Images of the Shareholder – The Regulatory Implications of Shareholder Power and Powerlessness

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- Image matters!

- Eg shareholder as (dispossessed) owner/principal; beneficiary; bystander; participant in a political entity; investor; or gatekeeper.

- Images lie across a continuum of "power".

- Shareholder protection and shareholder participation rights.

- Financial "sophistication".

- Impact of shareholder image on judicial decision-making and regulation. Shareholder power can be viewed as benign or problematic.

Portrayals of the Shareholder from Berle and Means to the Global Financial Crisis

- From Berle and Means (1932) to recognition of institutional investor power (1990s) and hedge fund power (2006-).

- GFC tested traditional conception of shareholders.

- Shareholders as vulnerable and "innocent" (*cf* Brandeis J (1915) – "there is no such thing...as an innocent stockholder").

- Post GFC – increased ambiguity regarding shareholders. Were they victims or collaborators?

- If image matters, so too does spin (Carl Icahn vs. Martin Lipton).

- Negative perceptions of the shareholder are common in the US), but also evident in a cross-border context.

- Eg Shareholders described as "fickle and irresponsible" (Japan, 2008).

- Private equity, hedge funds and foreign investors described as "swarms of locusts" (Germany, 2004-5).

- Ambiguity - regulatory and paradigm implications.

- "Sophisticated" versus "unsophisticated" investors (*Hirsch v du Pont* (1977).

- Classic efficient market hypothesis (Fama, 1965) – noise traders vs. sophisticated traders.

- But global financial crisis dented faith in market's own efficiency and ability to self-regulate (Turner Review, 2009).

- Crisis also suggested that some "sophisticated traders" not as astute as previously assumed (Goldman Sachs' Abacus scandal).

- Abacus challenged SEC's traditional self-image as the "Investor's Advocate" (William O. Douglas, 1937).

- Public enforcement mechanism for breach of directors' duties in Australia.

- Mixed results in actions for breach of duty of care brought by ASIC.

- ***James Hardie*** (2012) – involved major corporate restructure to quarantine asbestos liability.

- JHIL's market announcement stated that the Foundation was "fully funded". Did JHIL directors breach their duty of care and diligence?

- High Court upheld first instance judgment of Gzell J.

- According to Gzell J, the class to whom the ASX announcement was made included "the sophisticated and the unsophisticated" - "[t]he class was broad. It not only included financial market analysts and investors, but also <u>stakeholders of a wide range</u>".

- Gzell J held that this "unsophisticated notional class representative" would have been misled. Directors (including non-executive directors) found to be in breach of the duty of the statutory duty of care and diligence.

- *Cf* High Court decision in **Forrest v ASIC** (2012).

- Target audience viewed as a sophisticated class comprising "the business or commercial community" (French CJ, Gummow, Hayne and Keifel JJ).

- Target audience was "sufficiently tough, shrewd and sceptical"– "this was not a naïve audience" (Heydon J). Similar to Goldman Sachs' defence in the Abacus scandal.

- *Cf Stier v Smith* (1973). "Sophisticated investors, like all others, are entitled to the truth".

- Central issue – could shares be classified as "preference shares"?

- Is *Beck v Weinstock* an example of Meir Dan-Cohen's "personless corporation" (Dan-Cohen, Rights, *Persons and Organizations: A Legal Theory for Bureaucratic Society* (1986), 46-51)?

- Was "powerlessness" of the minority plaintiff shareholder a crucial, but overlooked issue in this case?

- Eg plaintiff argued that the true value of the 8 "C" class shares redeemed for $8 would have been $7,266,000 in a winding up.

- Power as a positive regulatory attribute - shareholders can protect their own and other shareholder's interests.

- ***In re M & F Worldwide (*MFW *)Shareholders Litigation*** (2013, Del Court of Chancery) (going private transaction with controlling shareholder).

- Shareholder consent traditionally more important in UK and Australia than the US.

- But shareholder vote qualified as a "cleansing device" in *MFW* decision.

- "Informed and uncoerced" shareholder vote gave shareholders the ability to protect themselves.

- UK Stewardship Code (2010, 2012).

- "It is [the shareholders'] business and his obligation to see that those who represent him carry out a policy which is consistent with the public welfare" (Brandeis J, 1915).

- Major theme in Walker Review (2009) and Kay Review (2012) – strong ethical overtones.

- Key terms responsibility, dialogue, trust, integrity. Will it work? (Cheffins 2010; Davies 2014; Reisberg 2011).

- Australia's two-strikes rule for public listed companies.

- Two-strikes rule designed to "drive a culture of change in the boardroom".

- Image matters in corporate regulation.

- Different images of the shareholder can lead to different outcomes in judicial decision-making and in regulation generally.

- Ambiguity re role of shareholders in the global financial crisis.

- Need for attunement in corporate theory and practice re fact that shareholders are not homogenous.

- Disclosure and sophisticated investors.