006, revised version released Dec. 5, 2006). For a summary of the Committee's recommendations, see Hal S. Scott, *What is the United States Doing About the Competitiveness of its Capital Markets*, 22(9) J. INT'L L. & REG. 487 (2007).

76. *See The Madoff Affair: Con of the Century*, THE ECONOMIST, Dec. 20, 2008, at 28; Joanna Chung & Tom Braithwaite, *Dodd Plans Self-funding of SEC through Fees*, FIN. TIMES, Nov 10, 2009 (discussing pressures on the Securities and Exchange Commission to adopt a more aggressive form of monitoring following the Madoff scandal).

77. In 2008, for example, President Obama criticized the Bush Administration's adherence to a deregulatory agenda, condemned U.S. regulators for having been "asleep at the switch," and indicated that major financial regulatory reform would be a priority for his government. *See* Joanna Chung & 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).

78. This statement was made by then-SEC Chairman Harvey Pitt. *See* Albert R. Hunt, *Loud Words, Little Action*, WALL ST. J., Jul. 11, 2002, at A17. Mr. Pitt would later resign from the position in November 2002 in controversial circumstances. *See* Gerard Baker, *SEC Chief Quits Amid Political Furore*, FIN. TIMES, Nov. 6, 2002, at 1; Joshua Chaffin, *Spitzer Glitz and a Humbling of Harvey Pitt: Attorney-General Role in Pitt's Downfall*, FIN. TIMES, Nov. 7, 2002, at 10.

over, for some time at least.[79] As Professor Coffee stated, if the credit crisis demonstrates anything, it is "that there are also costs to under-regulation."[80]

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 shareholder participatory rights and merely protecting shareholder interests.

In the United States, 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.[81] The preamble to the Sarbanes–Oxley Act of 2002 confirms this focus.[82] Nonetheless, at the time of the reforms, the Sarbanes–Oxley Act did not grant shareholders greater participatory rights in relation to matters such as the director election process, which some commentators saw as a striking omission.[83] Post-Enron legislation in the United States also paid relatively little attention to the issue of executive compensation.[84]

---

79. The International Corporate Governance Network (ICGN), for example, has blamed the current global financial crisis on the failure of 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.

80. 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." John C. Coffee, Jr., *Financial Crises 101: What Can We Learn from Scandals and Meltdowns—from Enron to Subprime?*, *in* THE CREDIT CRUNCH AND THE LAW 37 (R.P. Austin ed., 2008).

81. Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367, 392 (2005); Donald C. Langevoort, *The Social Construction of Sarbanes–Oxley*, 105 MICH. L. REV. 1817, 1829 (2007).

82. 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, 1828*ff* (2007) (arguing that although the Sarbanes–Oxley Act is, by its terms, about shareholder protection, the long-term effect of the Act may be less about protection of investor interests than about public accountability).

83. *See* William B. Chandler III & Leo E. Strine, Jr. *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 999 (2003); Donald C. Langevoort, *The Social Construction of Sarbanes–Oxley*, 105 MICH. L. REV. 1817, 1828*ff* (2007).

84. Only two provisions of the Sarbanes–Oxley Act of 2002, sections 304 and 402, addressed the issue directly. *See* Jennifer G Hill, *New Trends in the Regulation of Executive Remuneration*, *in* DIRECTORS IN TROUBLED TIMES 100 (R.P Austin & A.Y. Bilski, eds., 2009).

It is worth noting that, in spite of the focus on shareholder interests under the dominant U.S. corporate law paradigm, historically, U.K. and Australian shareholders were accorded far stronger powers than U.S. shareholders in a range of corporate governance matters, such as amending the corporate constitution, convening meetings, and the appointment and removal of directors.[85] Indeed, it has been said that U.S. corporate and securities law is "highly unusual in the extent to which it disenfranchises shareholders from both explicit and implicit influence."[86] In the area of takeovers, too, scholars have sought to explain significant differences in the allocation of power between shareholders and directors under U.K. and U.S. takeover regimes.[87]

In the light of these historical legal differences regarding shareholder rights, the post-Enron reforms in other common law jurisdictions presented an interesting contrast to the U.S. approach under Sarbanes–Oxley. Further strengthening of shareholder power was an explicit theme in the U.K. and Australian reforms, suggesting that legislators viewed increased shareholder participation in corporate governance as a valuable check on the abuse of managerial power and a potential antidote to future corporate collapses.

Additionally, non-common law jurisdictions have also enacted reforms that tend to increase shareholder participation rather than merely provide increased shareholder protection.[88] For example, the EU Directive on Shareholder Rights ("EU Directive")[89] sought to ensure more ef-

---

85. *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 847–50 (2005). Events surrounding News Corp.'s 2004 move from Australia to Delaware provide a good snapshot of many of these differences. *See generally* Jennifer G. Hill, *Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware*, 63 VAND. L. REV. 1 (2010).

86. 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).

87. *See, e.g.*, John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1727, 1730–32 (2007) (suggesting that the self-regulatory nature of the U.K. takeover regime may be relevant in explaining the clear preference for shareholder interests in the takeover context, in contrast to the U.S. judicial model that has traditionally supported managerial interests). *See also* Paul Davies & Klaus J. Hopt, *Control Transactions*, *in* REINIER R. KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 157, 172 (2004).

88. *See generally* Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 826–29 (2008).

89. Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 (available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF) (last accessed April 18, 2010)) on the exercise of certain rights of shareholders in listed companies was also introduced in direct response to the corporate scandals. *See* The EC Corporate Governance Action Plan homepage, http://ec.europa.eu/internal_market/company/modern/index_en.htm (last visited Apr. 18, 2010). The EU Directive was 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," imple-

fective institutional investor participation and voting in European listed companies, many of which operate with blockholder ownership structures and have a civil law regulatory tradition.[90]

The Australian post-Enron reforms appeared to rest upon the implicit assumptions that shareholders were victims of the corporate scandals, rather than collaborators, and that increased shareholder power would enhance managerial accountability. Australian policy documents relating to the reforms[91] contained numerous references to the desirability of improving shareholder participation,[92] increasing shareholder activism,[93] and enabling shareholders to "influence the direction of the companies in which they invest."[94]

Strong rhetoric on the need to encourage greater shareholder democracy and participation in response to recent financial scandals was also apparent in the United Kingdom.[95] Shareholder engagement was an

---

mentation costs, complexity, and legal disincentives to exercising voting rights under various European laws. *See generally* Paolo Santella, Enrico Baffi, Carlo Drago & Dino Lattuca, *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US* (Working paper, 2009, *available at* http://papers.ssrn.com/sol3/pap ers.cfm?abstract_id=1137491); Dirk A. Zetzsche, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, 8 J. CORP. L. STUD. 289, 290 (2008). *See also*, Michael C. Schouten, *The Political Economy of Cross-Border Voting in Europe*, 16 COLUM. J. EUR. L. 1 (2009–2010).

90. *See, e.g.*, Arthur R. Pinto, *The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and Observations*, 32 FORDHAM INT'L L.J. 587 (2009).

91. Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, Explanatory Memorandum. Australia's main legislative response to the international corporate scandals, the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth) ("CLERP 9 Act 2004") was passed on June 25, 2004. The majority of the Act's provisions commenced operation on July 1, 2004.

92. *See, e.g.*, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, Explanatory Memorandum, ¶¶ 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 ¶¶ 4.271–4.272.

93. *See, e.g.*, *id*. at ¶ 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 ¶ 4.71.

94. *Id*. at ¶ 4.174. The assumption that shareholder engagement enhances corporate performance and accountability also underlies more recent Australian reform proposals, such as a 2008 report by the Parliamentary Joint Committee on Corporations and Financial Services ("Parliamentary Joint Committee"). *See* PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES, BETTER SHAREHOLDERS—BETTER COMPANY: SHAREHOLDER ENGAGEMENT AND PARTICIPATION IN AUSTRALIA (2008).

95. *See* Oliver Morgan, *Labour Fosters Investor Revolt: Manifesto Pledge to Encourage Shareholder Activism*, THE OBSERVER, Apr. 4, 2004, at 1. *See generally* Eilis Ferran, *Company Law*

important subtext in the 2003 Higgs Committee Report[96] on which the U.K. Combined Code on Corporate Governance was based.[97] 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.[98] The theme of shareholder engagement has gained momentum in the United Kingdom during the global financial crisis. In 2009, the Walker Review,[99] a prominent U.K. report on the role of banks and financial institutions in the current crisis, advocated greater institutional investor activism as a protection against financial market failure. The review recommended adoption of a Stewardship Code to increase institutional investor engagement in corporate governance, with the goal of improving long-term corporate profitability and reducing the risk of catastrophic failure due to bad strategic decision-making.[100] It also urged institutional investors to adopt guidelines outlining when and how they will escalate activist conduct.[101]

It was in the area of remuneration that the most contentious U.K. and Australian post-Enron reforms for increased shareholder participation were introduced.[102] Both jurisdictions passed reforms, in 2002 and 2004 respectively, requiring an annual nonbinding shareholder resolution approving the directors' remuneration report.[103] Unlike the United

Reform in the UK: A Progress Report, ECGI Working Paper No. 27/2005 25, 27-28 (2005), *available at* http://ssrn.com/abstract=644203.

96. DEREK HIGGS (CHAIR), REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (2003), *available at* http://www.berr.gov.uk/files/file23012.pdf.

97. *See* Financial Reporting Council ("FRC"), *Press Notice 75: FRC Issues Revised Combined Code*, July 23, 2003, *available at* http://www.frc.org.uk/press/pub0311.html. Some specific recommendations of the Higgs Report were wound back in the revised Combined Code amendments.

98. *See generally* Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WIS. INT'L L.J. 367, 390 (2005). Also, reforms under the U.K. Companies Act 2006 went even further in encouraging shareholder participation by seeking to enfranchise indirect investors holding shares through a nominee. *See generally* Companies Act 2006 (U.K.), Part 9.

99. David Walker, *Walker Review: A Review of Corporate Governance in UK Banks and Other Financial Industry Entities. Final Recommendations*, *available at* http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf (Nov. 26, 2009).

100. *Id.* at 153.

101. *See* Principle 4, Stewardship Code (U.K.). *Id.* at 156.

102. *See generally* Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 829 (2008).

103. In the United Kingdom, see the Directors' Remuneration Report Regulations 2002, S.I. 2002/1986 (UK). The provision requiring shareholder approval of the directors' remuneration report is now found in section 439 of the Companies Act 2006 (U.K.). In Australia, see the Corporations Act 2001 (Cth), § 250R(2), which was introduced in 2004 under the CLERP 9 Act 2004. *See generally* Larelle Chapple & Blake Christensen, *The Non-Binding Vote on Executive Pay: A Review of the CLERP 9 Reform*, 18 AUST. J. CORP. L. 263 (2005).

States, which has a history of precatory shareholder voting,[104] there was no precedent for a nonbinding shareholder vote in these other common law jurisdictions.[105] In Europe too, the 2004 Recommendation on directors' pay has provided for a shareholder vote on remuneration policy.[106]

The value and efficiency of the non-binding shareholder vote has been questioned, partly on the basis that it does not appear to have resulted in reduced director pay levels in the United Kingdom.[107] Nonetheless, there is some evidence that the vote has had a significant impact in the United Kingdom and in Australia. Early empirical research suggests that it has been effective as an outrage constraint on pay packages with structures that deviate from best practice principles.[108] A study by Ferri and Maber indicated an increased degree of sensitivity of executive compensation (particularly cash compensation) to negative operating performance during the period since the non-binding shareholder vote was introduced in the U.K., which the authors view as consistent with the U.K. government's policy against "rewards for failure."[109]

Although significant shareholder protest votes in relation to the remuneration report were initially quite frequent in Australia,[110] they were far rarer in the United Kingdom.[111] However, in 2009, there were large protest votes against the remuneration reports at a number of major U.K.

104. *See generally* Brian R. Cheffins & Randall S. Thomas, *Should Shareholders Have a Greater Say Over Executive Pay? Learning from the US Experience*, 1 J. CORP. L. STUD. 277 (2001); Lucian Arye Bebchuk & Jesse M. Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 51–52 (2004).

105. *See* Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 830–31 (2008).

106. The shareholders' vote may be binding or non-binding. Commission Recommendation of December 14, 2004, fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC), ¶ 11. *See also* Guido A. Ferrarini, Niamh Moloney & Maria–Cristina Ungureanu, *Understanding Directors' Pay in Europe: A Comparative and Empirical Analysis* 25, Law Working Paper No. 126/2009 (August 2009) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1418463).

107. *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).

108. *See* Kym Sheehan, *Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and Preliminary Results from Australia*, March 3, 2007, *available at* http://ssrn.com/abstract=974965).

109. Ferri and Maber conducted an empirical study into the effect of the advisory vote on executive remuneration in the U.K. *See* Fabrizio Ferri & David Maber, *Say on Pay Votes and CEO Compensation: Evidence from the U.K.*, June 2009, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394. For discussion of the Ferri/Maber study, 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, 344–46 (2009).

110. *See* Jennifer G. Hill, *Regulatory Show and Tell: Lessons from International Statutory Regimes*, 33 DEL. J. CORP. L. 819, 832–36 (2008).

111. 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, 343 (2009).

companies, including Bellway,[112] BP,[113] and Pearson,[114] the parent company of the Financial Times. At the 2009 annual shareholders meeting of the Royal Bank of Scotland, an unprecedented 90.42% of votes were cast against the directors' remuneration report.[115]

Shareholder protest votes are also increasing in Australia.[116] According to a 2009 report on executive remuneration by the Australian Government Productivity Commission ("Productivity Commission"), approximately 5% of the top 200 companies listed on the Australian Securities Exchange received consecutive protest votes of 25% or higher in 2008 and 2009.[117] The Productivity Commission has recommended further strengthening shareholder power in circumstances where the board is non-responsive to a significant negative shareholder vote. The Productivity Commission report recommends that this be achieved by linking the advisory vote on executive pay to the unconditional right of shareholders to remove public company directors from office under Australian law.[118] The Productivity Commission report proposes that, where a company's remuneration report receives a "no" vote of 25% or higher at consecutive annual shareholder meetings, a resolution should be put to shareholders stating that the directors who signed the remuneration report should be required to stand for re-election.[119] In addition, the Productivity Commission report advocates legislative changes to prohibit directors and executives identified as key management personnel from participating in the nonbinding vote.[120]

---

112. Bellway shareholders voted against the directors' Remuneration Report after it was announced that the board of directors had agreed to award bonuses of more than £630,000 to senior executives, in spite of a 28% drop in share value and a 50% fall in sales. The bonuses constituted 55% of the executives' salaries. *See* Sharelene Goff, *Bellway Pay-Outs Prompt Concern*, FIN. TIMES, Jan. 5, 2009, at 19; Robert Cookson & John O'Doherty, *Bellway Investors' Vote Goes Against Bonuses*, FIN. TIMES, Jan. 17, 2009, at 13.

113. *See* William MacNamara & Kate Mackenzie, *Protest Vote Over BP Pay Packages*, FIN. TIMES, Apr. 17, 2009, at 20.

114. *See* Ben Fenton, *Pearson Pay Deal Opposed at AGM*, FIN. TIMES, May 2, 2009, at 15; Richard Wray & Julia Finch, *Shareholders Revolt at Pearson AGM Over Executive Pay*, THE GUARDIAN, May 2, 2009, at 40.

115. *See* Jane Croft & Andrew Bolger, *Thumbs Down for RBS Pay Report Reject RBS Pay Report*, FIN. TIMES, Apr. 4, 2009, at 12.

116. For some recent examples, *see* Australian Government Productivity Commission Inquiry Report No. 49, *Executive Remuneration in Australia*, Dec. 19, 2009, at 282–85.

117. *Id*. at 296.

118. *See* Corporations Act 2001 (Cth), § 203D.

119. If the resolution was carried by more than 50% of eligible votes cast, the board would then be required to give notice of an extraordinary general meeting to be held within ninety days for the purposes of re-electing the directors. *See* Australian Government Productivity Commission, Productivity Commission Inquiry Report No. 49, *Executive Remuneration in Australia*, Dec. 19, 2009, Recommendation 15, XL.

120. *Id.* at Recommendation 4, XXXVII.

It is noteworthy that, although shareholder participation has recently been enhanced under U.K. and Australian corporate law, the preeminence of shareholder interests has been subject to challenge. Section 172 of the U.K. *Companies Act* of 2006 introduced a new, codified duty requiring U.K. directors to "promote the success of the company" and to take into account the interests of a range of stakeholders in making that determination.[121] Section 172 is based upon a policy of "enlightened self-interest."[122] In Australia, two recent government reports have considered the issues of corporate social responsibility and stakeholder interests.[123] A major focus of these reports was the scope of directors' duties, and the extent to which current Australian law permits directors to consider the interests of stakeholders or the broader community.[124] Finally, a number of U.K. and Australian reports concerning aspects of the global financial crisis have focused on the need to re-evaluate the concept of interest alignment in relation to executive pay to include the interests of a range of stakeholders broader than only shareholders.[125]

In the United States, the global financial crisis seems to have pushed U.S. lawmakers and regulators away from a strategy aimed at protection of shareholder interests and toward one concerned with shareholder empowerment as a way to restore market trust.[126] In spite of concerns voiced by many U.S. commentators,[127] a broad law reform agenda is now underway in relation to shareholder power.[128] Two of the most

---

121. *See generally*, The Right Hon. Lady Justice Mary Arden, *Clause 173 (Section 172): The UK's Proposed Re-Formulation of the Directors' Duty of Good Faith*, *in* COMPANY DIRECTORS AND CORPORATE SOCIAL RESPONSIBILITY: UK AND AUSTRALIAN PERSPECTIVES 20, 20 (Austin ed., 2007); Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'*, 29 SYD. L. REV. 577 (2007).

122. *Id*.

123. Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (2006); CAMAC, *The Social Responsibility of Corporations: Report* (December 2006).

124. Shelley D. Marshall & Ian Ramsay, *Stakeholders and Directors' Duties: Law, Theory and Evidence*, U. of Melb. Legal Studies Research Paper No 411 (2009) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1402143).

125. *See* Jennifer G. Hill, *New Trends in the Regulation of Executive Remuneration*, *in* DIRECTORS IN TROUBLED TIMES 100 (R.P. Austin & A.Y. Bilski eds., 2009).

126. Bratton & Wachter, *supra* note 57.

127. *See*, *e.g.*, *id.*; Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 808 (2007); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1749, 1756 (2006); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 734, 748–49 (2007); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 598 (2006); Vice Chancellor Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1763 (2006).

128. *See generally* Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, CORP. GOV. (forthcoming 2010); Bratton & Wachter, *supra* note 57.

obvious examples of the attitudinal shift in terms of shareholder participation rights are the proposed SEC Rule 14a-11,[129] which would grant shareholders access to companies' proxy materials to nominate directors, and the non-binding shareholder vote on executive pay, which is included in several recent U.S. reforms and reform proposals.[130]

These U.S. reform proposals have become the subject of fierce debate. The shareholder election issue has been described as a "knock-down, drag out political brawl."[131] This comment evokes the view of Berle and Dodd that a state of constant warfare exists between the holders of power and their subjects, including in the modern corporation.[132]

IV. CONCLUSION

In the early part of the twentieth century, Professor Berle mapped out many major issues in contemporary corporate law, including the role of the shareholder, the balance of power between shareholders and directors, and regulatory techniques to constrain managerial power. As this Article shows, the role of shareholders in recent corporate law has become more fluid, more unpredictable, and more controversial than in Professor Berle's day. Nonetheless, the tracks leading from Professor Berle to contemporary developments in corporate law are still clearly visible, and the issues that first captured his interest and imagination continue to have great resonance today.

---

129. *See* Press Release, Securities and Exchange Commission, *SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors*, SEC Press release no. 2009-116 (May 20, 2009), *available at* http://www.sec.gov/news/press/2009/2009-116.htm; Brett McDonnell, *Setting Optimal Rules for Shareholder Proxy Access* (Minnesota legal studies research paper no. 10-03, University of Minnesota Law School, Minneapolis, Minnesota 2010).

130. "Say on pay" has, indeed, become emblematic of public backlash against excessive pay during the global financial crisis. Originally restricted to financial institutions receiving federal bailout funding, under, for example, the American Recovery and Reinvestment Act of 2009, there have been a number of subsequent proposals for broader application of "say on pay" principles. A "say on pay" provision appeared, for example in the Shareholder Bill of Rights and in the proposed Corporate and Financial Institution Compensation Fairness Act of 2009. Much of the content of the Shareholder Bill of Rights has now been incorporated into a larger draft bill on financial services regulation, the Restoring American Financial Stability Act of 2009.

131. *See, e.g.*, J.A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law,* 65 BUS. LAW. 361 (2010).

132. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 310 (1932).

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

Financial assistance for the services of the editorial assistant of these series is provided by the European Commission through its RTN Programme on European Corporate Governance Training Network (Contract no. MRTN-CT-2004-504799).

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (www.ecgi.org/wp) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html