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Minority Shareholders' Rights, Powers And Duties: The Market For Corporate Influence

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MINORITY SHAREHOLDERS' RIGHTS, POWERS AND DUTIES: THE MARKET FOR CORPORATE INFLUENCE

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ABSTRACT

Conventional corporate law scholarship attributes a high degree of homogeneity to minority shareholders. For example, the agency problems approach identifies conflicts between shareholders and managers in the case of companies with dispersed shareholding, and conflicts between minority shareholders and controlling shareholders for companies with concentrated shareholding. However, recent trends establish that minority shareholders come in different hues. Large institutional investors have mostly crowded out retail shareholders from the stock markets. Even within the institutional variety, differences abound. The current corporate governance paradigm fails to account for the diversity among minority shareholders and their interests.

In this chapter, I seek to establish that the assumptions regarding the homogeneity of minority shareholders are no longer valid due to market developments that have radically altered minority shareholder demographics in companies the world over. I argue that the expanding schism between the identity, outlook, actions and interests of varieties of minority shareholders creates agency problems among types of minority shareholders. This calls for a paradigm shift in corporate law's treatment of minority shareholders. The ability of one type of minority shareholders to affect the interests of others would call for the imposition of restraints on minority shareholder behaviour.

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I. INTRODUCTION

Minority shareholder protection constitutes a fundamental pillar of corporate law. Although corporate democracy operates within the rather pragmatic notion of "majority rule",[1] legal systems around the world confer express protection on minority shareholders against the actions of either managers or controlling shareholders. From a comparative perspective, literature is abound with assertions that the strength of legal protection to minority shareholders in a given jurisdiction correlates with the ability of companies within that jurisdiction to raise capital on attractive terms.[2]

To begin with, a minority shareholder is one who has no controlling interest in a company.[3] Such a shareholder holds less than fifty percent of the voting stock, thereby failing to possess *de jure* control.[4] The concept of control permeates beyond a simple quantitative determination, and extends to the qualitative realm as well. By this, a minority shareholder is one who does not also exercise *de facto* control.[5] Ultimately, minority shareholders do not have the power, whether in law or in fact, to appoint or replace board members—a key indicia of control.[6]

Conventional corporate law scholarship attributes a high degree of homogeneity to minority shareholders. For example, the agency problems approach identifies conflicts between shareholders and managers in the case of companies with dispersed shareholding, and conflicts between minority shareholders and controlling shareholders for companies with concentrated shareholding.[7] However, recent trends establish that minority shareholders come in different hues. Large institutional investors have mostly crowded out retail shareholders from the stock markets.[8] Even within the institutional variety, differences abound. Some focus on long-term sustainable gains, while others are short-termist. Some adopt a passive (or even apathetic)

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[1] Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 594 (2006).

[2] See e.g., Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

[3] Anupam Chander, *Minorities, Shareholder or Otherwise*, 128 YALE L.J. 119 (2003).

[4] Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1269 (2008).

[5] *De facto* control may exist if a shareholder who holds a numerical minority of voting rights nevertheless exercises significant influence over the company through its board. For example, in re Tesla Motors, Inc. S'holder Litig., Consolidated C.A. Mo. 12711-VCS, 2018 Del Ch. LEXIS 102 (Del. Ch. Mar. 28, 2018), the court found Elon Musk to be a controlling shareholder of Tesla Motors on account of his "outsized influence" even though he held only 22.1 percent of the common stock. But, see In Re Essendent, Inc. Stockholder Litigation, No. 2018-0789 (Del. Ch. Dec. 30, 2019). See also, Gaia Balp, *Activist Shareholders at De Facto Controlled Companies*, 13 BROOK. J. CORP. FIN. & COM. L. 371 (2019); Soo Young Hong, *Curb Your Enthusiasm: The Rise of Hedge Fund Activist Shareholders and the Duty of Loyalty*, 24 FORDHAM J. CORP. & FIN. L. 193, 211 (2018).

[6] They also do not have the power to determine the outcome of corporate decisions by exercising veto rights, which are an indication of negative control. Anabtawi & Stout, *supra* note 4, at 1297; Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. Rev. 915, 937 (2019).

[7] ARMOUR, ET AL, THE ANATOMY OF CORPORATE LAW 29-30 (2017).

[8] See *infra* Part IIA.

attitude towards companies in which they have invested, in contrast with others that adopt a more activist approach.

The current corporate governance paradigm fails to account for the diversity among minority shareholders and their interests. It operates on two fundamental assumptions: first, whatever is good for one minority shareholder is good for the entire body of minority shareholders; and, second, minority shareholders can generally act in their own interests rather than for the benefit of the company or other shareholders. In this chapter, I seek to establish that these assumptions are no longer valid due to market developments that have radically altered minority shareholder demographics in companies around the world. I argue that the expanding schism between the identity, outlook, actions and interests of varieties of minority shareholders creates agency problems among types of minority shareholders. This calls for a paradigm shift in corporate law's treatment of minority shareholders. The ability of one type of minority shareholders to affect the interests of others would call for the imposition of restraints on minority shareholder behaviour, which then logically leads to the question whether minority shareholders should be subject to duties (fiduciary or otherwise) under corporate law.

To analyse minority shareholders' rights and duties from a comparative perspective, one could embark on a detailed examination of the corporate and securities laws in each jurisdiction (or at least some key jurisdictions).[9] However, such an approach is unsatisfactory as it limits itself to law in the books, without considering how the law applies in practice.[10] In this chapter, I adopt a functional approach that enables a greater appreciation of not only the legal developments in various jurisdictions, but also the market trends that affect minority shareholders.[11]

In this light, I examine the role of institutional investors, who now constitute a substantial proportion of non-controlling shareholders in companies around the world.[12] This is not merely in the United States (US) and the United Kingdom (UK), traditionally the only jurisdictions with dispersed shareholding, but also in jurisdictions with concentrated shareholding, including in continental Europe and in Asia.[13] If one were to place institutional investors along a spectrum

[9] Andrei Shleifer & Robert Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997); The World Bank Group, *Doing Business 2020: Comparing Business Regulation in 190 Economies*, available at https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf ; Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430 (2008).

[10] Dan W. Puchniak & Umakanth Varottil, *Related Party Transactions in Commonwealth Asia: Complicating the Comparative Paradigm*, NUS Law Working Paper No. 2019/001, available at https://ssrn.com/abstract=3332131.

[11] In dealing with the subject matter of this chapter, I draw references from the law and practice primarily in the United States, the United Kingdom as well as select jurisdictions in continental Europe and common law Asia (that comprises Hong Kong, Singapore, India and Malaysia).

[12] *See e.g.*, Gur Aminadav & Elias Papaioannou, *Corporate Control Around the World*, NBER WORKING PAPER NO. w23010 (2017), available at https://ssrn.com/abstract=2892434; Adriana De La Cruz, Alejandra Medina & Yung Tang, *Owners of the World's Listed Companies*, OECD CAPITAL MARKETS SERIES (2019), available at http://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm.

[13] See *infra* Part IIA.

based on whether they actively exercise their minority rights and remedies, two types of investors would populate the extremes. At one end are activist investors, such as hedge funds, which actively engage with investee companies in the shadow of legal rights and remedies available to them.[14] At the other end are passive investors, including index funds and some mutual funds, which either abstain from the shareholder decision-making process altogether or simply vote along with management or controlling shareholders.[15] Due to the risk of oversimplification in such a binary approach, it is necessary to recognize that other varying types of investors populate the spectrum across different points.

Here, I consider the rights and powers, and associated duties, of activist investors on the one hand and passive ones on the other. Activist shareholders extensively engage with their investee companies both formally and informally to induce changes in the management and performance of companies to enhance value.[16] The underlying assumption is that activism by hedge funds can enhance overall value to all shareholders who share from the gains generated by hedge funds' actions. In that sense, activist shareholders perform a valuable corporate governance role. They do so without seeking to wrest control over the company, but by exercising their influence to correct specific managerial inefficiencies.[17] In doing so, they generate a "market for corporate influence",[18] an idea that stands in distinction from the well-known "market for corporate control".[19]

However, the role of activist shareholders has come under some cloud. Critics have attacked them for their short-termist tendencies and aggressive actions, thereby raising the spectre that their actions may not be beneficial either for the company or for other minority shareholders.[20] Moreover, through exercise of their influence with the investee companies on whom they mount legal actions, they possess the ability to extract private rents and suffer from conflicts of

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[14] Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 102-03; Dionysia Katelouzou, *Worldwide Hedge Fund Activism: Dimensions and Legal Determinants*, 17 U. PA. J. BUS. L. 789 (2015).

[15] Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017); Dorothy Lund, *The Case Against Passive Voting*, 43 J. CORP. L. 493 (2018); Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE - LAW WORKING PAPER NO. 463/2019, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3404298.

[16] Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 NYU L. REV. 263, 268 (2019); Kastiel, *supra* note 14, at 104.

[17] Bernard S. Sharfman, *The Tension between Hedge Fund Activism and Corporate Law*, 12 J.L. ECON. & POL'Y 251, 260 (2016).

[18] See, Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 58 (2011) (introducing the expression that has inspired the title to this chapter).

[19] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

[20] For a discussion of the critique, see Marcel Kahan & Edward B Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1026 (2007).

interest.[21] A symptom of minority-minority agency conflicts, this has resulted in a clamour to impose fiduciary duties on such investors to act in the interests of the company and other shareholders.[22]

If activists face criticism for engaging excessively, investors at the other end of the spectrum endure the diametrically opposite concern. The allegation here is that, regardless of their growing stock ownership in companies around the world, investors such as index funds are too passive. Their detractors argue that they do not invest sufficient resources in monitoring their investments and in exercising their rights and remedies as shareholders.[23] Some attribute this to the lack of appropriate incentives for managers of these funds to engage with investee companies,[24] and others to potential conflicts of interest that encourage them to remain silent over asserting their participation rights.[25] Regulators and scholars have generated a bevy of solutions to address these problems, including nudges through stewardship responsibilities,[26] imposition of fiduciary duties on shareholders and requiring them to disclose voting policies,[27] and even disenfranchising passive investors (either fully or partially).[28]

In this chapter, I analyze the exercise of rights, powers and duties of minority shareholders through the lens of institutional investors, who have become prominent outside shareholders in companies around the world. Appendix 1 carries a simple representation of the rights and duties in the context of institutional investors. This includes not only the rights and duties as they exist, but also the recommendations made so far.

Part II of this chapter maps out the evolution in the identity of minority shareholders and the rise of institutional investors. It also critically analyzes the shareholder empowerment movement. Part III examines the role of activist investors, particularly hedge funds, the benefits of their actions and potential conflicts of interest. Part IV shifts the focus to passive investors such as index funds, and examines the reasons for their passivity and identifies actual or potential conflicts of interest such investors may face. Part V discusses some possible legal tools to address concerns surrounding minority institutional investors, which range from imposing

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[21] Jay Frankl & Steve Balet, *The Rise of Settled Proxy Fights*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Mar. 22, 2017); John H Matheson & Vilena Nicolet, *Shareholder Democracy and Special Interest Governance*, 103 MINN. L. REV. 1649, 1650-51 (2019).

[22] See e.g., Anabtawi & Stout, *supra* note 4.

[23] Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance*, (2019), DISCUSSION PAPER NO. 896, available at http://ssrn.com/abstract_id=3282794.

[24] Bebchuk, et al, *supra* note 15.

[25] Gerald F. Davis & E. Han Kim, *Business Ties and Proxy Voting by Mutual Funds*, 85 J. FIN. ECON. 552 (2007).

[26] Jennifer G. Hill, *Good Activist/Bad Activist: The Rise of International Stewardship Codes*, 41 SEATTLE U. L. REV. 497 (2018); ERNEST LIM, A CASE FOR SHAREHOLDERS' FIDUCIARY DUTIES IN COMMON LAW ASIA 274 (2019).

[27] LIM, *supra* note 26, at 307.

[28] Lund, *supra* note 15; Griffith, *supra* note 15.

fiduciary duties on them to encouraging them to adopt stewardship responsibilities. Part VI concludes.

II. THE CHANGING IDENTITY OF MINORITY SHAREHOLDERS

In considering the rights and duties of minority shareholders, it is necessary to determine the identity of the minority and its changing nature, which are marked by the meteoric rise of institutional investors. After embarking on this initiative, I then explore the broad nature of minority shareholder protection, critically analyze the shareholder empowerment movement, and identify certain deficiencies.

A. Evolution of Shareholding Structures Around the World

Conventional discourse adopts the position that the US and the UK follow the Berle and Means model of dispersed shareholding, while the rest of the world is replete with companies that have concentrated shareholding.[29] Accordingly, scholars and regulators have worked towards structuring corporate governance mechanisms that address the agency problem specific to the type of shareholding (dispersion versus concentration).[30] However, such a dichotomy has recently come under strain on the ground that such polarization no longer holds well.[31]

While the debate between dispersed and concentrated shareholdings continues, one incontrovertible fact is that institutional investors have acquired significant positions in companies around of the world.[32] The rise of such institutional investors has altered the traditional corporate governance paradigm in a significant manner. For example, in the US the institutional shareholding "of publicly-traded corporations increased from 6.1% in 1950 to 70% in 2016".[33] Consequently, retail shareholding has dwindled from around 80% in the 1960s.[34] Elsewhere in the UK, institutional shareholding is said to be in excess of 80 per cent,[35] with individual shareholding having fallen from 54% in 1963 to 10.7% in 2012.[36]

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[29] Shleifer & Vishny, *supra* note 9.

[30] Lucian A. Bebchuk & Assaf Hamdani. *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009).

[31] Albert H Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53, 55 (2018); Leon Yehuda Anidjar, *Toward Relative Corporate Governance Regimes: Rethinking Concentrated Ownership Structure around the World*, 30 STAN L & POL'Y REV 197, 215 (2019).

[32] Bernard S. Black & John C. Coffee Jr., *Hail Britannia?: Institutional Investor Behavior under Limited Regulation*, 92 MICH. L. REV. 1997, 2007 (1994); Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. Rev. 1459, 1473-4 (2019).

[33] Matheson & Nicolet, *supra* note 21, at 1649. See also, Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. Rev. 971, 973 (2019).

[34] Matheson & Nicolet, *supra* note 21, at 1649.

[35] Tuch, *supra* note 32, at 1472.

[36] Paul Davies, *Shareholders in the United Kingdom*, in JENNIFER G. HILL & RANDALL S. THOMAS (EDS.), RESEARCH HANDBOOK ON SHAREHOLDER POWER 358 (2015).

In terms of the type of institutional investors, index funds have lately captured considerable attention for their phenomenal growth and the size they command in the securities markets. For example, the "Big Three" index funds—BlackRock, Statestreet Global Advisors (SSGA), and Vanguard—"collectively vote about 25% of the shares in all S&P 500 companies, and each holds a position of 5% or more in a vast number of companies".[37] Their dominance is only expected to grow in the near future.[38]

In such a scenario, the identity of minority shareholders has clearly undergone a metamorphosis. No longer can one conjure up an image of hapless individual shareholders who have invested their lifesavings into equity of companies.[39] Instead, institutional investors constitute minority shareholders in companies, primarily because retail shareholders prefer to invest in the stock market through intermediaries such as institutional investors rather than directly.[40] Institutional investors therefore enjoy the benefit of minority shareholders' rights and remedies granted to them under law.

No doubt, the increase in institutional investor holdings has (re-)introduced concentration in the capital markets. It is alluring, therefore, to consider major institutional investors such as the Big Three to "employ mechanisms of supervision and control over the conduct of office holders in the corporation that are similar to those of controlling shareholders in a concentrated ownership structure".[41] I, however, argue that the analogy between institutional investors and controlling shareholders, while true in certain circumstances, is generally inapt for several reasons. *First*, while traditional controlling shareholders intentionally seek and obtain control, institutional investors expressly disclaim control over their investee companies as they remain focused on the financial returns they obtain from their investments. *Second*, institutional investor shareholding taken together appears significant, but the shareholding of individual institutional shareholders is generally not substantial enough to confer control rights. Although there are instances of institutional investors collaborating to engage with or even aggressively act against managements or controlling shareholders, both collective action problems as well as legal restrictions in certain jurisdictions discourage concerted action by institutional investors. They neither are in the driver's seat of companies, nor are they puppeteers of management. Given their

[37] Bebchuk & Hirst, *Index Funds and the Future of Corporate Governance*, *supra* note 23.

[38] Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI) - FINANCE WORKING PAPER NO. 608/2019 available at http://ssrn.com/abstract_id=3385501.

[39] At the same time, it would be imprudent to ignore altogether the influence of retail shareholders in contemporary corporate governance, at least in some jurisdictions. See, Alon Brav, Matthew Cain & Jonathon Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE – FINANCE WORKING PAPER NO. 637/2019, available at https://ssrn.com/abstract=3387659; Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11 (2017).

[40] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV 863, 865 (2013).

[41] Anidjar, *supra* note 31, at 200.

characteristics and outlook, it is more appropriate to treat them as non-controlling minority shareholders,[42] albeit with a great deal of corporate influence.

B. Minority Shareholder Protection and Empowerment

Based on the framework set forth above, it would be possible to discern some broad trends in minority shareholder participation in corporate governance around the world. *First*, laws and regulations have generally enhanced shareholder participation in voting and facilitated remedies for victimized minority shareholders. This has enabled minority shareholders to obtain a greater say in corporate decision-making. *Second*, minority shareholders such as institutional shareholders have taken advantage of legal changes and begun to exercise their corporate franchise and other informal forms of corporate influence as a matter of practice. This has led to the increasing prevalence of "shareholder-driven corporate governance", by which minority shareholders (particularly of the institutional variety) exercise considerable influence over companies, in contrast to the hitherto prominent Berle and Means framework.[43]

Beginning with legal and regulatory reforms, a brief comparative analysis of trends in corporate regulation suggests that greater shareholder empowerment has taken on a universal status. Although both the UK and the US generally follow the dispersed shareholding model, the rights of shareholders have witnessed considerable divergence between the two jurisdictions. Historically, shareholders in the UK have enjoyed substantial influence over corporate managements, especially given their ability to vote on a wide range of proposals.[44] Moreover, the regime has permitted non-controlling shareholders to coordinate their actions to enhance their influence over managements.[45]

In contrast, shareholders were hitherto less influential in the US, because their powers in corporate decision-making had been limited, and several legal constraints prevented them from coordinating their actions.[46] Directors also enjoyed defensive mechanisms such as poison pills and staggered boards that effectively entrenched them without being subject to the market for corporate control.[47] However, recent events have moved the needle towards further shareholder empowerment in US companies and, in particular, in Delaware. Moreover, popular defensive

[42] See e.g., Assaf Hamdani & Yishay Yafeh, *Institutional Investors as Minority Shareholders*, 17 REV. FIN. 691 (2013).

[43] Anita Indira Anand, *Shareholder-Driven Corporate Governance and Its Necessary Limitations: An Analysis of Wolf Packs*, 99 B.U. L. REV. 1515, 1518 (2019).

[44] Tuch, *supra* note 32, at 1474.

[45] Davies, *supra* note 36, at 355-6.

[46] See Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in PETER NEWMAN (ED.), THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459-65 (1998).

[47] Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 Stan. L. Rev. 887 (2002).

tools such as poison pills and staggered boards are on the decline.[48] The Delaware courts too have played an influential role in empowering shareholders, attributable largely to a handful of crucial landmark decisions. In the *MFW Shareholders' Litigation*,[49] the Delaware Chancery Court was concerned with a controlling stockholder transaction in the form of a freezeout merger. In his ruling, then-Chancellor Strine stated that the deferential business judgment rule would apply to the transaction if two conditions are satisfied, i.e., the transaction had "been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors".[50] Soon thereafter, in *Corwin v. KKR Financial Holdings LLC*,[51] the Delaware Chancery Court pronounced in the context of a non-controller transaction that the approval of a merger by a fully informed body of disinterested stockholders is a precondition to the application of the business judgment rule.

The recent trajectory adopted by the Delaware courts seems to grant a great deal of importance to, and considerable faith in, the decision-making powers of shareholders.[52] Goshen and Hannes correlate this development to the changing nature of shareholders in the US context and argue, both powerfully and provocatively, that the "transformation of American equity markets from retail to institutional ownership has relocated control over corporations from courts to markets and has led to the death of corporate law".[53] The increasing sophistication of minority shareholders (in the form of institutions) and their greater interest in shareholder-driven corporate governance has led to the retreat, at least partially, of the Delaware courts in reviewing directors' decisions.

Moving elsewhere, minority shareholder empowerment is gaining traction even in markets where concentrated shareholding is the norm,[54] as minority shareholders are being empowered through "enhanced minority shareholder participation rights and legal protection devices" in corporate and securities laws.[55] For instance, in some jurisdictions such as Italy, the introduction of the mandatory list voting system allows minority shareholders to elect at least one director and one statutory auditor.[56] Indeed, the increased usage of "majority of the minority" (MoM) voting

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[48] Goshen & Hannes, *supra* note 16, at 277-82.
[49] *In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013), affirmed in Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2013).
[50] *Id.*
[51] 125 A.3d 304 (Del. 2015).
[52] Jennifer Hill, *Images of the Shareholder – Shareholder Power and Shareholder Powerlessness*, in JENNIFER G. HILL & RANDALL S. THOMAS (EDS.), RESEARCH HANDBOOK ON SHAREHOLDER POWER 65 (2015).
[53] Goshen & Hannes, *supra* note 16, at 265 (footnotes omitted).
[54] Amy Freedman, Michael Fein & Ian Robertson, *Fall of the Ivory Tower: Controlled Companies and Shareholder Activism*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Nov. 16, 2019) (observing that "controlled companies are no longer impenetrable").
[55] Tamar Groswald Ozery, *Minority Public Shareholders in China's Concentrated Capital Markets - A New Paradigm*, 30 COLUM. J. ASIAN L. 1, 13-14 (2016).
[56] Maria Lucia Passador & Federico Riganti, *Shareholders' Rights in Agency Conflicts: Selected Issues in the Transatlantic Debate*, 42 DEL. J. CORP. L. 569 (2018). See also, Balp, *supra* note 5, at 359.

enables the minority shareholders to influence the outcome of decision-making in controlled companies. In some jurisdictions such as Hong Kong, Singapore, India and Malaysia, material related party transactions require the approval of shareholders through MoM voting.[57] Other instances include a binding vote on "say on pay",[58] and the "two-strikes" rule in Australia.[59]

Early indications are that legal reforms to enhance shareholder participation have altered shareholder voting behaviour. Some studies indicate that voting participation by institutional investors around the world is effective. One study encompassing 43 countries suggests that "country-level laws and regulations regarding shareholder voting … allow for meaningful votes to be cast", that institutional investors "choose to engage in activism more often in cases where they fear expropriation the most" due to inadequate investor protection, and that "the dissenting votes cast by US institutional investors have governance-related outcomes".[60] Another study suggests that a requirement to place certain acquisition transactions before shareholders has a deterrent effect on overpayments by company managements.[61] Moreover, cross-country differences in shareholder voting rules bring about divergences in the practice and impact of such participation.[62]

At the same time, evidence suggests that the mere existence of rules that enable shareholder voting is insufficient on its own to encourage institutional investors to exercise their franchise. One study shows that institutional investors vote only when required to do so, and that merely empowering minority shareholders is inadequate unless accompanied by measures to resolve potential conflicts of interest.[63] In that sense, one may "view increased shareholder power as a necessary, but not a sufficient condition for improved governance."[64]

In addition to legal rights, institutional investors exercise other informal methods of engagement with their investee companies and managements.[65] Many disputes are resolved outside the courtroom, although often done so in the shadow of available legal protections.[66] Overall, there is no dispute that the legal framework governing minority protection across different

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[57] Puchniak & Varottil, *supra* note 10, at 20.

[58] *See*, Randall S. Thomas and Christoph Van der Elst, *Say on Pay Around the World*, 92 WASH. U. L. REV. 653 (2015).

[59] Hill, *supra* note 26, at 505.

[60] Peter Iliev, et. al., *Shareholder Voting and Corporate Governance Around the World*, 28 REV. FIN. STUD. 2167, 2171 (2015).

[61] Marco Becht, Andrea Polo & Stefano Rossi, *Does Mandatory Shareholder Voting Prevent Bad Acquisitions*, 29 REV. FIN. STUD. 3039 (2016).

[62] Bonnie G Buchanan, et. al., *Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom*, 49 AM. BUS. L. J. 739, 745-6 (2012).

[63] Hamdani & Yafeh, *supra* note 42 at 722.

[64] Yair Listokin, *If You Give Shareholders Power, do they Use it? An Empirical Analysis*, 166 JOURNAL OF INSTITUTIONAL AND THEORETICAL ECONOMICS 38, 53 (2010).

[65] Wolf-Georg Ringe, *Shareholder Activism: A Renaissance* in JEFFREY N. GORDON & WOLF-GEORG RINGE (EDS.), THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 389 (2018); Kastiel, *supra* note 14, at 104.

[66] Goshen & Hannes*, supra note 16, at* 283.

jurisdictions enables their greater participation, which then brings me to the impact that significant minority shareholders (such as institutional investors) have on other shareholders.

C. Costs and Conflicts Relating to Minority Shareholders

Given the growth of large institutional investors in the global stock markets, and the extent of their shareholder participation, the actions of individual institutional investors will likely impact the company, the controlling shareholders (if any) and other minority shareholders (whether institutional or retail). This is particularly true if the large institutional investors exert their influence to effect changes to the management or performance of the company that are consistent with their personal interests, but militate against the broader interests of the company and the other shareholders.[67]

Goshen and Squire theorize this as "principal costs", which could arise when shareholders exercise control or even influence.[68] According to them, when shareholders act in a manner that has an impact on the company, they could incur *competence costs* due to their "lack of expertise, information or talent" and *conflict costs* that emanate from "skewed incentives".[69] Hence, where shareholders obtain greater power, they are subject to the same governance risks that management's actions or omissions entail. The principal costs intensify due to conflicts of interest among investors and problems surrounding their coordination.[70] On similar lines, there are concerns that the shareholder-focused movement does not consider "the political science of empowerment and the divisions that exist within the institutional investor community" and that "undifferentiated empowerment of these so-called stockholders may disproportionately strengthen the hands" of some groups of shareholders such as activists, which may be contrary to others such as retail shareholders.[71]

Applying this thinking to current trends, conflicts among minority shareholders stand exacerbated because of concentration of power in the hands of a few institutional investors[72] whose exercise of the minority rights and remedies available under law may likely have an adverse effect on other shareholders.[73] Two scholars take a dim view of the role of institutional investors: "It is becoming increasingly apparent, however, that minority investors can play the part of the corporate villain as well as corporate victim".[74]

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[67] Anabtawi & Stout, *supra* note 4, at 1283.

[68] Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 770 (2017) (juxtaposing against agency costs relatable to the management).

[69] *Id*.

[70] *Id*., at 771.

[71] Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. Corp. L. 1, 7 (2007).

[72] Anabtawi, *supra* note 1, at 573.

[73] For a discussion of the adverse effects, see *infra* Part IIIC.

[74] Anabtawi & Stout, *supra* note 4, at 1293.

While minority shareholder protection has formed the anvil of corporate law and governance thus far, the role and growing powers of institutional investors must be viewed through a different lens altogether. The discourse surrounding rights in favour of minority shareholders is slowly but surely transitioning towards their stewardship responsibilities and even duties (whether fiduciary or otherwise). In this background, the remainder of the chapter moves to discuss two types of institutional minority investors and their roles in corporate governance. As will be seen, each of these roles raise concerns under corporate law, which call for additional measures to address them.

III. SHAREHOLDER ACTIVISM

As a variety of minority shareholders, activists engage with company managements and controlling shareholders, not only extensively but often also aggressively, using formal and informal means to effect changes to the company. While such activism, carried out in recent years largely by hedge funds, has received both praise and criticism in equal measure, the extent of its overall benefits to the company and its shareholders remains unclear. The level of minority shareholder protection as well as measures enabling shareholder participation play a role in determining the extent and effect of shareholder activism around the world. While activism began in the US in the dispersed shareholding context, it has swiftly spread to other parts of the world, including in controlled companies. A critique surrounding activism is the potential conflicts of interest of hedge funds and other activists, resulting in a call for restraining their behaviour through appropriate legal instruments.

A. Growth of Hedge Fund Activism

Shareholder activism has existed in the US for several decades, and the growth of hedge funds has propelled it even further.[75] Hedge fund activism now extends far beyond the US shores, and activist investors deploy a variety of models around the globe, thereby leading to considerable diversity in practice.[76] Activism has gained prominence in Europe where in "2017, more than 100 European companies were publicly targeted by activists".[77] Asia too has been at the receiving end of activists. Elliott Management's intervention in the Samsung group in Korea to prevent a group merger transaction,[78] and in Coal India Limited's conflicts of interest in fixing

[75] Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APP. CORP. FIN. 55, 57 (2007).

[76] One author demonstrates the diversity in models through a study of activism in the US, South Korea, Israel, the UK, Brazil, China, Australia, Japan, Italy, Germany and France. Yaron Nili, *Missing the Forest for the Trees: A New Approach to Shareholder Activism*, 4 HARV. BUS. L. REV. 157 (2014).

[77] Balp, *supra* note 5, at 343.

[78] Hill, *supra* note 26, at 502.

product prices[79] are only specific instances that demonstrate the foray of US hedge fund activism into Asia.

Hedge fund activism attracts both positive and negative narratives.[80] On the positive side, it permits shareholders to take on a more participatory role in investee companies and engage effectively with managements to cause change.[81] On the other hand, critics have highlighted the risks of hedge fund activism, including that of inducing short-termism.[82] The negative perceptions "suggest that investor engagement in corporate governance and activism is dangerous, both to the corporation and to society as a whole".[83] Given the mixed responses shareholder activism attracts, it is useful to determine the role that law and legal systems around the world play in either engendering or hindering shareholder activism.

B. Factors Influencing Activism Globally

At a comparative level, several factors explain the higher incidence of shareholder activism in certain jurisdictions such as the US in contrast with others. Scholars have sought to analyze the effect of law and legal systems on the rate and success of activism. At the outset, one may view activism as an assertion of shareholder democracy where investors exercise their right to vote.[84] Hence, voting and shareholding disclosure rules in different jurisdictions bear some correlation to the prevalence and success of shareholder activism.[85] For example, one study notes a combination of factors that has led to evidence of an aggressive stance from activist shareholders in the US, to informal activism in the UK, and then a whole range of activist patterns in continental Europe, all of which are attributable to the laws and regulations in each jurisdiction.[86] Others have itemized different stages in the activism process and found that "the extent to which legal parameters matter depends on the stage that hedge fund activism has reached".[87] Varied legal, historical, financial and institutional factors, including the robustness of law enforcement in each jurisdiction affect shareholder activism therein.[88] It appears that legal systems around the world that either facilitate or restrain activism are still evolving, although they have been

[79] James Crabtree, *TCI turns up the heat in Coal India dispute*, THE FINANCIAL TIMES (13 October 2012).

[80] Hill, *supra* note 26.

[81] Rafel Crespi & Luc Renneboog, *Is (Institutional) Shareholder Activism New? Evidence from UK Shareholder Coalitions in the Pre-Cadbury Era*, 18 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 274 (2010).

[82] However, proponents of hedge funds activism strongly resist this claim on the ground that they "find no evidence that activist interventions … are followed by short-term gains in performance that come at the expense of long-term performance". Lucian A Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1090 (2015).

[83] Hill, *supra* note 26, at 501.

[84] Dov Solomon, *The Voice: The Minority Shareholder's Perspective*, 17 NEV. L.J. 741, 744 (2017).

[85] Kastiel, *supra* note 14, at 78-79.

[86] Ringe, *supra* note 65, at 394.

[87] Katelouzou, *supra* note 14, at 789.

[88] Kastiel, *supra* note 14, at 78-79.

criticized as being either too specific (focusing on hedge funds) or too general (as they have evolved through arguably inappropriate legal transplants).[89]

Shareholding pattern too tends to shape the nature of activism. While conventional wisdom dictated that activism was prevalent (or even possible) only in companies with dispersed shareholding, recent trends indicate otherwise, as activism has taken root in companies with concentrated shareholding. Legal developments such as MoM voting for conflicted transactions and list voting for director appointments facilitate the influence of minority shareholders in controlled companies.[90] However, activists do face challenges in controlled companies, as the controlling shareholders often possess significant voting powers for activists to make inroads.[91]

Despite some weaknesses, minority shareholder activists have resorted to participation, engagement and even litigation in companies with controlling shareholders to exercise their corporate influence. This is evident not only from instances of shareholder activism in controlled companies in the US or the UK, but also in the rest of the world where concentrated shareholding is the norm.[92]

C. Concerns Surrounding Activist Minority Shareholders

Several concerns arise in the context of shareholder activism, which have led to calls to impose duties on activist minority shareholders. One of the significant downsides of shareholder activism is that an activist shareholder may enjoy private gains because of its engagement, which it does not share with the other shareholders. As noted, when "shareholders have divergent private interests, it is no longer accurate to think of shareholder action as a collective good".[93] Some commentators caution against too much optimism over shareholder activism, especially of the hedge fund variety, because the interests of hedge funds could vary from those of other shareholders.[94]

On the one hand, hedge funds face limited conflicts of interest, as they are independent organizations in comparison with conventional institutional investors who are part of a larger group and may have connections with the target companies or their managements.[95] On the other hand, it is their exertion of minority shareholder powers in individual companies that creates

[89] Nili, *supra* note 76, at 160.
[90] See *supra* Part IIB.
[91] Ringe, *supra* note 65 at 393-394.
[92] *See e.g.*, *supra* Part IIIA for a discussion on activism in Korea and India that predominantly have companies with concentrated shareholding.
[93] Anabtawi, *supra* note 1, at 575. For a discussion of these issues in the context of Asia, see LIM, *supra* note 26, at 297.
[94] Kahan & Rock, *Hedge Funds in Corporate Governance and Corporate Control*, *supra* note 20, at 1022.
[95] *Id*.

potential conflicts vis-à-vis other shareholders.[96] Therefore, the corporate structure of hedge funds rarely creates the conflicts, their actions (usually aggressive) in dealing with portfolio companies and their managements do so.

Conflicts tend to arise when activist investors enter into arrangements with portfolio companies with a view to resolving shareholder campaigns. For example, certain activist investors may obtain specific rights such as the ability to nominate or elect board representatives or to veto related party transactions.[97] At a fundamental level, it is reasonable to ask why this constitutes a conflict because a successful activist campaign that results in such rights to the investor enhances monitoring and engagement, which ought to benefit the company and all shareholders. However, concerns arise because these rights are available to individual successful activist investors, and not to other minority shareholders, with the result that the activist shareholders could exercise such rights for their private benefit even if that conflicts with the larger benefit of the overall shareholder body.

Evidence of such conflicts emanates through bilateral agreements that activist investors enter into with management teams or controlling shareholders for exercise of board representation and veto rights.[98] Companies are inclined to enter into settlement agreements with activist investors to avoid public (and media) scrutiny and to save themselves the distraction and costs associated with proxy campaigns.[99] Such settlement agreements may provide disproportionate control and influence to activist investors compared to their financial investment in the company.[100] These concerns have led to criticism against the actions of activist investors and a call for imposing robust duties on them to contain their private benefits and resolve conflicts of interest.[101]

Before discussing the possible duties imposed (or to be imposed) on activist minority shareholders, I consider the trends and issues emanating from passive investors. Arising from the passivity in their approach, their role and impact on corporate governance are at considerable variance with those of activist shareholders. Nevertheless, the discussion surrounding duties and responsibilities of minority shareholders is relevant even for passive investors.

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[96] Nicole Stracar, *Applying a New Regulatory Framework to Interested Transactions by Minority Shareholders*, 20 U. PENN. J. BUS. L. 993, 1020 (2018).

[97] Kastiel, *supra* note 14, at 126); Hong, *supra* note 5, at 200.

[98] Jordan Schoenfeld, *Shareholder-Manager Contracting in Public Companies*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Oct. 24, 2017).

[99] Frankl & Balet, *supra* note 21

[100] *Id*.

[101] One study, though, "finds no evidence to support concerns that settlements enable activists to extract rents at the expense of other investors". Bebchuk, et al, "Dancing with Activists", EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI) - FINANCE WORKING PAPER NO. 604/2019, available at https://ssrn.com/abstract=2948869.

IV. MINORITY SHAREHOLDER PASSIVITY

While the engagement of active investors tends to be episodic, other institutional investors such as mutual funds, pension funds and index funds follow a pattern of investment that is not only more widespread (in that they invest in a larger pool of companies), but they also hold shares for a longer time horizon. Unlike hedge funds and other activist investors, their investment remains passive, which too raises concerns from a corporate governance perspective. Despite holding significant voting powers (at least collectively) in companies, they fail to exercise that power, thereby ceding decision-making to managements or controlling shareholders and, sometimes, even to activist investors. Apart from their passivity, they suffer from conflicts of interest that influence their behaviour. This Part seeks to ascertain the trends in the growth of passive investors, to examine the reasons for their passivity and to identify actual or potential conflicts of interest.

A. Recent Evolution of Passive Institutional Investments

As seen earlier,[102] institutional investors are now among the largest shareholders of listed companies, in both the US as well as the rest of the world. However, "institutional investors that favor a passive investing strategy are beginning to crowd out the active investors".[103] Either these investors do not vote or, when they do, they vote in favour of management. Given the size of their shareholding, they are capable of exercising significant influence over corporate boards and controlling shareholders.[104]

Some scholars have identified a trend by which activist shareholders such as hedge funds can motivate otherwise passive investors to support them (through a "teaming up" strategy)[105] in activist campaigns in which hedge funds may not have the capability to succeed on their own.[106] In doing so, passive institutional investors have the potential to affect the nature of hedge fund activism, by discerning beneficial moves from others that may be disadvantageous.[107]

B. Factors Influencing Passivity

Passive investors, in particular index funds, lack the appropriate incentives to be active in relation to their investments. For instance, the financial incentive structures of fund managers of

[102] See *supra* Part IIA.
[103] Lund, *supra* note 15, at 496.
[104] Bebchuk & Hirst, *Index Funds and the Future of Corporate Governance*, *supra* note 23, at 2.
[105] Ringe, *supra* note 65 at 221.
[106] Gilson & Gordon, *supra* note 40, at 861.
[107] Lund, *supra* note 15, at 495.

index funds do not motivate them to invest sufficiently in monitoring and stewardship efforts.[108] It does not pay for them to be active.

A number of reasons underscore the passive attitude of institutional investors such as index funds. As the goal of an index fund is "only to match the performance of a market index—not outperform it—the fund lacks a financial incentive to ensure that the companies in their portfolio are well run".[109] Moreover, "passive funds face an acute collective action problem because a beneficial governance intervention will improve the performance of all funds tracking the index".[110] The performance results of one investor's intervention will likely have knock-on effects on the results of its competitors. As a result, each fund may be better off remaining passive, rather than to generate governance effects in portfolio companies.

Critics suggest that this will have adverse effects from the perspective of corporate governance. For example, "the substantial proportion of equity ownership with incentives towards deference will depress shareholder intervention overall, and result in insufficient checks on corporate managers".[111] Hence, there is all-round pessimism regarding the ability to motivate institutional investors into action.

C. Possible Conflicts of Interest

In addition to the lack of incentives to engage with portfolio companies, institutional investors may suffer from conflicts of interest that motivate them to side with managements or controlling shareholders in contested matters of corporate decision-making. Historically, passive institutional investors have been reluctant to engage in any form of activism "for fear of retaliation" due to their "current or potential business relations with the corporation".[112] Such a conflict of interest exerts pressure on them to support management even if it is against their investment interests as a shareholder. For example, wider business reasons may compel some investment managers of funds (that are part of larger financial groups) to take a passive stance in portfolio companies that may be clients of other entities within the group such as investment banks.[113] Even in case of independent financial entities, the managers may be motivated to side with management to ensure they retain management of pension plans of such companies, which is a lucrative source of business.[114] The existence of cross-holdings and concentrated business groups in several parts of the world, in particular in Asia, exacerbate such conflicts of interest.[115]

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[108] Bebchuk, et al, *supra* note 15, at 107.
[109] Lund, *supra* note 15, at 511.
[110] *Id*.
[111] Bebchuk & Hirst, *The Specter of the Giant Three*, *supra* note 38, at 3.
[112] Stuart L Gillan & Laura T. Starks, *Corporate Governance, Corporate Ownership, and the Role of Institutional Investors: A Global Perspective*, 13 J. APP. FIN. 10 (2003).
[113] Kahan & Rock, *Hedge Funds in Corporate Governance and Corporate Control*, *supra* note 20, at 1055.
[114] *Id* at 1055.
[115] Ozery, *supra* note 55, at 27.

Available empirical evidence supports the view that conflicts of interest influence institutional investors' votes. One study found that mutual funds that suffer from conflicts of interests in relation to certain portfolio companies tend to vote with management across all firms in which they have invested.[116] In that sense, the larger the number of business ties the institutional investor has, the more passive it is likely to be. Another study from Israel is more emphatic and provides "consistent evidence linking various proxies for institutional investors' conflicts of interest with their likelihood of voting against insider-sponsored proposals".[117] The obtrusive focus on shareholder empowerment without addressing the conflicts will likely not address the institutional passivity problem.[118] Hence, there is a need to reorient legal and regulatory instruments to "reduce the impact of conflicts on voting decisions".[119]

After identifying the trends pertaining to passive institutional investors (in comparison with activist investors) and the various concerns surrounding their attitude towards participation and engagement in investee companies, the chapter now proceeds to consider the available (and potential) legal tools to address various agency problems emanating from minority shareholder voting. In particular, these tools relate to the institutional variety of minority shareholders that has come to dominate the capital markets in recent years.

V. MINORITY SHAREHOLDER: DUTIES AND RESPONSIBILITIES?

Under corporate law, minority shareholders receive considerable protection from the conduct of management and controlling shareholders. They enjoy several rights and remedies and are generally not subject to fiduciary or other duties to act in the interests of the company or other shareholders, except under very specific circumstances. They are entitled to act in their own interest. However, given the significant corporate influence that minority shareholders such as hedge funds and index funds can exercise in the governance of companies, it is necessary to reconsider the legal principles in several jurisdictions to account for possible governance concerns that may arise due to minority shareholder conduct. This may range from the actions of activist hedge funds at one end of the spectrum to the passivity of institutional shareholders such as index funds. In this Part, I discuss some possible legal tools one can use to address the concerns raised herein. They include imposing fiduciary duties on minority shareholders to act in the interests of the company and other shareholders and encouraging them to adopt stewardship responsibilities.

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[116] Davis & Kim, *supra* note 25, at 569.
[117] Hamdani & Yafeh, *supra* note 42 at 693-694.
[118] *Id*.
[119] Bernard S Black, "Shareholder Passivity Reexamined" (1990) 89 *Mich L Rev* 520, at 607.

A. Duties and Responsibilities of Activist Investors

The primary tool available thus far is to impose fiduciary duties on activist minority investors if their actions are likely to have an adverse impact on the company or other shareholders, especially when the minority shareholders suffer from actual or potential conflicts of interest. Anabtawi and Stout, the primary proponents of the fiduciary duty approach to rein in activist investors, "propose that all shareholders, like all directors and officers, be viewed as owing latent duties to the firm and their fellow shareholders."[120] Such duties will come into play when a shareholder's stance is capable of influencing the company's conduct on any particular matter.[121]

This approach recognizes the fact that when it comes to specific engagements and exercise of shareholder power, activist minority shareholders could compel managements to introduce significant changes that may affect the interests of the company as a whole. Although activists do not in fact exercise control over the management of the company, their corporate influence could be significant. Hence, the argument goes, in such circumstances, the minority shareholders must be subject to fiduciary duties as much as controlling shareholders are.[122]

1. Minority Shareholder Fiduciary Duties: A Comparative Analysis

While such fiduciary duties are desirable from a normative perspective, a comparative analysis would indicate the lack of uniformity among jurisdictions in their current treatment of minority shareholder duties. Beginning with the US, courts have already recognized fiduciary duties of shareholders in certain specific circumstances. First, in controlled transactions such as freeze out mergers, courts have imposed fiduciary duties on controlling shareholders.[123] These duties are transaction-specific. Second, some courts have imposed fiduciary duties on controllers in close corporations, with the understanding that these entities are akin to partnerships where the partners owe duties to each other.[124] These duties are company-specific. In these circumstances, the assumption is that the controlling shareholders are as much in a position as directors to steer the affairs of a company in a manner that could adversely affect the interests of shareholders as a whole.[125]

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[120] Anabtawi & Stout, *supra* note 4, at 1295.
[121] *Id*.
[122] Stracar, *supra* note 96, at 1019.
[123] Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).
[124] Donahue v Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975). See also, Roberta S. Karmel, *Should a Duty to the Corporation Be Imposed on Institutional Shareholders?*, 60 Bus. Law. 1, 2 (2004).
[125] CARSTEN GERNER-BEUERLE & MICHAEL ANDERSON SCHILLIG, COMPARATIVE COMPANY LAW 619-20 (2019) (noting though "Delaware law, however, is more hesitant to accept a broad principle of equal treatment of all shareholders").

Interestingly, some US courts have gone as far as to extend these fiduciary duties to minority shareholders as well. For example, the Appeals Court of Massachusetts found, in the context of a close corporation, that a shareholder possessing a veto right over certain corporate actions effectively has an *ad hoc* controlling interest, and that such a shareholder owes a duty of "utmost good faith and loyalty to the other shareholders".[126] Although some state courts in the US have opened the door for imposing fiduciary duties on minority shareholders, the question of whether those duties extend to minority shareholders of public companies, and in the light of wider corporate governance considerations involved therein, is yet up for determination.

In comparison, the law in Germany goes much further to recognize the duties of minority shareholders. Not only is the principle of equality of treatment of shareholders statutorily enshrined,[127] but also aggrieved shareholders may challenge a resolution wherein a shareholder has exercised its voting rights in such a manner that it confers specific benefits to such shareholder to the detriment of the company or other shareholders.[128] German courts too have recognized shareholder fiduciary duties. In the *Linotype* case, the court held that since the majority shareholders of a stock corporation have the power to influence management, "it is necessary to impose a duty under stock corporation law to have due regard for the minority's interests as a counterbalance to the power of the majority".[129] The *Linotype* court, however, clarified that such duties for small (minority) shareholders "will usually not be determined by fiduciary principles."[130]

The more precise question of fiduciary duties of minority shareholders came up for consideration soon thereafter in *Girmes*.[131] Here, the court was categorical in imposing fiduciary constraints on minority shareholders, given that they have the ability to exercise their rights in a manner that could be detrimental to the company and other shareholders.[132] It clarified that fiduciary duties are owed not only by controlling shareholders, but also by minority shareholders, to both the controlling shareholder as well as other minority shareholders. Hence, in the German context, minority shareholders are limited by the extent to which they can exercise their rights and powers, as the law treats them effectively as fiduciaries in certain circumstances, similar to controlling shareholders and directors.

[126] Smith v. Atlantic Properties, Inc., 422 N.E.2d 798 (1981).
[127] German Stock Corporation Act, s. 53a.
[128] German Stock Corporation Act, s. 243.
[129] BGH Judgment of 1 February 1988, BGHZ 103, 184 (*Linotype*) from GERNER-BEUERLE & SCHILLIG, *supra* note 125, at 627-8.
[130] *Id*.
[131] BGH Judgment of 20 March 1995, BGHZ 129, 136 (*Girmes*) from GERNER-BEUERLE & SCHILLIG, *supra* note 125, at 630-32.
[132] *Id*.

The UK, however, adopts a far more restrictive approach when it comes to recognizing the fiduciary duties of shareholders.[133] UK law rejects the idea that shareholders are, as contrasted with directors, fiduciaries who must exercise their powers in favour of others' interests over their own.[134] At the same time, it is not as if shareholders can exercise their powers without any constraints. For example, when shareholders vote to amend the corporate constitution, they must act "bona fide for the benefit of the company as a whole" and not in their personal interest.[135] Furthermore, shareholders of UK companies are entitled to exercise the statutory remedy of "unfair prejudice",[136] which is an important investor protection tool. However, these remedies against shareholder conduct come with significant limitations. The *bona fide* test comes into play only in the limited circumstance of amendment of the corporate constitution. The unfair prejudice remedy is fact-specific, as it is based on equitable considerations.[137] While this remedy is used extensively in closely held companies, its utility in companies with large shareholding is less clear.

Moving elsewhere, leading jurisdictions in common law Asia such as Hong Kong, Singapore, India and Malaysia tend to follow the UK position,[138] which leads to limited constraints imposed on minority shareholders for their actions. Despite such a restrictive approach taken by the legislatures and courts in common law Asia, Lim has compellingly argued that minority shareholders such as institutional investors must be subject "to a legally enforceable duty to act in good faith in the best interests of the investee companies, as well as to avoid unauthorised conflicts of interest".[139]

In all, while jurisdictions such as Germany and the US recognize that minority shareholders could be fiduciaries, at least in certain limited circumstances, the UK and leading common law Asian jurisdictions adopt a restricted view on the ground that shareholders exercise proprietary rights, and can do so in their own interests. Finally, there is some divergence as to who the beneficiaries of any shareholder duties are. In the US and German contexts, the duties are owned to the company and other shareholders, but in the contexts of the UK and common law Asia the position varies considerably as fiduciary duties (such as those of directors) are owed only to the company and not to other shareholders.[140]

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[133] ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW 714 (2nd. edn, 2018).

[134] PAUL L. DAVIES & SARAH WORTHINGTON, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 637 (10th edn, 2016); GERNER-BEUERLE & SCHILLIG, *supra* note 125, at 604-5.

[135] Allen v. Gold Reefs of West Africa, [1900] 1 Cho. 656 (CA); Greenhalgh v. Ardene Cinemas Ltd., [1951] Ch. 286.

[136] Companies Act 2006, s. 994.

[137] CAHN & DONALD, *supra* note 133, at 714.

[138] For a recent and exhaustive study of shareholder duties in common law Asia, see LIM, *supra* note 26.

[139] *Id*., at 302.

[140] *Id*., at 381.

2. Other Measures

Since there is a likelihood that the measures discussed in the preceding sub-part may not materialize in the immediate future, jurisdictions may consider other interim solutions in the meanwhile. One route to address concerns arising from shareholder conduct is to modulate the definition of "control". Carrying both quantitative (*de jure*) and qualitative (*de facto*) connotations, this might require a broader understanding of control. Under this analysis, activist investors who obtain powers to influence changes to companies and their boards and managements without actually exercising control may nevertheless be stated to have control over the company, if that influence is found to be significant.[141] Activists may not obtain control over the board of the company in the longer term, but may only influence specific decisions. Such a dispensation has the effect of blurring the distinction between the market for corporate control and the market for corporate influence. Proponents of this approach harbor in the expectation that such a loosening of the definition of control will reduce the incentives of activist investors to act in the manner that satisfies their private interests at the cost of the long-term outlook of the company and the other shareholders.

From a practical perspective, there could be methods to address the concerns surrounding the settlement agreements that hedge funds enter into with portfolio companies in the wake of a proxy fight. For example, the agreements could be subject to a disinterested shareholder vote.[142] Ultimately, all of these tools envisage that when activist investors are able to exert their shareholder powers to exert significant corporate influence, they must also be subject to responsibilities akin to that of directors or controlling shareholders, as the exercise of their rights have wider implications surrounding the company.

B. Stewardship Responsibilities of Passive Investors

When it comes to passive investors, the approach is somewhat different. The legal, regulatory or market instruments here need to address two issues. The first is to nudge passive investors to exercise their participation rights in investee companies. Several jurisdictions have introduced stewardship codes by which institutional investors are encouraged to take a more active approach towards participation in and engagement with companies.[143] The UK was the first country to adopt a stewardship code in 2010, a concept that has since spread to several countries around the world.[144] These codes largely operate as "soft law" and set out the principles by which institutional investors can engage with companies. Not only do the stewardship responsibilities require investors to participate more actively, but they compel investors to be transparent about

[141] Anabtawi & Stout, *supra* note 4, at 1296-1297; Hong, *supra* note 5, at 211.
[142] Matheson & Nicolet *supra* note 21, at 1689-1690.
[143] Bebchuk & Hirst, "Index Funds and the Future of Corporate Governance", *supra* note 23, at 12.
[144] Hill, *supra* note 26, at 506-507.

their voting policies and practices in companies. This places a greater burden on them to be active.

While stewardship appears at the outset to be an attractive idea, there are problems with implementation. For instance, in the UK, studies found that a large body of foreign investors was not even within the purview of the code.[145] Others have questioned its general nature and the lack of bite.[146] From a comparative perspective, although several other jurisdictions are adopting stewardship codes, it remains unclear whether they are likely to be effective given differing shareholder structures, legal systems, institutional and other considerations. Another model could be the more robust approach taken in the EU Shareholder Rights Directive II in 2017.[147] Scholars have observed that this "introduces a duty to *demonstrate* engagement on the part of institutional investors and asset managers, and is, therefore, a tentative step towards hardening of stewardship/engagement duties".[148]

Others have made more far-reaching recommendations such as the need to disenfranchise passive investors for fear that this would be a more optimal outcome compared to allowing them to vote along with management due to the lack of appropriate incentives or due to conflicts of interests. Either the proposal to restrict voting may be complete[149] or only in respect of certain matters of shareholder voting.[150] Finally, one may have to address the conflicts of interests of passive investors in a somewhat similar method as discussed in the case of activist investors. The difference in relation to passive investors is that they do not exercise influence directly (except through their voting), and hence their actions may have to be subject to lighter constraints in comparison with activist investors.

VI. CONCLUSION

One of the important goals of corporate law and governance norms is to protect the interest of minority shareholders. While the concept of corporate democracy has evolved over time, so has the nature, identity and interests of minority shareholders. They are no longer retail investors, but institutional investors who have taken on significant shareholding positions in companies around the world. These include mutual funds, pension funds and hedge funds. While some of them are activist in nature, others are passive, although these characteristics could vary by degree.

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[145] Brian R. Cheffins, *The Stewardship Code's Achilles' Heel*, 73 MODERN LAW REVIEW 1004 (2010).

[146] Arad Reisberg, *The UK Stewardship Code: On the Road to Nowhere?*, 15 JOURNAL OF CORPORATE LAW STUDIES 217 (2015).

[147] Directive EU/2017/828 (also referred to as "SRD II").

[148] Iris Chiu & Dionysia Katelouzou, *From Shareholder Stewardship to Shareholder Duties: Is the Time Ripe?* in HANNE S BIRKMOSE, SHAREHOLDERS' DUTIES 145 (2017). In particular, *see* SRD II, *supra* note 147, arts. 3g (engagement policy) and 3h (investment strategy of institutional investors and arrangements with asset managers).

[149] Lund, *supra* note 15.

[150] Griffith, *supra* note 15.

Legal systems around the world enable minority shareholders to enhance their participation in companies. Activist investors like hedge funds have utilized these developments to challenge managements in not only companies and countries with dispersed shareholding, but also in those with concentrated shareholding. While their actions could be beneficial in enhancing corporate performance by creating a market for corporate influence, activist investors have the potential to derive private benefits not shared with other shareholders. They may also suffer from conflicts of interests. Hence, there is an increasing call to subject activist shareholders to legal constraints such as the imposition of fiduciary duties, similar to that for controlling shareholders. When it comes to passive investors, the solutions vary from imposing on them a stewardship role to disenfranchising them. The question of minority shareholder rights and duties continue to evolve along with the nature of investors and market practice.

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Appendix 1
Rights and Duties of Institutional Investors

Attitude of investors	Activism	Passivity
Types of investors	• Hedge funds • Private equity funds	• Index funds • Some mutual funds
Exercise of rights	• Voting • Engagement • Exit • Litigation	None or minimal
Possible risk	• Conflicts of interest • Private benefits	• Lack of monitoring • Conflicts of interest
Possible tools for mitigation of risk	Fiduciary duties to act in the interests of company and other shareholders	• Stewardship • Disclosure of voting • Disenfranchisement • Alteration of incentives