TOWARDS MANDATORY SHAREHOLDER COMMITTEES IN AUSTRALIAN COMPANIES

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[A common objective in recent Australian and international corporate governance reform programs is the enhancement of shareholder participation. Active shareholder involvement brings accountability to the board and management, and is appropriate considering that shareholders are the ultimate owners of the company. Curiously, however, while shareholder participation and representation has become a priority in the contemporary corporate governance arena, the bulk of recent governance reform initiatives operate on the assumption that there is a clear separation of the board and management from the general body of shareholders, and that this is necessary to achieve optimal performance. The requirement that directors be 'independent' of the company and its shareholders is a prime example. In this article, the authors propose the establishment of a mandatory shareholder committee in Australian companies as a way of enhancing shareholder participation and representation.]

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To say that shareholder primacy has been corporate law’s governing norm is not to say that corporate law has succeeded to everyone’s satisfaction in achieving its shareholder welfare objective. To the contrary, the ongoing theme in corporate law discourse has been the need to increase the accountability of management to the corporation’s shareholders. Berle and Means articulated this concern … identifying the separation between ownership and control as the source of the accountability problem. A complete solution has proved elusive.¹

I  I N T R O D U C T I O N

A  Background

The separation of ownership and control in companies² is an unavoidable and fundamental attribute of modern, particularly large, companies. As the introductory quotation suggests however, it is also viewed as the main reason behind the growing trend of minority shareholder apathy and disenchantment,³ particularly in large companies. This article puts forward a proposal that attempts to address these concerns by enhancing shareholder participation and representation in Australian companies.

In support of this proposal, the authors introduce the concept of ‘corporate cooperation’, already used in the United States to distinguish between traditional corporate governance reforms and reforms designed ‘to assimilate shareholders

² See generally Adolph Berle and Gardiner Means, The Modern Corporation and Private Property (1932). We do not agree that the rise in institutional investment, with the consequent concentration of ownership in many large companies, has removed this separation for individual shareholders. Individual shareholders continue to experience a passive role in companies, and have come to expect that they will remain merely passive observers in the companies in which they invest. Hence, while the recent trend towards more concentrated ownership may have restrained the ‘physical’ separation of ownership and control, there remains a strong ‘psychological’ separation.
³ See generally Millon, ‘New Directions in Corporate Law’, above n 1.
into the corporate activity fabric’.\textsuperscript{4} In 1994, John Matheson and Brent Olson proposed that company law reform should assume the existence of ‘corporate cooperation’ rather than ‘corporate governance’.\textsuperscript{5} They argued that corporate governance is an outdated term that implies an inevitable and immutable focus on the board and management, which emphasises the separation of ownership and allows directors to insulate themselves and management from shareholder accountability.\textsuperscript{6} According to Matheson and Olson, a regime of corporate cooperation would be guided by a primary objective of promoting ongoing communication and cooperation among a ‘trialogue’ of key players: long-term shareholders, long-term stakeholders and the board, with the board mediating between competing factions.\textsuperscript{7} They state, in referring to ‘corporate cooperation’, that reform proposals must simultaneously recognize the preeminent status of the board, the need for input from major institutional shareholders, and the need to supplement shareholder input with that of stakeholders. Reform must boost monitoring effectiveness by increasing the trialogue among the three key players. …

Ideally, the board would serve as a central nervous system linking longterm shareholders and longterm stakeholders. This proposal contemplates three primary board functions: a management function, in which the board actively makes corporate policy; a monitoring function, in which it keeps tabs on issues and areas it does not actively manage; and a new, relationship management function, in which it aggressively creates a communication trialogue with shareholders and stakeholders. The only way to strengthen the board is to enhance the focus on the third function.\textsuperscript{8}

As Matheson and Olson state, one of the functions of the board in a cooperative corporate law regime is ‘relationship management’, enhancing communication between the board of directors, long-term shareholders and long-term stakeholders. This is referred to as the ‘trialogical imperative’.\textsuperscript{9} Indeed, Matheson and Olson propose the creation of a new board committee — the ‘relationship management committee’ — to bring about a ‘corporate trialogue’.\textsuperscript{10} Australia does not have in place non-shareholder constituency statutes similar to the United States,\textsuperscript{11} and therefore there will not be the same degree of concern

\begin{itemize}
  \item See John Matheson and Brent Olson, ‘Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law’ (1994) 78 Minnesota Law Review 1443, 1445.
  \item Ibid.
  \item Ibid 1444–6.
  \item Ibid 1446.
  \item Ibid 1480.
  \item Ibid 1446.
  \item Ibid 1481.
  \item So-called ‘constituency statutes’, which have been enacted in a majority of states in the United States, empower directors to consider non-shareholder related issues, such as the interests of employees, creditors and, indeed, the community in general, when making decisions for the company, particularly in the context of a hostile takeover. For a critical analysis of the operation of the constituency statutes, see the collection of articles in ‘Symposium: Corporate Malaise — Stakeholder Statutes: Cause or Cure?’ (1991) 21 Stetson Law Review 1. See also Jonathan Springer, ‘Corporate Constituency Statutes: Hollow Hopes and False Fears’ [1999] Annual Survey of American Law 85; Michael DeBow and Dwight Lee, ‘Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation’ (1993) 18 Delaware Journal
for non-shareholder stakeholders’ (including employee, creditor and environmental) interests in a cooperative corporate law regime. However, the overriding objective of bridging the separation of ownership and control by making the board more accountable and establishing a framework for improving communication with shareholders, as well as other stakeholders, accords with the authors’ objectives.12

The authors are guided by the concept of corporate cooperation throughout the article in proposing that a formal shareholder committee be introduced, as a positive reform initiative, to enhance the participation and representation of shareholders. The reform proposal is very much designed to ‘assimilate shareholders into the corporate activity fabric’,13 which the authors believe is crucial to ensuring an environment of accountability towards shareholders within the organisation. This was recognised by Matheson and Olson in their exploration of the relationship between corporate cooperation and the shareholder advisory committees operating in the United States.14

The authors understand and appreciate that the governance of corporations — particularly large corporations — in most of the developed world is based on the ‘director primacy’ model,15 under which the board of directors exercise ultimate control over the direction and activities of the corporation.16 Nevertheless, the authors believe that the internal governance of a company can accommodate, and indeed can be designed to facilitate, an enhanced role for the company’s shareholders. Therefore, the authors outline their proposal for the establishment of a shareholder committee within public companies and large proprietary companies. This would have the practical benefit of improving communication between

12 However, it is important to note that the concept of corporate cooperation in the United States tends to focus on large institutional investors, rather than shareholders as a whole. In Australia, the encouragement of participation by institutional investors is less of an imperative. The authors believe that the composition of shareholder committees should be somewhere between large investor dominance and random selection, with the overriding objective being the establishment of a shareholder committee which is in the best interests of shareholders as a whole.

13 Matheson and Olson, above n 4, 1445.

14 Ibid 1470–9.

15 The concept of ‘director primacy’ was recently developed by Professor Stephen Bainbridge, of the University of California Law School. ‘Director Primacy’ theory is essentially an offshoot of the nexus of contracts conception of the corporation, with Professor Bainbridge submitting that ‘the board of directors is not a mere agent of the shareholders, but rather is a sui generis body — a sort of Platonic guardian — serving as the nexus for the various contracts comprising the corporation’: Stephen Bainbridge, ‘Director Primacy: The Means and Ends of Corporate Governance’ (2003) 97 Northwestern University Law Review 547, 550–1 (citations omitted). Professor Bainbridge has recently published a series of articles which consider the implications of director primacy theory across a range of corporate law doctrines and issues. See, eg, Stephen Bainbridge, ‘Director Primacy in Corporate Takeovers: Preliminary Reflections’ (2002) 55 Stanford Law Review 791; Stephen Bainbridge, ‘Director v Shareholder Primacy in the Convergence Debate’ (2002) 16 Transnational Lawyer 45; Stephen Bainbridge, ‘The Board of Directors as Nexus of Contracts’ (2002) 88 Iowa Law Review 1; Stephen Bainbridge, Corporation Law and Economics (2002).

16 Bainbridge, ‘Director Primacy: The Means and Ends of Corporate Governance’, above n 15, 550. The director primacy model operates on the assumption that shareholders are the ultimate beneficiaries of directors’ fiduciary duties and responsibilities.
shareholders and the directors, and would set in place a more constructive relationship between the management of the company and its shareholders.

The structure of this article is as follows. Part II looks at some of the reasons supporting the establishment of a mandatory shareholder committee within Australian companies. Part III discusses in detail the operation of shareholder committees in the United States, and briefly considers the similarities and differences between the shareholder committee concept and the operation of the two-tier board structure in Germany. In Part IV, the authors outline the key considerations involved in establishing a shareholder committee and detail their proposal for the establishment of mandatory shareholder committees within public companies and large proprietary companies in Australia. This includes an explanation of the role and powers of the proposed committee.

B Research Methodology

The authors canvassed a broad range of material for references to, and discussions of, shareholder committees. These included texts and monographs on corporate law and corporate governance, scholarly legal and management articles either dealing specifically with shareholder committees or discussing corporate governance and shareholder rights more generally, searches of a selection of the Top 500 Australian company annual reports and websites, and general internet searches via the main search engines. These were all explored for references to ‘shareholder committees’, ‘stockholder committees’ and ‘shareholder advisory committees’ on both an Australian and international level.

Apart from useful United States material, the authors found it extraordinarily difficult to find any relevant information about shareholder committees. This was particularly the case in relation to Australia, with the authors unable to find even one public company with a formal or informal shareholder committee, nor any

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17 See, eg, John Farrar, Corporate Governance in Australia and New Zealand (2001); Paul Ali et al, Corporate Governance and Investment Fiduciaries (2003); Geof Stapledon, Institutional Shareholders and Corporate Governance (1996); Elizabeth Boros, Minority Shareholder Remedies (1995); Jeffrey Lawrence and Geof Stapledon, Corporate Governance in the Top 100: An Empirical Study of the Top 100 Companies’ Board of Directors (1996).


19 Such as FindLaw, Yahoo, Google, AltaVista and Ninemsn.

20 The only reference to a ‘shareholder committee’ forming part of a management structure of an Australian corporate entity was in relation to the proposed Desert Knowledge Cooperative Research Centre. Desert Knowledge Australia has been formed by a number of ‘core’ and ‘supporting’ partners (comprising universities, government departments, NGOs and state governments) with a view to organising research, product development, health, education and marketing programs in order to cultivate desert knowledge economies in regional Australia. The proposed Cooperative Research Centre is the core component of the organisation’s operations, enabling people with different skills and ideas to combine and focus their activities to achieve common goals. In the original proposed business plan for the Cooperative Research Centre released in May 2002, the management structure for the Centre outlined included a Shareholder Committee, to be comprised of representatives of each of the ‘core’ and ‘supporting’ partners. It was proposed that the Centre would have a Board led by an independent Chair and Deputy Chair — one of whom would be indigenous and one who would bring a strong business perspective —
scholarly articles, company law or corporate governance texts or monographs referring to, discussing or assessing shareholder committees as a concept or as a law reform proposal.\textsuperscript{21} There has been the occasional reference to the idea of a shareholder committee for certain specific purposes, such as monitoring executive remuneration,\textsuperscript{22} reviewing audit reports\textsuperscript{23} or as a consultative body to consider relevant future law reform proposals.\textsuperscript{24} However, there has been no

with five other members. It was proposed that the Shareholder Committee would meet at least annually, prior to a Board meeting, and would have the core function of ‘managing linkage and equity issues among partners’. See Desert Knowledge Australia, \textit{Growing in the Desert: Desert Knowledge Cooperative Research Centre Proposal — Business Plan: 2003–2011} (2002) 17.

In the current structure of the proposed Centre (accessed September 2003), the Shareholder Committee idea has been retained. However it is no longer referred to as a ‘Shareholder Committee’, but rather as a ‘Partner Group’ which, along with the ‘Stakeholder Advisory Group’, will consult the Board in relation to the activities and responsibilities of the Centre. See Desert Knowledge Australia, \textit{Desert Knowledge Australia Cooperative Research Centre: Structure} (2003) <http://www.desertknowledge.com.au/crc_structure.html>.

\textsuperscript{21} But see Elizabeth Carson, ‘The Development of Board Sub-Committees’ (2000) 18 \textit{Company and Securities Law Journal} 415, 423. Carson notes (at 421) the extent to which a sample of 363 of the Top 500 listed companies in Australia had instituted board subcommittees as a corporate governance mechanism. Apart from the typical audit, remuneration and nomination committees, Carson also found from her research that a total of 173 other subcommittees were present throughout the entire sample companies. While there were no shareholder committees (and in any event, the study was confined to board subcommittees, rather than formal or informal stakeholder-type committees existing outside the board subcommittee structure), 13 companies did have ‘corporate governance committees’, which may perhaps perform a similar role to a shareholder committee in terms of considering shareholder needs and so on. Such committees are however different in the sense that they are not comprised of shareholders and hence lack the element of shareholder agency.

\textsuperscript{22} Mr Len Cooper raised this as a proposal when he announced his nomination for a position on the board of Telstra in 2000. Mr Cooper proposed that directors’ fees should be set in line with performance requirements similar to those applicable to Telstra employees, with the requirements to be reviewed by a shareholder committee in consultation with the board: Valerie-Ann Butler, \textit{Letters to the Editor: Union Official Nominates for Telstra Board} (2000) Workers Online <http://workers.labor.net.au/72/letters3_election.html>.

\textsuperscript{23} In a report released in January 2002 in response to the Ramsay Review of audit independence, PricewaterhouseCoopers raised the prospect of a form of shareholder committee being established within companies to review audit reports. While it was suggested that such a reform proposal could improve shareholder participation in the governance process of companies, the idea was ultimately dismissed as being ‘impractical’. According to the Chief Executive, Tony Harrington, the problem is that members of the committee would be unduly privileged in having access to sensitive company information which is not available to all shareholders. See John Kavanagh, ‘PwC Pleads for a Light Touch’ (2002) 24(2) \textit{Business Review Weekly} 74, 75.

\textsuperscript{24} See \textit{Commonwealth Treasury, Corporate Disclosure: Strengthening the Financial Reporting Framework}, Corporate Law Economic Reform Program Proposals for Reform, Paper No 9 (2002) 182 (‘CLERP 9’). In that report, the government proposed the establishment of a Shareholders and Investors Advisory Council. The Council would be ‘consult[ed] on all disclosure-related reforms to ensure [that] they [met] the needs of retail investors’: at 183. In raising the Shareholders and Investors Advisory Council as a proposal, the government noted that:

Further proposals to facilitate the effective and informed participation by shareholders in the governance of companies … [include convening] a group representing shareholder interests to act as a consultative body to consider relevant future reform proposals. … The concept of a shareholder reference group has been considered as a way of ensuring that the concerns of retail investors are appropriately considered in the context of policy issues affecting them. Such a group would act as an external advisory body reporting directly to the Government on issues of corporate law and governance affecting shareholders.

This proposal was not included in the federal government’s \textit{Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003} (Cth), introduced into Parliament in December of that year (‘CLERP 9 Bill’).
support or suggestion for a mandatory shareholder committee performing general functions as the authors propose.

While the paucity of consideration about shareholder committees both in Australia and internationally is no doubt due to strong boardroom resistance, based on the perceived risk that such committees would challenge the power enjoyed by directors and managers, it needs to be recognised that the tide is definitely turning. Recent corporate law reform in Australia has indicated that enhancing shareholder participation is now undoubtedly a legitimate corporate governance objective. A principal example of this is the Corporate Law Economic Reform Program (‘CLERP 9’) reforms to be introduced in mid-2004. Under these reforms, shareholders are, for example, given the right to express their opinion about executive remuneration policies of the company through a non-binding advisory vote at the company’s Annual General Meeting (‘AGM’). This is in order to ‘facilitate more active involvement by shareholders’ and ‘provide an avenue for shareholders to actively express any views they may have regarding decisions taken in relation to remuneration’.25

II THE NEED FOR MANDATORY SHAREHOLDER COMMITTEES IN AUSTRALIA

A Theoretical Justifications for Enhancing the Participation and Representation of Shareholders vis-a-vis the Company

1 Shareholders as Owners of the Company

It should be a simple proposition that by holding a stake in the primary mechanism by which a company is legally constituted — its shares — shareholders are the effective owners of the company and do therefore deserve a central role in the company. This is based on an economic, rather than social, perspective of the company.26 However, over time, as the study of shareholder rights and theoreti-
cal models of the company has been subject to continued analysis and examination, a number of arguments as to why shareholders should not be considered owners of the company have emerged. The two main arguments used by commentators to undermine the status of shareholders within the company are that:

1. treating shareholders as owners of the company demonstrates a misunderstanding of the nature of shares; and

2. elevating shareholders to a primary position within the company necessarily undermines the legitimate interests of other stakeholders in the company by directing company resources and attention towards shareholder interests and away from these other interests.

The authors recognise these reasons against privileging shareholder rights and interests within the company. A closer inspection of the issues involved demonstrates that elevating the rights of shareholders to a primary consideration


28 See, eg, Hill, ‘Public Beginnings, Private Ends’, above n 26, 30–1; Millon, ‘New Directions in Corporate Law’, above n 1, 1377. For a general discussion and analysis of the stakeholder theory of the corporation, and academic discourse surrounding the movement, see James Post, Lee Preston and Sybille Souter-Sachs, Redefining the Corporation: Stakeholder Management and Organizational Wealth (2002). The preparation of this book was part of the ongoing project entitled ‘Redefining the Corporation: An International Colloquy’, funded by the Alfred P Sloan Foundation, which aims to ‘refine and advance the concept of a business corporation as an interdependent network of “stakeholders”’. For further discussion of the Project and its achievements to date, see Clarkson Centre for Ethics & Board Effectiveness, Core Research Project, Redefining the Corporation: An International Colloquy <http://www.rotman.utoronto.ca/~stake/Core_Research_II.htm>.

within the company is justifiable, and is not necessarily at the expense of inadequate recognition of the rights of other stakeholders.

Regarding the first argument, it has been said that the nature of shares is ‘autonomous’ — that is, a share does not provide a shareholder with a direct interest in the company’s assets, but rather a right to share in company profits and other specific rights upon the winding up of the company. Therefore, it is argued, shareholders do not have a proprietary interest in the company and cannot be considered the true ‘owners’ of the company.\(^{30}\) While the authors concede that the nature of shares makes it difficult to explain precisely the status of shareholders in the company, we disagree that their autonomous nature is incompatible with shareholders having a proprietary interest in the company. Property, as a concept, is dynamic enough to extend to ‘autonomous’ interests. If property can exist in ideas,\(^{31}\) thin air\(^{32}\) and other interests with a similar intangible quality,\(^ {33}\) it is clear that property can exist in shares and, accordingly, that shareholders have a proprietary interest in the company.

Thus, the fact that the nature and scope of the interest represented by a share is somewhat amorphous and subject to countervailing interests does not detract from its proprietary nature. Recent attempts to undermine the importance of the interest represented by a share evince a misunderstanding of the often nebulous character of property. They provide no reason to seriously question the long accepted maxim that shares are ‘a species of intangible movable property which comprise a collection of rights and obligations relating to an interest in a company of an economic and proprietary character, but not constituting a debt’.\(^ {34}\)

The classification of shares as proprietary in nature and shareholders as owners of the company is more than a theoretical point. Property is the strongest legal interest recognised by our system of law (at least in so far as inanimate objects are concerned), and ownership is the most basic form of proprietary interest.\(^ {35}\) This classification emphasizes to other stakeholders, such as employees and creditors, the primacy of the interests held by shareholders, and is a major weapon in the shareholder armory towards obtaining a greater role in company affairs.

\(^{30}\) See Ireland, Grigg-Spall and Kelly, above n 27, 153–4.
\(^{31}\) Through intellectual property laws protecting such things as copyright, designs and patents.
\(^{33}\) Ireland, Grigg-Spall and Kelly, above n 27, 153.
\(^{34}\) Pennington, above n 27, 144 (emphasis added). See also *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143, 156. In *Yanner v Eaton* (1999) 201 CLR 351, the High Court emphasised that the term ‘property’ can be used to describe many different types of relationships between a person and the subject matter.
\(^{35}\) For a discussion regarding the rationale for the right to property, see Peter Benson, ‘Philosophy of Property Law’ in Jules Coleman and Scott Schapiro (eds), *The Oxford Handbook of Jurisprudence and Philosophy of Law* (2002) 752, who suggests that the right of property stems from the notion of bodily integrity and ‘is an extension of the moral idea underlying the prohibition against slavery to mutual relations among persons respecting their purposive dealings with external things’: at 814. He also notes that the three incidents of private property are the rights to possess, use and alienate: at 771. Clearly these are all incidents of shares. Regarding the justification and nature of property ownership, see also Jeremy Waldron, *The Right to Private Property* (1988); James Penner, *The Idea of Property in Law* (1996); John Locke, *Second Treatise on Government* (1690).
As to the second argument, concerning the relationship between shareholders and other stakeholders, the authors do not accept that characterising shares as a proprietary interest in the company necessarily diminishes the company’s ability to deal effectively with the interests of non-shareholder stakeholders. Recognising the proprietary status of shareholders’ interest in the company does not suggest that the management of the company should be solely and exclusively devoted to fattening the pockets of shareholders. Consistent with corporate cooperative thinking, management should be able to generate wealth in the company to suit the needs of shareholders, while simultaneously responding to the needs of other stakeholders.

The dynamic nature of property accommodates such an approach. A proprietary classification of shares merely defines the relationship between the company and its shareholders such that shareholders enjoy certain benefits and protections from having a proprietary interest in the company. This does not give shareholders carte blanche over the affairs of the company. Management is still required to govern the company in the best interests of the company as a whole. This requires, in certain circumstances, specific attention to be given to the interests of other stakeholders, particularly when the company is insolvent or pending insolvency. The authors have also found no evidence to suggest that unincorporated trading and financial institutions, which have an even more direct connection between ownership and decision-making, are more derelict in their obligations to other stakeholders.

Finally, it is misguided to attempt to reduce the interests of one party because of the purported effects on others. If it is felt that the rights of other parties are inadequately protected, the way to ameliorate this is not to cheapen the rights of shareholders, but to strengthen the rights of the other stakeholders. This could be achieved, for example, by expanding the unfair dismissal provisions for employees, or by making it easier for creditors to utilise the insolvent trading provisions of the Corporations Act 2001 (Cth) (‘Corporations Act’).

In light of the above, the authors believe that there is a theoretical justification for giving primary attention to the interests of shareholders in corporate affairs. This elevates a corporate law reform agenda that privileges shareholder interests through the primary objective of enhancing shareholder participation and representation.

2 The Virtues of Participation in the Decision-Making Process

It is important to emphasise that participation and involvement in activities that affect a person’s interests is not merely an aspirational ‘feel good’ objective. Moreover, the advantages of directly involving shareholders in the decision-making process of the company extend considerably beyond enhancing corpo-

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36 These include employees, creditors, customers and possibly even the environment and the community at large. See also Joseph Healy, Corporate Governance and Wealth Creation in New Zealand (2003); Post, Preston and Souter-Sachs, above n 28.

37 In times of insolvency or pending insolvency and as part of the directors’ duty to act in the best interests of the company, case law suggests the director is obliged to consider the interests of creditors. See, eg, James McConvill, ‘Directors’ Duties to Creditors in Australia after Spies v The Queen’ (2002) 20 Company and Securities Law Journal 1.
rate governance practices. Empirical studies show consistently that involvement and a sense of contribution and control over the activities which impact on one’s life are key ingredients to a sense of wellbeing and happiness.38

While there has yet to be specific research undertaken to determine whether there is a link between the level of shareholder participation in companies and their level of happiness, given that shareholders (excluding institutional investors) are individuals like everybody else with the same needs and desires, the above studies have a number of potential implications concerning the reforms proposed in this paper. First, individual shareholders are likely to feel far more satisfied with their investment decision if given the opportunity to have their views represented by a shareholder committee, as well as having a meaningful level of involvement in corporate decision-making. Given that studies have shown that an individual’s happiness generally decreases as their level of wealth increases, this is likely to be the case irrespective of whether shareholder participation leads to an increase in corporate profits. Secondly, while studies of happiness and wellbeing generally show a weak correlation between wealth and happiness,39 even the ‘hard-nosed’ economic rationalist can readily appreciate the likely benefits of reforms that increase shareholder contentment. A greater level of satisfaction among shareholders potentially could result in more share ownership, resulting in more corporate capital and, presumptively, more economic prosperity.

In light of the above, the authors believe that establishing a link between the level of a shareholder’s happiness and their ability to participate in the company in which they have a shareholding is an area where empirical research should be undertaken. This investigation could provide very strong support for greater shareholder participation within companies.

38 See, eg, Ronald Ingelhart, *Culture Shift in Advanced Industrial Society* (1990) 41, where it was found that there appears to be a strong correlation between democracy and happiness. This is the case irrespective of the outcome. See also Bruno Frey and Alois Stutzer, ‘Happiness Prosper in Democracy’ (2000) 1 *Journal of Happiness Studies* 79.

39 Within any country there is only a modest link between wealth and happiness. Citing a University of Michigan survey, David Myers notes that what matters more than absolute wealth is perceived wealth. Money is two steps removed from happiness. Actual income doesn’t much influence happiness; how satisfied we are with our income does. If we’re content with our income, regardless of how much it is, we’re likely to say we’re happy. Strangely, however, there is only a slight tendency for people who make lots of money to be more satisfied with what they make. It’s true: [satisfaction isn’t so much getting what you want as wanting what you have.

David Myers, *The Pursuit of Happiness: Who Is Happy — and Why* (1992) 39 (emphasis omitted). Myers also notes that ‘our becoming better off over the past thirty years has not been accompanied by one iota of increased happiness or life satisfaction ... Once beyond poverty, further economic growth does not appreciably improve human morale’. at 44 (emphasis omitted).

It is important to keep in mind that the purpose of establishing mandatory shareholder committees within companies is to assist in bridging the separation of ownership and control. The authors consider this the most effective way to enhance the participation and representation of shareholders within companies and accordingly, to improve the accountability of directors and managers to shareholders.

There are, no doubt, a myriad of possible reform initiatives, including refining existing remedies and shareholder actions (such as proceedings by a member on behalf of a company under Part 2F.1A of the Corporations Act) that could be implemented to enhance shareholder participation and representation. However, most, if not all, of these initiatives are premised on a traditional corporate governance perspective of the company — that is, a strong board and management vested with all the power, and a weak and vulnerable body of shareholders in what is essentially a ceremonial role. For example, the oppression remedy in Part 2F.1 of the Corporations Act is usually only used when the interests of minority shareholders have been unfairly prejudiced by the actions of a particular director or the board. This remedy thereby assumes the superior position of the board and management, and the concomitantly weak position of minority shareholders. If shareholders had some degree of agency or influence over the way in which directors and management use their powers, it could be argued that such a remedy would not be needed. Shareholders would be in a position to negotiate with directors and management to refrain from potential or actual prejudicial behaviour, and directors and management would be more inclined to conform as much as possible with the best interests of all shareholders.

Tinkering with existing remedies and constructing new proposals to protect shareholders from the powers of the board and management is not the right approach. Under this scenario, shareholders continue to remain outside the management structure of the company, and are therefore inherently limited in their ability to participate and be effectively represented in the affairs of the company.

Advocates of the ‘director primacy’ perspective of the company will no doubt be critical of the potential for shareholder committees to interfere with the important job of directing and managing the company. From a corporate governance perspective, however, establishing a shareholder committee has important practical implications and is theoretically justifiable. While academic commentary in the United States on shareholder advisory committees acknowledges the potential weaknesses of such committees — in terms of tension and possible conflict between shareholders and the directors and managers — it is also argued that such committees, comprised of and representing shareholders, assist in

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resolving the so-called ‘collective action problem’ in corporate governance.\textsuperscript{41}

The collective action problem has emerged over time as a direct result of the structure and operation of modern corporations which have a widely dispersed group of shareholders, and a board and management which is clearly separated from the company’s shareholder.\textsuperscript{42}

The result of having a widely-dispersed group of shareholders in modern corporations is that it becomes very difficult for individual shareholders to be actively involved in keeping the board and management accountable. Applying a simple cost/benefit analysis, while there is a large cost of one shareholder or a small group of shareholders supervising the board and management, there is also very little chance that this small number of shareholders will successfully influence the board and management to change their position or implement new policies. In other words, shareholder activism is an irrational, rather than rational, practice. Because of this, shareholder apathy, particularly in minority shareholders, is common in companies (especially large public companies).\textsuperscript{43}

According to Edward Rock, the best way to increase the rationality of shareholder action within the company is to group shareholders together through a shareholder committee, and to provide the shareholder committee with a clear role within the governance structure of the company.\textsuperscript{44} This overcomes the collective action problem by making shareholder involvement in the governance of the company legitimate.\textsuperscript{45}

According to Rock:

The shareholders’ committee may significantly moderate the collective action problem facing shareholders, even in a concentrated corporation … Because this committee would be more likely to effect change than would individual action by even large shareholders, the total gross benefits from disciplining … would likely increase … At the same time, the costs to the participating shareholders of organizing, monitoring, and influencing management would decrease. The organizational and operating costs would be lower because it is cheaper to organize and maintain a smaller group than a larger group, and, in addition, some of these costs would be reimbursed by the corporation. Finally, the costs of effectuating the decisions of an officially recognized committee would likely be lower than the comparable costs for an ad hoc group formed to influence a particular issue. In these regards, shareholders’ committees … reduce the costs of organizing shareholders.\textsuperscript{46}

It is the ability of a shareholder committee to incorporate shareholders into the internal governance structure of the company which constitutes the main justification for their mandatory implementation.


\textsuperscript{42} This problem was foreseen in Berle and Means, above n 2.


\textsuperscript{44} Rock, above n 41, 490–96.

\textsuperscript{45} Ibid 495–7.

\textsuperscript{46} Ibid 495.
C Shareholders and the Annual General Meeting

In light of this, it could potentially be argued that there already exist other ways in which shareholders can form part of the governance structure of a company. Arguably the primary existing mechanism for shareholders to participate in the management of the company is by voting on resolutions at the company’s AGM. Shareholders can attend the AGM either in person or by proxy and have the opportunity to ask questions of board members. Shareholders are also empowered, either through specific procedures under the Corporations Act, the Australian Stock Exchange (‘ASX’) Listing Rules (for publicly listed companies) and/or the company’s constitution, to vote on a number of specific matters such as the appointment of directors, related party transactions, raising capital and financial assistance.

While the AGM does provide both a mechanism for and feeling of involvement for shareholders, it is the authors’ view that the AGM process only acts to highlight the clear separation of ownership and control within the company. The role of the shareholder under the AGM model is effectively nothing more than acting as an infrequent ‘rubber stamp’, with the decisions already made and the direction of the company set. This can be contrasted to a framework under which

47 In releasing the Business Council of Australia’s new Code of Conduct for General Meetings on 23 September 2003, Chairman Dr John Schubert commented that ‘[t]he annual general meeting is an important element of corporate governance and the main opportunity each year for ordinary shareholders to comment and question the Board and management of their companies’: Business Council of Australia, ‘Getting Value from AGMs’ (Press Release, 23 September 2003) <http://www.bca.com.au/content.asp?newsID=92403>. Importantly, rule 4(d) of the Business Council of Australia’s Code of Conduct for General Meetings states the Chairman is empowered to discourage and, if necessary, curtail ‘irrelevant’ questions and comments from shareholders (which includes asking the security guards to escort the shareholder from the meeting where the Chairman ‘judges it necessary to maintain good order and the functioning of the meeting’). However, what constitutes ‘irrelevant’ questions and comments is not defined in the Code of Conduct. It has been suggested by some shareholders and shareholder groups that this rule could be used by the Chairman to exclude questions which relate to the company’s environmental record and efforts to implement operational practices which adhere to best practice sustainability principles. As to the function of AGMs generally in Australia, see Ralph Simmonds, ‘Why Must We Meet? Thinking about Why Shareholders Meetings are Required’ (2001) 19 Company and Securities Law Journal 506; Darvas, above n 26; Companies and Securities Advisory Committee, Shareholder Participation in the Modern Listed Company: Final Report (2000); Mitchell, above n 40, 77–9. There are also other mechanisms, such as a shareholder-requisitioned extraordinary meeting pursuant to s 249D of the Corporations Act, whereby shareholders can participate in the governance of the company, but these will not be discussed here.

48 Corporations Act s 250S(1).

49 With regard to requirements under the Corporations Act for the appointment of directors, see s 201G (replaceable rule) that provides that a company may appoint a person as director by passing a resolution in a general meeting, and s 201H (replaceable rule) which provides that directors can appoint a director in order to meet the quorum for a directors’ meeting, but this appointment must be subsequently approved by shareholders at a general meeting. For related party transactions, see ch 2E which requires a public company to obtain the approval of shareholders for a benefit given to a ‘related party’ (as defined under s 228). In relation to raising capital, s 124(1)(a) provides companies with the power to issue shares, but the company’s constitution could impose a requirement that shareholder approval be obtained first, particularly when there is other than a pro rata issue to existing shareholders. For listed companies, ASX, Listing Rules r 7.1 also requires shareholder approval for a share issue if this means the company will have issued equivalent to 15 per cent of its total shares over a 12 month period. For financial assistance, s 260A(1) of the Corporations Act states that a company may only financially assist a person to buy shares in the company if (amongst other things) shareholder approval to do so under s 260B has been obtained.
shareholders are regularly consulted about issues and developments that affect the company as they arise or are being considered.

Indeed, it is the authors’ view that the AGM model as the primary vehicle for shareholder participation is an insult to shareholders. The only real function of the AGM is to ensure that the company complies with the Corporations Act, and sometimes other legislation, by seeking shareholder approval for arrangements, appointments and transactions when required. Apart from the short period of time for questions from shareholders, the AGM does not go any further in facilitating shareholder participation and representation. While it is important that the board and management have every opportunity to proceed with the business of making money for the company without being subjected to the corporate ‘straightjacket’ of shareholder harassment and disturbance, opening up the doors to shareholders only one day a year for coffee, cake and questions tips the corporate governance pendulum too far in the other direction.

The authors’ shareholder committee proposal would be more favourable to shareholders than the existing AGM model. The proposed shareholder committee would not mandate interference in the day-to-day management decision of the company. However, the proposed committee would allow the shareholders to have, through their elected representatives, on a consultative basis, an ongoing involvement in the overall and long-term management of the company, rather than being limited to the items on the agenda for the AGM. The formation of a formal and gradually entrenched communication channel between the board and the proposed shareholder committee would see a system of corporate cooperation truly begin to take shape in Australia.

D Are the Australian Shareholders Association’s Company Monitoring Committees a Sufficient Alternative?

An interesting question that was considered is whether a shareholder committee is unnecessary given the active role played by the Australian Shareholders Association (‘ASA’) in promoting shareholder issues to corporate Australia. This is particularly relevant given that under the CLERP 9 reforms to the Corporations Act expected to come into force in July 2004, shareholders will be able to appoint the ASA as their proxy to vote and participate on their behalf at AGMs.50 While the ASA has played and will play a very useful role, particularly in raising issues with regard to related party transactions and executive remuneration, the authors do not believe that their shareholder committee proposal is unnecessary.

As an independent organisation seeking to generate publicity for shareholder issues to influence law and internal governance reforms, the ASA does its best to bridge the separation of ownership and control within Australian companies. Like the initiatives and remedies discussed above however, the ASA is limited because it also works within a system which assumes a traditional corporate governance framework. As such, incremental change is all the ASA can legitimately expect from its lobbying and reform initiatives, rather than a significant

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50 See the proposed new section of the Corporations Act which states that ‘the person appointed as the member’s proxy may be an individual or a body corporate’: CLERP Bill s 249X(1)(1A).
change in direction from the traditional corporate governance framework towards real corporate cooperation.

The authors’ shareholder committee proposal is, in contrast, designed to directly bridge the separation of ownership and control. Indeed, the authors suggest that the ASA and the shareholder committee would have a complementary relationship. This is because the primary focus of the shareholder committee would be to work with the board and management to achieve shareholder-oriented objectives relevant to the particular company. The primary focus of the ASA would be to continue lobbying government and business for reforms which would benefit the entire shareholding community.

When considering the role of the ASA, the authors’ attention was also drawn to the Company Monitoring Committees that the ASA has established in each state. Formerly called Investor Relations Committees, each state Company Monitoring Committee consists of between six and 12 members. People decide to become members for a number of different reasons, such as an interest in corporate affairs generally or a desire to closely monitor the companies in which they own shares. Members of Company Monitoring Committees are often chosen to be the ASA’s representative at company AGMs if a shareholder nominates that an ASA representative be appointed as proxy. In that situation, they vote in accordance with the general ASA position, which is usually detailed on the ASA website.

The Company Monitoring Committees, as their name suggests, monitor the financial performance and corporate governance practices of a range of companies. Their primary focus is on the Top 200 companies, particularly companies with the most shareholders. Company Monitoring Committees are created for each state rather than each company, due to the ASA’s limited resources and the fact that the ASA and business in general consider the present structure of company monitoring committees to be quite effective in providing companies with an opportunity to discuss ideas in order to seek out shareholder views. There has not been, and there is unlikely to be, an attempt in the near future by the ASA to lobby for the introduction of mandatory or voluntary shareholder committees within companies.

While the authors acknowledge that there are some similarities between the ASA’s Company Monitoring Committees and the proposed shareholder committee, the authors believe that there are a number of differences between the two initiatives that warrant the separate establishment of mandatory shareholder committee within companies. The main reason why an internal shareholder committee is necessary is that the committee’s entire focus would be on the company in which its members have a shareholding, thus giving members a better opportunity to establish a workable relationship with directors and management. This compares favourably to the Company Monitoring Committees.

51 The authors thank the representative of ASA who they consulted for details about the Company Monitoring Committees. Any errors or inaccuracies in the explanation in this article of the operation of these committee are, of course, the responsibility of the authors alone.

Towards Mandatory Shareholder Committees

which monitor a vast number of companies. Significant time and effort is therefore likely to be spent by the Company Monitoring Committees monitoring companies in which members are not shareholders, at the expense of devoting the same amount of time and effort to the company, or companies, in which members have a shareholding.

Another advantage of the shareholder committee proposed by the authors is that it would operate inside, and as part of, the governance structure of the company. This provides shareholders with a real opportunity to be involved in and influence the development of the decisions of the board and management, and sets in place a real line of communication between shareholders and the board. This contrasts with Company Monitoring Committees, which perpetuate the separation of ownership and control by operating outside of the company. The resources of Company Monitoring Committees also need to be spread across a large number of companies, which results in a majority of companies being monitored superficially — or indeed not at all — by members who often lack a specific interest in the company in question.

In summary, while the Company Monitoring Committees are a useful mechanism to bring about general improvements in the financial performance and corporate governance practices of companies with a large shareholder base, they do not sufficiently enhance shareholder participation and representation or bridge the separation of ownership and control. Therefore, they are not an effective alternative to the mandatory shareholder committee which the authors advocate.

E. The Erroneous Argument of Cost

An inevitable argument against the proposal for a mandatory shareholder committee is that it would impose an unnecessary and unwelcome cost upon companies for very little benefit.

However, in the authors’ view, it would be hypocritical for companies to raise cost as an argument against introducing shareholder committees. Over the last few years there has been an explosion, both in Australia and overseas, in the number of board subcommittees and ad hoc committees that perform specialist functions and assist the board in effectively monitoring all aspects of the company’s business. For example, the Nomination Committee is involved in the process of appointing directors and executives, and the Audit Committee supervises the external auditors and assists the directors in confirming that the accounts represent a true and fair view of the company’s financial performance and complies with accounting standards. However, surely this schematic subcommittee process is a cost burden on the company, as more administration means more expense. The common objective of each of these subcommittees and ad hoc committees is improving the financial and operational performance of companies for the benefit of shareholders. In other words, the position of shareholders as the owners of the company demands that the company organise

53 Carson, above n 21, 416.
54 To satisfy the requirements of ss 295(4), 296 and 297 of the Corporations Act.
its governance structure in the most effective manner possible, to provide positive returns for shareholders.

On the other hand, there is more to being a shareholder than simply banking a dividend cheque once a year.55 Whilst respecting the role of the directors and executives to maximise company profits,56 shareholders, as the owners of the company, rightly deserve some role within the management structure of the company. After all, effective shareholder participation within the company is considered to be the primary objective when establishing corporate governance standards and rules,57 and a mandatory shareholder committee would be the best way of achieving this. Whilst this comes at a price, it would not be an ‘outlandish’ cost foreign to management. Members of the shareholder committee would not enjoy overly generous options payments or ‘golden parachutes’. In fact, the only costs generated by a shareholder committee would be those reasonable expenses incurred by members in terms of travel, engaging professional advice on a needs basis, plus a small remuneration fee to members for attending committee meetings. These issues will be explored in more detail below.

If the company is prepared to meet the cost of establishing subcommittees that have the basic objective of benefiting shareholders, it appears logical to invest a little more to implement and maintain a system that truly benefits shareholders by providing what the subcommittees lack — an avenue for real and effective shareholder participation in the company. Indeed, if the financial position of a

55 See the High Court of Australia’s decision in Gambotto v WCP Ltd (1995) 182 CLR 432, 447, where a share was held to be more than a capitalised dividend stream. A contrary view is raised by Paula Darvas: ‘The commercial reality for many shareholders is that they have little commitment to the corporations in which they invest, apart from seeking a good return on their investment’: Darvas, above n 26, 394. See also Stephen Bainbridge, ‘In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green’ (1993) 50 Washington and Lee Law Review 1423.

56 According to Greenfield, the shareholder primacy model of the company means that the fundamental task of corporations is to make money for their shareholders, with no reference to facilitating shareholder participation in the company. See Kent Greenfield, ‘From Rights to Regulation in Corporate Law’ in Fiona Macmillan Patfield (ed), Perspectives on Company Law 2, 1, 1–2.

57 See Principle 1 of Organisation for Economic Cooperation and Development, OECD Principles of Corporate Governance (1999) 17–18. According to the Treasury’s 2002 CLERP 9 discussion paper this has ‘widespread acceptance as a framework for good corporate governance practices’ and refers to the basic rights of shareholders to ‘participate in, and be sufficiently informed on, decisions concerning fundamental corporate changes’: CLERP 9, above n 24, 182. The authors consider it important to raise here the obiter comments of the New South Wales Court of Appeal in Whitlam v Australian Securities and Investments Commission (2003) 199 ALR 674. The case resolved the issue of whether a chairman who was also a company director had an obligation when appointed as proxy to vote as directed. In doing so, the New South Wales Court of Appeal (comprising Hodgson, Ipp and Tobias JJA) suggested that it was open to the Australian Securities and Investments Commission (‘ASIC’), in trying to establish a link between the director’s obligations to the shareholder as proxy and the director’s duties to the company, to submit that the chairman-appointed proxy had a duty to the company ‘to make an appropriate contribution to the proper running of the annual general meeting, and in particular to the carrying out of voting procedures, and a duty not to subvert those procedures’: at 734. It has subsequently been suggested that this duty articulated by the Court of Appeal may be part of a ‘broader duty upon directors to communicate effectively with shareholders’: see Sebastian Hempel and Silvana Noveska, ‘ Casting Proxy Votes: Which Hat Was Mr Whitlam Wearing?’ (2003) 55 Keeping Good Companies 476, 478. If the duty of directors does extend this far, this would obviously emphasise the important place of effective shareholder communication and participation within the corporate governance practices of Australian companies.
company is so tight that it cannot even afford the cost of establishing and maintaining a shareholder committee, shareholders would be justified in demanding that existing board subcommittees be consolidated to reduce cost. A company with multiple board subcommittees focused on wealth maximisation, but not one committee focused on shareholder participation, is evidence of a board that does not regard balancing corporate governance objectives seriously enough.

Accordingly, on balance, the proposal is justified in light of the authors’ primary objective of achieving real improvements in shareholder participation and representation within Australian companies by seeking out reforms which will bridge the separation of ownership and control.

III EXPLORATION OF THE POSITION OVERSEAS

A United States

1 Chapter 11 Equity Security Holder Committees

According to Jayne Barnard, the original concept of a shareholder committee can be attributed to Adolph Berle’s 1928 book, *Studies in the Law of Corporate Finance*. Berle urged that German banks holding depositors’ shares on trust should act as a ‘permanent protective committee’ to negotiate for financial disclosure and to represent shareholder interests in the face of managerial abuses.

In the United States, the modern concept of a shareholders’ advisory committee is apparently modelled on the equity security holders’ committee which can be established pursuant to Chapter 11 of the United States *Bankruptcy Code*, when a public company in financial distress has filed for bankruptcy protection. The reason for permitting equity security holders’ committees is to enable shareholders (particularly institutional shareholders) and the company’s unse-
cured creditors to become involved in restoring the company to financial health by forming a separate committee. Greater attention is given to shareholder issues and concerns by companies in the United States than in most other countries, as fiduciary obligations are placed on directors to protect shareholder interests. Shareholders in the United States also tend to be more active in raising issues and concerns with the board and management due to the Shareholder Proposal Rule which enables shareholders to submit proposals to the company that the board to obliged to consider.

The establishment of an equity security holder committee is provided for in § 1102 of the Bankruptcy Code. Under this section, equity security holder committees are appointed by the United States trustee following a request by an interested party, or by court order. In accordance with § 1102, the court has a discretion to appoint an equity committee ‘if necessary to assure adequate representation of equity security holders’. According to Thomas Henry Coleman and David Woodruff, what constitutes ‘adequate representation’ of equity security holders is not defined in the Bankruptcy Code, but there is case law on point which indicates that the court will consider a number of factors in deciding whether to appoint an equity committee.

63 Consider, however, the ‘absolute priority rule’ operating in the United States and codified in the Bankruptcy Code § 1129(b)(2)(B). This rule requires that creditors be paid out in full before shareholders are paid when the company is insolvent. See Elizabeth Warren, ‘A Theory of Absolute Priority’ [1991] Annual Survey of American Law 9.

64 See §§ 1101–74.

65 The Shareholder Proposal Rule, expressed in Securities Exchange Act of 1934 General Rules and Regulations 17 CFR § 240.14a-8 (2003), empowers shareholders to submit proposals to corporate management for inclusion in a corporation’s annual proxy statement. There are, however, a number of exceptions to r 14a-8, the most limiting being the ‘ordinary business’ exception, which is regularly used by boards to exclude shareholder proposals from being included in the corporation’s annual proxy statement. See Christine Ayotte, ‘Reevaluating the Shareholder Proposal Rule in the Wake of Cracker Barrel and the Era of Institutional Investors’ (1999) 48 Catholic University Law Review 511 where Ayotte discusses how the Shareholder Proposal Rule has quite limited application in practice. According to Ayotte, the Shareholder Proposal Rule came about in response to the Berle and Means thesis (see Berle and Means, above n 2, 304–5) that separation of ownership and control would produce ‘passive owners’ and result in ‘inefficiency throughout the corporation’: at 519. The United States Securities and Exchange Commission (‘SEC’) ‘determined that shareholders needed some method of acquiring information about corporations and participation in corporate governance’: at 519.

66 According to Coleman and Woodruff, above n 18, 301–2, while § 1102(b)(2) ‘stat[es] that the equity committee shall ordinarily consist of the persons … who hold the seven largest amounts of shares’ (at 301), there are ‘a number of factors preventing the United States trustee from simply appointing the seven largest shareholders from the shareholder list’. These include the fact that some large shareholders may have a conflict of interest which prevents them being appointed to a company’s equity committee (for example, if the shareholder ‘is also a creditor or director or other officer of the debtor’ company) and that, among the largest shareholders, some may not be ‘willing to commit the time and undertake the responsibility of serving on the equity committee’: at 302.

67 According to Coleman and Woodruff, above n 18, 301–2, while § 1102(b)(2) ‘stat[es] that the equity committee shall ordinarily consist of the persons … who hold the seven largest amounts of shares’ (at 301), there are ‘a number of factors preventing the United States trustee from simply appointing the seven largest shareholders from the shareholder list’. These include the fact that some large shareholders may have a conflict of interest which prevents them being appointed to a company’s equity committee (for example, if the shareholder ‘is also a creditor or director or other officer of the debtor’ company) and that, among the largest shareholders, some may not be ‘willing to commit the time and undertake the responsibility of serving on the equity committee’: at 302.

68 See § 1102(a)(1).

69 See § 1102(a)(2).

60 These factors include the number of shareholders in the debtor company, the complexity of the case, the solvency of the debtor company and whether a plan of reorganisation of the company has been filed. See, eg, Re Johns-Manville Corporation, 68 BR 155, 159 (SDNY, 1986); Re Johns-Manville Corporation, 38 BR 331, 332 (SDNY, 1983); Re Wang Laboratories Inc, 149 BR 1, 2 (BankrDMass, 1992); Re Beker Industries Corporation, 55 BR 945, 948–9 (BankrSDNY, 1985); Re Baldwin-United Corporation, 45 BR 375 (BankrSDOhio, 1983); Re Emons Industries Inc, 50 BR 692, 694 (BankrSDNY, 1985); Re Public Service Co of New Hamp-
As to the function of the equity security holder committees in the reorganisation of companies, § 1103(c) of the Bankruptcy Code allows an official committee, including an equity committee, to consult with the trustee or debtor in possession, investigate the conduct, financial condition and business of the debtor, participate in the plan of reorganisation and ‘perform such other services as are in the interests of those represented’, amongst other things. Coleman and Woodruff note that § 1103(c)(1) ‘emphasizes the fact that equity committee participation in the case should be an interactive process, involving regular communication with the trustee or debtor in possession’. 70 Furthermore, the catch-all language of § 1103(c)(5) ‘offers the equity committee broad authority to engage in activities necessary to meet the needs of each particular case’.71

Section 1109(b) is another important source of statutory authority for the equity committee to act72 as it provides that an equity security holders’ committee can raise, appear and be heard on any issue in a case. Coleman and Woodruff suggest that § 1109(b), when read literally, appears to provide standing to the equity committee to engage in any kind of action it wants in a Chapter 11 reorganisation case.73 Case law has however limited the standing of the equity committee to matters which affect the rights of shareholders and the value of their shares.74

While creditors have an automatic involvement in the reorganisation process as the formation of a creditor committee is mandatory, the formation of equity security holder committees is relatively rare, and is used mainly in so-called ‘mega cases’ involving very large public companies in severe financial distress.75 According to Rock, however, there is no reason why the equity committee should not be a feature of the governance of public companies when the company is in good financial health as ‘the relationship between the shareholders and the board of a non-bankrupt corporation may be similar to the relationship between these groups in a bankruptcy context, at least with regard to certain issues’.76 It is Rock’s thesis that in a bankruptcy context, an equity committee is justified due to the natural tendency of the company, through its board of directors, to pacify creditors that the company wishes to continue business with. Therefore, shareholders can no longer rely upon the board of directors to protect their interests.77 Rock suggests, however, that even in a non-bankruptcy context, as independent directors are appointed by the chief executive officer and are susceptible to internal board dynamics, there is a ‘structural bias’ in favour of

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70 Coleman and Woodruff, above n 18, 313.
71 Ibid.
72 Ibid 313–14.
73 Coleman and Woodruff, above n 18, 314.
75 Coleman and Woodruff, above n 18, 295–6.
76 Rock, above n 41, 493.
77 Ibid.
management, with independent directors becoming little more than a ‘cheering
section for management’. 78

Accordingly, as Rock argues, the ‘inability of shareholders to rely on directors
to protect their interests in a bankruptcy context’ — the fundamental reason for
equity security holder committees under Chapter 11 — is really a particular
example of a pervasive problem in contemporary corporate governance, which
justifies equity committees in both a bankruptcy and non-bankruptcy context. 79
Rock’s views certainly support the authors’ proposal, detailed below, that the
formation of a shareholder committee become a mandatory requirement for all
large companies at all times, regardless of whether the company is experiencing
financial difficulty.

2 Formal Shareholder Committees in US Companies

In addition to Chapter 11 equity committees operating when the company is
experiencing financial difficulty, a number of United States companies have
implemented so-called ‘shareholder advisory committees’. There are two main
forms of shareholder advisory committees in the United States:
• ‘formal’ committees which are established by the company, usually in
response to a shareholder proposal, and form part of the internal governance
structure of companies (albeit separate and distinct from management and the
board); and
• ‘informal’ committees which are typically formed by shareholders to exert
pressure on the company regarding specific issues.

Generally, formal shareholder committees have a cooperative relationship with
the board and management, and the committee is used to improve communica-
tion between the various groups. In contrast, informal shareholder committees
usually have a rather hostile relationship with the board and management given
their supervisory function.

According to Matheson and Olson, despite the enormous potential of formal
shareholder advisory committees, they are used only in extreme circumstances. 80
This is because the proposal for the establishment of a formal shareholder
advisory committee will usually only be raised by a large shareholder, 81 and
there usually need to be significant problems with the company’s operation and/or performance before institutional shareholders will focus their energies on
creating shareholder advisory committees to change the governance of the
company. 82

Although still a rarity in the United States, the shareholder advisory committee
is increasingly being considered by large institutional investors as a way of
enhancing their role in the corporate governance practices of companies and

78 Ibid 494 (citations omitted).
79 Ibid 494.
80 Matheson and Olson, above n 4, 1478.
81 Though there are cases where a small shareholder may propose the establishment of a share-
holder committee. See, eg, the Texaco shareholder committee proposal discussed below.
82 Matheson and Olson, above n 4, 1476.
improving corporate decision-making. Indeed, according to Barnard, the original impetus for establishing formal shareholder advisory committees was to encourage large institutional investors, historically ‘non-participatory providers of capital’, to become actively involved in corporate governance matters with a view to increasing corporate performance.

While most formal shareholder advisory committees have rules that membership of the committee is limited to the largest shareholders in the company (typically institutional investors), shareholder committees are yet to have a definitive composition, and remain an evolving concept in United States corporate governance. The following examples illustrate some of the forms such committees can take.

(a) Californian Public Employee Retirement System Proposals

The Californian Public Employee Retirement System (‘CalPERS’) is a large pension fund in the United States managing over US$50 billion in assets. It has been active since the late 1980s in making proposals to boards of large companies that they establish a shareholder advisory committee as a supplemental body to the company’s existing board of directors. A proposal is generally made by CalPERS when the targeted company is in financial difficulty, or when there is internal bickering within the company. It has been said that ‘CalPERS’ proposals to establish shareholder advisory committees [are] the most important shareholder initiative attempting to influence shareholder–board relations’.

CalPERS has yet to establish a definitive composition for a shareholder advisory committee, with each proposal differing. One of the most well-known CalPERS proposals was that for Avon Products Inc during the 1990 spring proxy season where it was proposed that the Avon shareholder advisory committee consist of at least nine members. The board of directors was to have the discretion to establish procedures for selecting members willing to serve. However, requirements that each member of the committee be a beneficial owner of the company’s stock.

Formal shareholder committees within companies are also being established in other parts of the world, though these are not as common as in the United States. For example, Eurotunnel, a market leader for cross-Channel travel that is listed on the London, Paris and Brussels Stock Exchanges, established UK and French shareholder committees as part of the board’s initiative to advise the company on its communication with individual shareholders. Nine members of the committee each serve a maximum three year term.

This followed the Texaco–Pennzoil litigation in 1984, in which CalPERS, as a government entity with a large shareholding in Texaco, was not entitled to vote in the Chapter 11 equity security holders committee for Texaco. The latter committee was established when Texaco filed for Chapter 11 bankruptcy after Pennzoil secured a judgment against Texaco for $10.3 billion. This spurred interest from CalPERS in the shareholder advisory committee concept and it lobbied other troubled companies to establish such a committee. See Barnard, above n 18, 1144–6.
of at least 1000 shares in the company for the entire period of membership, no member would have an affiliation with the company other than as a shareholder, and that at least five members were to be selected from the 50 largest beneficial owners of the corporation’s voting shares, were also to be imposed. 91 Furthermore, it was proposed that membership of the committee be limited to one year and that no member be eligible to serve more than three consecutive terms. 92 The function of the committee would be limited to providing non-binding, advisory counsel to the company’s board. 93 The Avon proposal only just failed to be approved by Avon’s shareholders, being approved by 45 per cent of the votes cast. 94

(b) CIRI — A Case Study

The active shareholder committee of CIRI serves as a useful example of how formal shareholder advisory committees operate in the United States. 95 CIRI is a large United States company with a broad range of investments in a variety of different business segments, including telecommunications, construction services, natural resources, real estate and tourism. The focus of CIRI’s business is in Alaska, though the company also has interests, predominantly in the area of telecommunications, in New Orleans, Philadelphia, Las Vegas, South Texas and other major markets in the US. 96

In 1995, the board of CIRI established three ‘Shareholder Participation Committees’ to ‘increase communication between the corporation and shareholders, and to represent all shareholders living within and outside Alaska’. 97 One committee represents shareholders living in Anchorage, another committee represents shareholders living in Alaska but outside Anchorage, and the third committee represents shareholders living in the United States but outside Alaska. 98

(i) Composition

Each Shareholder Participation Committee consists of nine shareholders. Membership of the committee is not limited to the largest investors of the company. Instead, members are drawn randomly from a pool of shareholders

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91 Ibid.
92 Ibid.
93 Ibid.
95 Another interesting example is the ‘Shareholder Liaison Committee’ of the BNP Paribas Group, established following the BNP Paribas merger in 2000. The composition of this 10 member committee is different from CIRI’s shareholder participation committees in that while any shareholder can become a candidate for membership, a maximum of two current employees are eligible for its membership. The BNP Paribas Committee is also guided by a Committee Charter which comprises internal rules with which all members are required to comply. See BNP Paribas, Shareholder Liaison Committee (2004) <http://bnpparibas.com/en/sustainable_development/committee.asp>.
98 Ibid.
who have raised an interest in becoming involved. Prior to each CIRI Annual Meeting, Shareholder Participation Committee ‘reply cards’, for the random selection of members, are mailed to all voting shareholders. To be eligible for membership, interested shareholders must complete and return the reply card no later than the day of the Annual Meeting. The drawing of members is usually held the week following the Annual Meeting, with new and continuing members then being announced in the subsequent CIRI newsletter.

Members of each Shareholder Participation Committee must be at least 18 years of age and own voting stock in the company. To ensure that each committee adequately represents shareholders and is focused on shareholder issues, board members, management staff and the employees of CIRI, its subsidiaries and non-profit affiliates are excluded from serving on a committee. Rather, committee members serve staggered, three-year terms which begin on selection and end at the CIRI Annual Meeting held three years later.

(ii) Purpose and Actions

According to CIRI’s website, there are three main purposes of the company’s Shareholder Participation Committees:

1. increasing communication between CIRI and its shareholders;
2. identifying issues of immediate and long-term importance to shareholders; and
3. assisting the corporation in providing information to shareholders on the corporation’s mission, business operations, corporate policies and other matters.

The website adds that each Shareholder Participation Committee is to ‘advise the corporation on specific issues and activities identified by committee members, the corporation or shareholders’.

Since their inception in 1995, the Shareholder Participation Committees have had a number of achievements in representing shareholder interests. These include: giving shareholders a greater role in electing the board of directors; participating in the update of qualification for board candidates; negotiating for shareholder presence on the Nomination Committee and consulting with management and providing guidance to shareholders in relation to a ‘Special Shareholder Vote’ on the strategic direction of the company.

(iii) Remuneration and Expenses

Members of each of CIRI’s shareholder participation committees receive a small fee for each regularly scheduled meeting, and are also reimbursed for

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100 Ibid.
101 Ibid.
102 Ibid.
103 CIRI, Shareholder Participation Committees, above n 97.
105 Ibid.
transportation and other reasonable expenses involved in having to attend meetings of the committee.107

(c) The Texaco Proposal — A Case Study

In the United States, proposals are often raised by shareholders for the establishment of a shareholder advisory committee within the particular company. These proposals will usually be included as a resolution to be voted upon at the Company’s Annual Meeting.108 Such resolutions for the establishment of shareholder committees are often met with challenge however, particularly when the proposal is to establish a shareholder committee in a large public company.

An example of this was the proposal made at the 1997 Annual Meeting of the large petroleum product company, Texaco. The proposal was raised by Mr Robert Dowling, the beneficial owner of 50 shares in the company.109 While it was not passed, the authors consider it useful to state the resolution below, and the response of Texaco’s board of directors who recommended a vote against it. The correspondence between the shareholder and directors of Texaco provides a valuable resource in assessing the merits of establishing formal shareholder committees in Australian companies, and in developing a model for an effective shareholder committee.

The resolution (‘Item 5 — Stockholder Proposal Relating to a Shareholder’s Advisory Committee’) states:

RESOLVED, that the company shall be requested to establish a Shareholder’s Advisory Committee. The Committee will provide non-binding recommendations to the Board of Directors pertaining to Shareholders’ interests on policy matters relevant to the company and its business, such as major acquisitions, restructurings, executive compensation, ethical issues, mergers and other significant matters on which the Board is to consult with the Committee. The Board shall insure the effective operation of this Committee and will give consideration to its recommendations. This resolution shall in no way limit or otherwise restrict the ability of the Board to take any action it deems in the company’s best interest.

Members of the Committee shall serve without compensation, except for the reimbursement of reasonable expenses. The Committee will have a minimum of fifteen (15) members and the Board shall develop procedures for the selection of members willing to serve, provided that the following apply:

- Members will be the beneficial owner of at least 500 shares of the company’s voting stock for the entire period of membership.
- Members will be the beneficial owner of at least 50 shares of the company’s voting stock for the entire period of membership.

At least seven (7) members shall be selected from the 1,000 largest beneficial owners of the company’s voting shares.

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107 CIRI, ‘How to Become a Member of a Shareholder Participation Committee’, above n 99.
108 This is permitted as the SEC generally considers it acceptable for shareholders to propose the establishment of a shareholder advisory committee. This has been confirmed on numerous occasions where the SEC has registered proposals for the establishment of a shareholder committee, lodged by individual shareholders or groups of shareholders, and the company has been required to include the proposal in its proxy materials in that year.
Members will have no present affiliation with the company, other than as a Shareholder.

The term of each member shall be for two (2) years and in no instance can a member serve more than two (2) consecutive terms.\(^{110}\)

In support of the resolution, the following statement was provided:

Although it may be argued that procedures are in place to communicate with Shareholders, many view management’s periodic overviews as insufficient. The proposed committees personnel composition has the potential to make a significant contribution and will be neither costly to maintain nor bureaucratic. As an advisory group, the Committee by definition cannot impede the decision-making process and it’s [sic] quality will be such that confidentiality will be maintained. The Committee would also assist in assuring that ethical standards are enforced and applied to all employees, regardless of position, in a uniform and fair manner.

The formation of the Committee will act as a valuable resource and will benefit the company by strengthening confidence between Shareholders and Board representatives.\(^{111}\)

In recommending a vote against the resolution, Texaco’s directors argued that:

A shareholder advisory committee is unnecessary since the responsibilities of the Board and its Committees include the functions described in the proposal. They review and approve the company’s financial and competitive positions; review operations and activities that pose risk to the company; and review the company’s adherence to its vision and values and compliance with our Corporate Conduct Guidelines.

The Board’s legal and fiduciary obligations include gathering all the information it deems necessary, from whatever sources, in order to make decisions that are in the best interest of the company and its stockholders. Although this proposal states it will not limit or restrict the Board’s ability to act in the stockholders’ best interest, it provides that on stated issues the Board ‘is to consult with the committee’ and ‘give consideration to its recommendations.’ Thus, before taking action on such issues the Board must call together this committee, wait while the committee gathers its consultants or advisors, and delay acting until it has had the opportunity to consider in good faith the committee’s recommendations.\(^{112}\)

The authors believe that this statement against shareholder advisory committees by Texaco’s board underestimates the importance of shareholder participation within companies, and therefore is not persuasive in the Australian context with regard to the implementation of mandatory shareholder committees.

\(^{110}\) Ibid.

\(^{111}\) Ibid.

\(^{112}\) Ibid. Barnard has raised similar arguments against establishing shareholder committees in the US. According to Barnard, it is unclear whether shareholders of a company would benefit from a shareholder advisory committee. These committees duplicate many of the functions of the board and produce unnecessary costs to the corporation, ‘deplet[ing] assets otherwise available for reinvestment or for distribution to shareholders’. Barnard, above n 18, 1139.
3 Informal Shareholder Committees

(a) General

Informal shareholder committees are not actually part of the company’s internal governance structure in the way that formal shareholder committees are. This is because they are usually formed by one or more dissident shareholders to focus on specific issues affecting the company. Formal shareholder committees, by contrast, are established by the company typically in response to a shareholder proposal being approved at the company’s Annual Meeting.

Furthermore, informal shareholder committees often operate differently from formal shareholder committees. In contrast to the advisory and cooperative role of formal shareholder committees, informal shareholder committees are typically more active in pressuring the board and management to try to generate outcomes that benefit shareholders (or, at least, those shareholders that are members of the informal committee). As a result, an informal committee’s relationship with the board and management can become rather hostile.

Informal shareholder committees are much more common than formal shareholder committees in the United States, given that they are much easier to establish as approval of the board and a majority of a particular company’s shareholders is not a prerequisite. One company may also have numerous informal shareholder committees.

(b) Tenet Healthcare — A Case Study

At this point, it is worthwhile discussing the informal shareholder committee established by a minority shareholder of Tenet Healthcare Corporation, which provides an excellent demonstration of the differences between informal and formal shareholder committees, like the CIRI committee discussed above.

Tenet Healthcare is the second largest hospital operator in the United States, with the company owning and operating 114 acute care hospitals in 16 states. The (unofficial) Tenet Shareholder Committee was formed in 2000 by Dr M Lee Pearce, a medical doctor and hospital proprietor. At the time of writing, Pearce owned approximately 25,000 of the company’s 473 million shares (far less than one per cent).

The relationship between the Tenet Shareholder Committee and the company’s board and management has been hostile rather than cooperative since the committee was established. The original purpose for establishing the informal shareholder committee was to gather together a group of four ‘dissident’ shareholders to stand for election as independent directors on Tenet’s board in a proxy contest waged at the 2000 Tenet Annual Meeting. In addition to enabling independent members to be elected to Tenet’s board, it was also intended that the Shareholder Committee would push for changes to the company’s corporate governance structure to improve the company’s financial

114 Ibid.
115 Tenet Shareholder Committee, Tenet Shareholder Committee, LLC <http://www.tenetshareholdercommittee.org/>.
performance and encourage a stronger emphasis on quality health care.\textsuperscript{116} Although the members of the Shareholder Committee were not elected to join the board of Tenet, the Shareholder Committee’s view is that the proxy contest in 2000 was justifiable. For example, the committee’s website states:

Although not now involved in a proxy contest, the goals of the Committee today are the same ... to serve as a catalyst for change at Tenet Healthcare, to improve the quality of health care, reform corporate governance, and thereby improve long-term performance. These goals and recommendations are best described in the December 9, 2002 letter to Tenet’s board.\textsuperscript{117}

The letter of 9 December 2002 referred to above outlined the action that the Tenet Shareholder Committee wanted Tenet’s board and management to implement in order to improve the company’s financial performance and corporate governance practices. The required action involved removing and replacing senior management, appointing a qualified and independent special committee of non-management Board members to investigate past practices, adopting a policy of transparency and openness and adding at least five new independent directors.\textsuperscript{118}

Although these demands created further tension between the Shareholder Committee and Tenet’s board, it was far overshadowed by the very public legal battle between the committee and the board that exploded in 2003 following a press statement released by the Shareholder Committee in April of that year. In the press statement, the Shareholder Committee confirmed that it had hired six attorneys (including the committee’s general counsel) to examine whether Tenet’s practices complied with United States Medicare regulations and with federal civil and criminal health care statutes.\textsuperscript{119} According to the press statement, what the Shareholder Committee found was that the company could face up to US$6 billion worth of legal liabilities to the United States federal government for making Medicare claims which exceeded its fair entitlement.\textsuperscript{120}

Tenet’s board of directors immediately countered the Shareholder Committee’s press statement by filing a lawsuit against the committee. They claimed that the committee used misleading and incorrect information in the statement for the purpose of harming the public perception of Tenet in order to deflate the company’s share price — opening up the possibility for Dr Pearce to make a hostile bid for the company.\textsuperscript{121} In response to Tenet’s lawsuit, Dr Pearce filed an answer

\begin{enumerate}
\item\textsuperscript{116} Ibid.
\item\textsuperscript{117} Ibid.
\item\textsuperscript{118} M Lee Pearce, \textit{Letter Urging Tenet’s Board to Remove Existing Management and Adopt Reforms} (2002) Tenet Shareholder Committee  \textltt{http://www.tenetshareholdercommittee.org/letters/four.htm}. It is important to note that at the 2003 Annual Meeting of Tenet, the Shareholder Committee finally succeeded in having appointed its endorsed candidate for director. See Tenet Shareholder Committee, above n 115.
\item\textsuperscript{119} Tenet Shareholder Committee, ‘Tenet May Face Up to $6 Billion Liability in Medicare Outlier Fraud According to Tenet Shareholder Committee’ (Press Release, 8 April 2003)  \textltt{http://www.tenetshareholdercommittee.org/press8.htm}.
\item\textsuperscript{120} Ibid.
\item\textsuperscript{121} Reuters, \textit{Tenet Suit Takes Aim at Dissident Shareholder} (2003) KPMG’s Insiders  \textltt{http://www.kpmginsiders.com/display_reuters.asp?cs_id=62668}.
\end{enumerate}
and counterclaims in May 2003, in which he labelled Tenet’s lawsuit against him and the Shareholder Committee a ‘fabrication’.

B Germany

1 The Two-Tier Board System

The German two-tier board corporate governance system is often raised as a comparable model to shareholder advisory committees, mainly because shareholder representatives in Germany play an important role in monitoring the activities of the management board. There are, however, some fundamental differences between the German model and the shareholder advisory committee proposal that the authors believe should be adopted in Australia.

The German Aktiengesellschaft (‘AG’), or public company, is different to Australian public companies in that it is governed by two separate and distinct bodies: the Vorstand (management board); and the Aufsichtsrat (supervisory board).123 The Vorstand runs the company and is responsible for the company’s performance, whereas the Aufsichtsrat supervises the activities of the Vorstand but is not permitted to interfere in the policy-making function of the Vorstand.124 The two primary tasks of the Aufsichtsrat are to hire the members of the Vorstand and to approve the company’s yearly balance sheet and profit statement.

Reference is often made to the German Aufsichtsrat when discussing shareholder advisory committees because it is comprised of a number of shareholder representatives — mainly bankers, but also business people and members of the public — which provides shareholders with a role in maintaining the accountability of the management board. However, as part of the ‘co-determination’ system in German corporate governance,125 up to 50 per cent of the Aufsichtsrat is also comprised of employee representatives, to assimilate employees within the governance of the company. Due to this very high proportion of employee rather than shareholder participation, the German model, although a useful reference, cannot be reliably be used by advocates of shareholder advisory committees to illustrate how such a committee might function.126

124 Barnard, above n 18, 1147.
126 Barnard, above n 18, 1147.
Towards Mandatory Shareholder Committees

IV OUTLINING THE KEY FEATURES OF THE AUTHORS’ PROPOSED SHAREHOLDER COMMITTEE

There are various ways to develop a shareholder committee and such an entity can assume different forms. This section of the article maps out a framework for the proposed shareholder committee by addressing the following matters: composition; function; powers; duties of committees; as well as general issues. For each matter, the authors outline the considerations that have been taken into account in forming our proposal and then discuss what is actually proposed in relation to each matter.

At the outset, it must be emphasised that under the reform proposal, decision-making power within the corporation will still rest primarily with the board and management. The authors’ shareholder committee proposal is not designed to improve the decision-making function of directors and managers, but seeks to influence the decision-making of directors, so that the interests and issues of shareholders are given greater recognition during the decision-making process.

The shareholder committee would be a committee of the company, but not an offshoot of the board like other committees operating within the company. It would be designed to act as a bridge between shareholders and the board of directors in order for shareholders to have an influence over how decisions are made and to uphold their rights as owners of the company when management is acting in flagrant disregard of those rights (primarily through the internal review mechanism that will be a feature of our plan). Furthermore, the shareholder committee would set in place policies and procedures for improving communication between shareholders and the directors so that shareholders — minority shareholders in particular — feel more like a part of the company.

The composition, functions, powers and duties of the shareholder committee would be outlined in a template Committee Charter, which would be given legal effect as a Schedule to the Corporations Act.

A Composition

1 Considerations

(a) How Should Members of the Committee Be Chosen?

There are various ways in which membership of the committee can be constituted. The shareholder committees in the United States provide some guidance, being committees comprised of either representatives of the largest shareholders — usually institutional investors — or of interested shareholders who are randomly selected, such as CIRI’s shareholder advisory committee. Other threshold requirements could be used to limit eligibility for membership, such as having a specified percentage of shares in the company and/or having held shares in the company for a certain minimum length of time.

There are arguments for and against each of the various composition options. For example, a random selection method under which any shareholder could

127 See above Part III(A)(2).
nominate is theoretically the best method to ensure all shareholders are represented and have a chance to participate in the company, but includes the risk that some committee members would not have the capability, time or expertise to perform their role effectively. This may undermine the operation and legitimacy of the shareholder committee. On the other hand, institutional investors would have the capacity to appoint professional representatives to act on their behalf to perform the functions of the committee. This would ensure that the committee operates professionally and efficiently, but at what price in terms of real shareholder participation and representation?

Another issue for consideration is whether, if a random selection approach is endorsed, ordinary shareholders would in reality be given the opportunity to serve on the shareholder committee of a company, and whether shareholder committees would end up dominated by large institutional investors. These institutional investors could use the committee to exert enormous influence over corporate practices and pursue their own agenda, which may be contrary to the best interests of shareholders as a whole.

(b) How Would the Situation of Shareholders Being Unwilling to Serve on the Committee Be Resolved?

In an era of rational apathy and professional managerialism, there is a real issue as to whether shareholders would be willing not only to join the committee, but also serve effectively during their tenure. Rational apathy is especially pertinent to individual shareholders, and though it would also apply to institutional investors, the fact they have more at stake through a larger shareholding in the company may encourage these organisations to take on an active role in the committee. In constructing a shareholder committee, it is necessary to consider initiatives which will encourage participation from all shareholders.

2 Proposal

The authors have resolved that the shareholder committee should be comprised of members elected through a process of random selection, rather than large institutional investors as under the United States equity committee model. This is necessary in order to guarantee effective representation and participation by shareholders as a whole.

Ordinary shareholders must have an opportunity to serve on a committee formed to represent their interests if the committee is to have any legitimacy. In Australia, increased participation by institutional investors is not as significant a priority as it is in the United States. In August 2003, the Investment and Financial Services Association, the peak Australian body representing fund managers, released a study which confirms this view. The study found that between December 2000 and December 2002, fund manager activism in the corporate governance practices of companies they invested in actually increased, with fund managers voting on an average of 92 per cent of all company resolutions.


129 Ibid.
Moreover, routine voters, defined as those institutions that vote on at least 90 per cent of all resolutions, represented 91 per cent of fund managers, and 98 per cent of all funds under management. However, the authors do propose that some small protective measures be taken to deal with the potential problem of shareholders not taking their responsibility seriously. The authors’ proposed shareholder committee would be comprised of between five and seven members to be automatically rotated every three years. This is to avoid any possibility of committee members becoming too close to the board of directors.

One member of the committee would, however, be chosen from the board of directors. Each year, the board would nominate this member, and this would be endorsed by the shareholders at the AGM. The other members of the committee would be chosen from among the remaining shareholders of the company. As a compromise between institutional investor composition and random selection, there would be a threshold requirement imposed, but only that shareholders must have held their shares for a certain period of time (probably three years) and hold at least one per cent of the total shares in the company. This shareholding would need to be maintained throughout the shareholder’s term on the committee. Where there is an insufficient number of shareholders with a one per cent shareholding, the threshold could be reduced so that the requisite number of shareholders could be appointed to the committee.

This compromise is intended to ensure that only committed shareholders nominate for membership, which will assist in overcoming the potential problem of shareholders failing to perform when serving on the committee. We also believe that these shareholders would be the most willing to serve on the committee, as the period in which they have held shares demonstrates a commitment to the company, and generally an interest in the company’s corporate governance practices. Although some shareholders would not have professional expertise, they would be able to engage professionals for advice when appropriate. This compromise will ensure that the committee functions in the best interests of all shareholders.

The committee would also have a panel of at least three professionals, who would need to have tertiary qualifications in law and/or commerce. Panel members would not be required to attend each meeting of the committee, but could be drawn upon to facilitate meetings when there is a shareholder grievance and to prepare formal submissions or reports to the board. As discussed further below, the committee would be empowered under the Corporations Act to provide reasonable remuneration to these professionals for services rendered.

B Function

Considerations

A key question concerning the proposed committee’s function is whether it would have an active, supervisory role (similar to the supervisory board which is

130 Ibid.
a key component of German corporate governance), or a more advisory role. The question is then whether the committee has the objective of facilitating and encouraging management and board action for the benefit of shareholders, rather than acting as a ‘second board’ in competition with the board of directors. Rock refers to a shareholder committee in the latter case as a ‘general purpose monitor’ or a ‘conduit’ for the formation and expression of shareholder views.

2 Proposal

The authors’ proposed shareholder committee will have a more active role than some of the formal advisory committees in companies in the United States (such as the CIRI shareholder committee discussed above) so as to provide a mechanism for internal review of shareholder grievances, alongside the committee’s other roles and functions. However, in light of some of the problems experienced with active informal committees in the United States (such as the Tenet Shareholder Committee), the proposed shareholder committee should have a predominantly advisory, rather than supervisory, role. But it is not intended that the proposed shareholder committee be established merely for show; the committee will possess a number of important functions, which the authors will now outline.

(a) Internal Review of Shareholder Grievances

The committee would be the first point of call for shareholder grievances, and would perform an internal review function. Shareholders who are dissatisfied with particular aspects of the company’s commercial behaviour, or believe that the company or its directors and similar officers have engaged in a breach of the Corporations Act, could petition the shareholder committee to hear the dispute, and try to reach a commercial outcome satisfactory to all parties. This should occur within a limited time frame, such as one week from the time of application. For such ‘internal review’ hearings, the shareholder committee would need to be comprised of between three and five members, with at least one member being a shareholder, one being the board member on the committee and one being a member of the professional panel selected by the committee. This is to achieve a balanced hearing.

Adopting this function would assist in overcoming the present sense of shareholder apathy and disenfranchisement, as shareholders would be able to have their disputes heard promptly and informally, without needing to pursue litigation. If a satisfactory outcome cannot be achieved by the shareholder committee from the shareholders’ or the company’s perspective, there would be an option to have the matter reviewed by a quasi-judicial Shareholder Panel modelled on Australia’s successful Takeovers Panel.

131 Rock, above n 41, 498.
132 Ibid 499.
Towards Mandatory Shareholder Committees

(b) Promotion of Effective Communication and Shareholder Participation

The overriding practical function of the (albeit few) company shareholder committees throughout the world is to advise the company on ways to improve communication with its shareholders, and actively engage in devising policies to improve communication with shareholders.

Various methods and approaches can be applied to improve communication between the company and its shareholders, but the key role of the proposed shareholder committee would be to discuss and formulate initiatives and policies that not only enhance communication with shareholders in the short to medium term, but also encourage the board and management to implement strategies for the long term. Shareholder communication must be a two-stage process, with shareholders informing the company of their needs, and the company informing shareholders of the company’s performance, policies and objectives.

The reforms of the United States Securities and Exchange Commission (‘SEC’) which took effect in January 2004 are a useful guide for the types of initiatives the shareholder committee could implement. The SEC has outlined a number of possible reform proposals designed to improve communications between shareholders and the company’s board members. The essence of the SEC’s new Final Rule, ‘Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors’ is ‘more disclosure’. The new rule is designed to encourage more disclosure either in the company’s proxy materials or via the company’s website. Disclosure should be made with regard to, among other things, any procedures for communications by shareholders with directors, changes to the process for shareholders submitting director nominations, how the Nominating Committee considers the nominations, company policy regarding director attendance at annual meetings, and other related matters.

While the new disclosure obligations in the SEC’s Final Rule are useful, the proposed shareholder committee need not limit itself to the initiatives of the SEC. Improving communication between shareholders and the company will be an ongoing process, and new ideas will be required over time as the nature of doing business, the affairs of the corporation and the needs of shareholders

134 See, eg, Financial Reporting Council, Combined Code on Corporate Governance (2003). Issued in response to the 2003 Higgs Report on Corporate Governance, the Code elevates communication with shareholders to a primary objective by designating a senior independent director on the board to act as a kind of ‘shareholder liaison’ (together with the chairman). This role would involve the director meeting with a range of shareholders as a way of ‘develop[ing] a balanced understanding of the issues and concerns of major shareholders’: at 18. Also, under the section entitled ‘Relations with Shareholders’, the main principle is that ‘[t]here should be a dialogue with shareholders based on the mutual understanding of objectives’: at 18.

135 SEC (Division of Corporate Finance), Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors (2003) 728.


change. Regular consultation between members of the shareholder committee and the company’s shareholders, as well as between the shareholder committee and the company’s board members and senior executive officers, will be essential to this evolving process.

It is anticipated that the approach of the shareholder committee to achieving enhanced communication between shareholders and the company will be very much policy-oriented. New issues and developments will occur from time to time requiring the committee to consider how to respond with a view to facilitating improved communication between shareholders and the board, and enhancing shareholder participation and representation. For example, technological change is a present area of focus in developing ways to improve shareholder communication. In Australia, through the CLERP 9 reform proposals, the federal government has recommended the introduction of new rules to allow the use of videoconferencing facilities, which enables shareholders in regional areas to participate in general meetings. Greater use of a company’s website to inform shareholders is another initiative that is being promoted by the ASX to enhance communication.\(^{138}\)

As new issues emerge which potentially impact on shareholder communication, the company’s shareholder committee, particularly in larger companies, would play an important role in the development of reform proposals through formulating submissions and developing initiatives to be implemented within the company. These could later be adopted more broadly by companies.

C Powers

1 Considerations

(a) Should the Shareholder Committee Have a Role in Nominating Directors?

A common feature of many of the formal shareholder advisory committees in the United States, and the supervisory boards operating in Germany, is participation in the process of nominating and electing directors to join the board. While this function is not performed by the Chapter 11 equity committees in the United States, and is rarely performed by the very few shareholder committees operating in other parts of the world, the involvement of shareholders in the nomination process has become an important corporate governance initiative in recent times. The new Final Rule adopted by the SEC in January 2004 discussed above is a good example.\(^{139}\)

In determining the role, if any, that the proposed shareholder committee will have in nominating directors of the company, a fundamental consideration is that the authors are recommending essentially an advisory committee, rather than an active supervisory committee. The powers of the shareholder committee cannot therefore be so extreme that its relationship with the board is characterised by

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Towards Mandatory Shareholder Committees

Conflict rather than cooperation. At the same time, it is equally important that the committee is given defined functions and powers so that it can play a part in actively enhancing shareholder participation and representation in the company, rather than merely having a decorative role. Achieving a balance between these two possibly conflicting objectives is the authors’ central concern in determining this issue.

(b) Should the Shareholder Committee Be Able to Participate in Setting and Revising Remuneration Rules for the Company Directors and Senior Management?

In light of recent controversy, both in Australia and overseas, about the extremely high salaries and payouts for directors and senior management,140 there has been a consistent call for law reform to introduce rules which would make the process of setting executive remuneration more accountable and transparent. This is to ensure that executive remuneration is more closely related to the performance of the company — in other words, ‘pay for performance’.141 This culminated in the proposal in the CLERP 9 package of reforms that shareholders be given the power to vote on a non-binding resolution regarding the appropriateness of the company’s executive remuneration policies with a view to encouraging more active shareholder involvement.

Significantly, there are a number of formal shareholder advisory committees in the United States that have some involvement in influencing executive remuneration practices. Many more informal shareholder committees include, among their key functions, lobbying for lower executive remuneration, or at least executive remuneration which better reflects company performance.

Accordingly, it is worthwhile considering whether the authors’ proposed shareholder committee should be empowered to participate in setting and formally monitoring executive remuneration. Executive remuneration rules form an important part of the corporate governance practices within a company. If executive remuneration is not sufficiently linked to corporate performance, in good times shareholders could be adversely affected by excessive remuneration eating into profits at the expense of higher dividends and building up corporate infrastructure to accommodate increased production and profits. In bad times, if remuneration levels do not follow the drop in profits and production there will be

140 In Australia, the most recent debate about the levels and transparency of company practices in setting executive remuneration was sparked by the announcement in early 2003 by the Commonwealth Bank that it arranged a $33 million ‘separation payment’ to be paid to former executive Chris Cuffe. See, eg, Lisa Murray, ‘Frayed Cuffe Stands by $33m Payout’, Australian Financial Review (Sydney), 11 March 2003, 60. In the United States, there was similar outcry arising from the announcement in September 2003 by the New York Stock Exchange, a not-for-profit organisation, that it arranged a US$140 million ‘compensation package’ to be paid to its chairman, Dick Grasso. See Agence France-Presse, California, New York Ask NYSE’s Grasso to Resign, Renegotiate’ (2003) Yahoo! News <http://au.news.yahoo.com/030916/19/lq9a.html>.

very little personal incentive for management to improve performance, which is again not in the interests of shareholders.

2 Proposal

(a) Nomination of directors

In order for the shareholder committee to have a real part in enhancing the representation and participation of shareholders within the company, the shareholder committee should have at least some role in the process of nominating directors. The issue becomes whether this should be a minor role, limited to perhaps advising the board in consultation with the company Nomination Committee (if existent) as to ways in which to improve the transparency of the process of nominating directors. This is similar to the new SEC Final Rule discussed above. Alternatively, the shareholder committee could have a more active role, to the extent of recommending to the board particular nominees for the position of director, or perhaps even being entitled to put forward a particular nominee for guaranteed inclusion on the board on nomination forms.

As the authors are proposing a more advisory rather than supervisory shareholder committee, it may be appropriate to limit the involvement of the shareholder committee in the nomination process to minimise the potential for conflict with the board. However, the extent of involvement should really be guided within reason by what the committee considers to be in the interests of shareholders as a whole. Thus, if the committee unanimously resolves that the circumstances warrant active involvement in the nomination process, this should also be accommodated.

(b) Executive Remuneration

Although the authors earlier recommended that the shareholder committee should be empowered to settle and monitor director and manager remuneration, it was ultimately resolved that the shareholder committee not be so empowered.

The recently implemented and proposed reforms in Australia to make the process of setting executive remuneration more transparent and accountable to shareholders\(^{142}\) should be allowed to stand on their own for the time being, in order to

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\(^{142}\) The most prominent recent initiative, and one that has already been discussed in this article, is the proposal in CLERP 9 that shareholders be empowered to register a non-binding vote on the pay levels of each director and the top five executives. See Fiona Buffini, ‘Chairmen Fear Legal Action on Pay Issue’, Australian Financial Review (Sydney), 1 October 2003, 4; John Schubert and David Gonski, ‘Leave Pay Decisions to Boards’, Australian Financial Review, 2 October 2003, 63.

Another important initiative is the inclusion in the ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (2003) of recommendations for improved disclosure of executive and director remuneration to shareholders. Listed companies, under ASX, *Listing Rules* r 4.10.3, are required to comply with these recommendations, or explain why they did not comply in their annual report. Recommendation 9.1 states that the company should ‘[p]rovide disclosure in relation to the company’s remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance’: at 52. Box 9.1, following on from Recommendation 9.1, lists the different sorts of benefits paid to directors and key executives which need to be disclosed to comply with Recommendation 9.1: at 52. This recommendation builds on the requirement in s 300A of the *Corporations Act*, introduced in 1998, that listed companies disclose in their annual reports the nature and value of ‘emoluments’ paid to the company’s directors and the five highest paid senior executives.
determine whether they are sufficient in influencing cultural reform within companies, so that executive remuneration better reflects company performance.

In any event, if the proposed shareholder committees are as successful as the authors hope and anticipate in generating a cooperative relationship between directors and shareholders, directors will make an effort to consult with the company’s shareholder committee and vice versa during the course of setting and revising remuneration rates and rules for directors and senior management. Participation in setting executive remuneration will therefore, in time, naturally become an aspect of the shareholder committee’s functions, without any need for prescriptive rules.

D Duties of Committee Members

1 Considerations

(a) Should Members of the Shareholder Committee Have Fiduciary Duties to Other Shareholders?

This issue arises because in becoming members of a committee formed for the purposes of respecting and acting in the interests of shareholders, the members are potentially acting as fiduciaries vis-a-vis the other shareholders.

(b) Is There a Risk of Shareholder Committees Owing Fiduciary Duties to Other Shareholders?

A ‘shadow director’ is a person who is not validly appointed as a director, however the directors of the company are accustomed to act in accordance with their instructions and wishes. The definition of ‘director’ in s 9 of the Corporations Act specifically includes shadow directors, but clearly states that a person is not a shadow director merely because the directors act on advice given by the particular person in a professional capacity (for example, in the course of providing advice as a lawyer, accountant or financial adviser), or as part of the person’s business relationship with the directors of the company.\(^\text{143}\)

Even though under the authors’ proposal it is unlikely that the courts will find that members of the shareholder committee will fit the definition of a shadow director given that the shareholder committee will essentially have an advisory role only, the possibility should nevertheless be addressed. This is because the courts have, in recent times, taken a rather wide view of the ‘shadow director’ definition.\(^\text{144}\)

In June 2003, ASIC reinforced the application of s 300A through a media release stating that companies are required to disclose the valuation of options provided to directors and senior executives to comply with s 300A, even when there is some degree of uncertainty as to the method of valuation or the process of valuation would be too onerous. See ASIC, ‘Valuing Options for Directors and Executives’ (Press Release, 30 June 2003). Accompanying the Media Release, ASIC has issued final guidelines about the way Australian listed companies should include the valuation of options in the disclosure of directors’ and executive officers’ emoluments in their annual directors’ reports for reporting years ending on or after 30 June 2003. See ASIC, Guidelines to Valuing Options in Annual Directors’ Reports (2003).

\(^{143}\) Butterworths, Ford’s Principles of Corporations Law, vol 1 (at 22-6-00) [8.020].

\(^{144}\) Courts have held that one company can be a shadow director of another. See Standard Chartered Bank of Australia Ltd v Antico (1995) 38 NSWLR 290; Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991] AC 187. In the latter case, the Privy Council accepted that, in a corpo-
The implication of a committee member being considered a shadow director is that members would be required to comply with the general duties imposed on directors under ch 2D of the *Corporations Act*. These include the duty to act with due care and diligence, the duty to act in good faith and for a proper purpose, the duty not to misuse the position of director or company information, and the duty to prevent insolvent trading under s 588G of the Act. Both ch 2D and s 588G pick up the statutory definition of ‘director’ which includes shadow directors.

Interestingly, most of the duties in ch 2D (except the duty to avoid insolvent trading in s 588G) also apply to ‘officers’. The concept of ‘officer’ is also defined in s 9 of the *Corporations Act* to mean, inter alia:

(b) a director or secretary of the corporation; or

c) a person: —

(i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or

(ii) who has the capacity to affect significantly the corporation’s financial standing; or

(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person’s professional capacity or their business relationship with the directors or the corporation) …

As can be seen, the definition of ‘officer’ in s 9(c)(iii) above is the same as the definition of shadow director. Moreover, if there is the possibility that committee members, even if acting as advisers to the board and management, could be considered as shadow directors and hence ‘shadow officers’, it is also possible that a court could find that a committee member could satisfy the other limbs of the definition of ‘officer’ above. Specifically, a committee member might be found to be a ‘person who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation’, or ‘who has the capacity to affect significantly the corporation’s financial standing’.

Accordingly, to ensure that committee members are protected from being exposed to statutory duties as shadow directors, it would be necessary to deal with the possibility of committee members being exposed to the same duties as ‘officers’ of the company.

rate group arrangement, the parent company could become the shadow director of the subsidiary company.
Proposal

(a) Fiduciary Duties

It is possible that a member of the shareholder committee would fit the definition of ‘fiduciary’ in their relationship with the company’s remaining shareholders, in that they may be a person who

undertakes or agrees to act for, or on behalf of or in the interests of another person, in the exercise of power or discretion which will affect the interests of that other person in a legal or practical sense.\textsuperscript{145}

In the United States, apart from members of the Chapter 11 equity committees who enjoy an implied immunity from liability (as an incentive for institutional investors to take a more active role in the companies that they invest in),\textsuperscript{146} members of shareholder committees generally \textit{do} owe fiduciary duties to other shareholders. However, this is because the law of fiduciary obligations as it relates to shareholders is very different in the United States as compared to Australia. In Australia, the longstanding common law rule that directors and other officers owe their duties to the company rather than to each individual shareholder applies, meaning that in a corporate context, fiduciary duties will rarely be found to be owing to shareholders.\textsuperscript{147} In the United States however, fiduciary duties are indeed owed to other shareholders in this context.\textsuperscript{148}

Given the position in Australian law, there is little risk of members of the proposed shareholder committee being found by a court to owe fiduciary duties to the remaining shareholders of the company. To avoid any doubt however, the authors recommend that as part of the reform package, a specific provision should be included in the \textit{Corporations Act} stating that members of the shareholder committee do not owe fiduciary duties to other shareholders. Any liability would need to be founded on other grounds, such as tortious liability for negligence or breach of contract under common law. This would achieve a balance

\textsuperscript{145} See Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41, 96–7 (Mason J). See also John Toohey, ‘Fiduciary Obligations’ in Tony Blackshield, Michael Coper and George Williams (eds), \textit{The Oxford Companion to the High Court of Australia} (2001) 279.

\textsuperscript{146} Coleman and Woodruff, above n 18, 311. According to Coleman and Woodruff, cases on point in the United States reason that, given that the \textit{Bankruptcy Code} § 1103 authorises an equity security holder committee to take certain actions with respect to a reorganisation case, the Code bestows an implied grant of limited immunity on committee members in relation to those particular actions: at 311–12.

\textsuperscript{147} The classic case confirming this principle is \textit{Percival v Wight} [1902] 2 Ch 421. However, in very special cases, a duty resembling a fiduciary duty to shareholders may be found: Bunninghauzen v Glavanics (1999) 48 NSWLR 538. See generally Robert Valentine, ‘The Director–Shareholder Fiduciary Relationship: Issues and Implications’ (2001) 19 \textit{Company and Securities Law Journal} 92. It is also important to note that while fiduciaries duties are not owed to individual shareholders, directors do owe fiduciary duties to shareholders as a general body as part of their overriding duty to the company. See \textit{Ngurli Ltd v McCann} (1953) 90 CLR 425; Peters American Delicacy Co Ltd v Heath (1939) 61 CLR 457; James Edwards and Corrine Campbell, \textit{Whitlam v Australian Securities and Investments Commission: What the Decision of the Court of Appeal Means for Directors Acting as Proxies} (2003) 21 \textit{Company and Securities Law Journal} 457.

\textsuperscript{148} See Valentine, above n 147, 101–2 fn 66 for a summary of the main decisions in the United States dealing with the position of director–shareholder relationships. Valentine also notes that in the United States ‘there appears to be little doubt that directors are fiduciaries to shareholders’: at 100.
between encouraging members to serve on the committee, and providing some avenue for action against members who engage in egregious or willfully negligent conduct.

(b) Committee Members as ‘Shadow Directors’ and ‘Officers’

Similar to the proposal above, to avoid any doubt that a member of a shareholder committee could be classed as a ‘shadow director’ or ‘officer’ under the Corporations Act, there should be a provision in the definitions of ‘shadow director’ and ‘officer’ that specifically excludes shareholders acting in the capacity as members of a company’s shareholder committee.

This approach is justified on the basis that similar provisions currently exist for persons providing advice in a professional capacity. Given that members of the shareholder committee will be appointed by the company to perform a role which will be mandated under the Act and will necessitate the exercise of independent judgement in order to best represent the shareholders of the company, it is appropriate that a similar carve-out is included. Furthermore, protecting committee members from the possibility of being exposed to the statutory duties owed by directors and officers will hopefully encourage shareholders to both nominate themselves for election to the committee and, if elected, enthusiastically perform their role. Potential exposure to statutory duties, particularly in an increasingly litigious corporate environment, would no doubt have the reverse effect.

The authors also note that, as with the above discussion of the potential fiduciary duties of committee members, this aspect of our proposal does not entail completely removing committee members from the possibility of legal sanction. Members who clearly disregard their obligations could still be exposed to liability through a range of common law and statutory actions.

E General

1 Considerations

(a) Should It Be Mandatory that all Public or Listed Companies Have a Shareholder Committee?

An important consideration is whether the requirement to have a shareholder committee be mandatory and thus enshrined in law under the Corporations Act, or companies should have some choice (guided by commercial considerations) as to whether to establish a committee. The latter would operate in a similar way to the corporate governance requirements in the ASX Corporate Governance Council’s Principles of Good Corporate Governance and Best Practice Recommendations. Listed companies are required to implement these recommendations, or indicate in their annual report why they have not implemented particular recommendations to comply with Listing Rule 4.10.3.

149 ASX Corporate Governance Council, Principles of Good Corporate Governance and Best Practice Recommendations (2003).

150 ASX, Listing Rules.
(b) Would the Committee Have the Ability to Engage Professionals for Advice, and If So, How Would This Be Regulated?

In the United States, § 328(a) of the Bankruptcy Code allows an equity security holder committee to appoint professionals on ‘any reasonable terms and conditions’. The position in the United States is that engagement of professional advice should not be curtailed, but should naturally be limited to the provision of services needed to effectively represent shareholders.151 Although this is difficult to regulate, it appears, at least in theory, to be an acceptable position.

(c) Should Committees Be Entitled to Reimbursement for Reasonable Expenses Incurred?

The United States Bankruptcy Code does not articulate such a right in relation to equity security holder committees, but with formal shareholder advisory committees in the United States the practice seems to be that committee members are entitled to reimbursement for reasonable expenses incurred.

2 Proposal

The issue of whether implementation of a shareholder committee in Australian companies should be mandatory or voluntary needs to be decided by taking into consideration the objective for establishing shareholder committees. Specifically, the goal of enhancing shareholder representation and participation in the company needs to be kept in mind, while also considering what is in the best interests of the company.

Given the very important role of the proposed shareholder committee in providing a mechanism for greater shareholder participation and representation within the company (a necessary plank in further dismantling the separation of ownership and control within the company), requiring all public companies and large proprietary companies to implement a shareholder committee within the organisation is warranted.152

The authors recognise that implementing a mandatory requirement of a shareholder committee on companies is a radical change that will be, at least initially, burdensome for companies. Accordingly, the authors propose that while the requirement will be mandatory and enshrined in the Corporations Act, the requirement will be subject to an express power of the Australian Securities and Investments Commission (‘ASIC’) to modify the requirement, or exempt certain companies from the requirement where companies can provide a good case for why it should not apply to them. This would be consistent with ASIC’s existing range of exemption and modification powers in the Corporations Act.153

151 See Coleman and Woodruff, above n 18, 309–10.

152 The authors have used ch 6 of the Corporations Act (which relates to takeovers) as the basis for setting this requirement. While there are benefits in having a mandatory shareholder committee in all companies, we think this may be too onerous a requirement for some small proprietary companies, many of which have a close relationship with their shareholders in any event.

power could be used, for example, where no nominations for membership of the committee are forthcoming after a genuine nomination process, or when the company can establish that for a certain period the interests of shareholders would be better served by not having a shareholder committee (due to particular circumstances, such as financial difficulties, the size of their share registry, and costs).

Providing ASIC with this particular power provides for a favourable balance between achieving effective corporate governance reform via enhanced shareholder participation and representation, and accommodating the genuine commercial interests of companies. This in turn benefits shareholders as it is counter-productive to mandate shareholder committees if the financial and/or operational performance of companies is hindered by their implementation.

As to the ability of the proposed committee to engage professionals and reimburse committee members for expenses incurred, the authors believe that the shareholder committee should have both powers, subject to all expenses and fees satisfying a general test of ‘reasonableness’ based on what is necessary for the committee to operate effectively and professionally.

V Conclusion

There is a contradiction involved in elevating shareholder interests to a key concern in contemporary corporate governance, while maintaining the separation of ownership and control within the internal governance structure of modern companies. This needs to be addressed.

The primary objective of the reform initiatives outlined in this article is to enhance shareholder participation and representation in relation to corporate affairs by proposing that shareholder committees be established in Australian public companies and large proprietary companies.

If governments worldwide are serious about elevating shareholder interests in the quest for improved corporate governance practices within companies, then maintaining distance between the company’s shareholders and its directors and managers is no longer tenable. Both board composition and general governance structures within companies needs to be fundamentally reconsidered. The end product should be rules which facilitate and encourage a very close link within companies between the directors and management as the holders of power, and the shareholders as the ultimate owners of the company.

Placing shareholders in the centre of the governance structure of the company, which is certainly achieved by the concept of a shareholder committee within the company, is the best way to bridge the separation of ownership and control, so that the company is capable of enhancing and maintaining shareholder participation and representation into the future.