

# The GovNet eJournal

## Evolving 'Rules of the Game' in Corporate Governance Reform

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*GovNet eJournal*, Vol. 1, No. 2. (Dec 2007). Pp. 112-139.

URL:

<http://www.griffith.edu.au/epress/govnet>

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The GovNet eJournal is the online journal for the Australian Research Council Governance Research Network.

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# EVOLVING 'RULES OF THE GAME' IN CORPORATE GOVERNANCE

## REFORM

JENNIFER HILL

### INTRODUCTION

Parallels between Jean Renoir's classic film, *La Règle du Jeu* ('The Rules of the Game') and contemporary corporate governance might not be readily discernible. Renoir's film, a box office flop at the time of its release in 1939, was notable for displaying a set of strictly ordered social rules and mores of the French haute bourgeoisie, which the audience witnesses dissolve as the film progresses. Renoir himself said that his aim in making the film was to show 'a rich, complex society where ... we are dancing on a volcano'.<sup>1</sup>

Contemporary corporate governance has had its own seismic shift in the form of the international corporate collapses, epitomised by Enron and WorldCom in the US, and HIH and One.Tel in Australia. In the pre-scandal era at the beginning of this decade, the convergence–divergence debate in comparative corporate governance was at its height, with some scholars claiming that orderly convergence of corporate governance regimes was both inevitable and imminent.<sup>2</sup> A background assumption to this argument was that a cohesive Anglo-American governance model already existed and would form the point of convergence. Even scholars on the opposite side of this debate<sup>3</sup> at times seemed to share the assumption of a unified common law governance

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<sup>1</sup> From Jean Renoir's 1961 interview with the Office de Radiodiffusion Télévision Française (ORTF), cited in Alexander Sesonske, *Jean Renoir: The French Films, 1924–1939* (1980) 382.

<sup>2</sup> Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 469.

<sup>3</sup> Mark J Roe, 'Path Dependence, Political Options and Governance Systems' in Klaus Hopt and Eddy Wymeersch (eds), *Comparative Corporate Governance: Essays and Materials* (1997) 165, 165.

model,<sup>4</sup> while disputing the view that civil law jurisdictions would inevitably adopt these rules.

The international corporate collapses complicated this debate. Common law jurisdictions, such as the US, UK, Australia and Canada introduced a variety of regulatory responses to the corporate scandals.<sup>5</sup> Similar motivations underpinned these reforms, potentially providing evidence of the convergence hypothesis at work. Nonetheless, there are several factors which challenge such a straight-forward regulatory picture. In spite of the existence of common themes in the international post-scandal reforms, significant differences emerged in terms of focus, structure and regulatory detail.

Some of the common law post-Enron reforms are interesting from the perspective of what they did *not*, rather than what they did, address. Thus, for example, there is an interesting dichotomy between strengthening of shareholder participatory rights versus protection of shareholder interests evident in the reforms. Strengthening of shareholder participatory rights was a significant theme in the Australian and the UK reforms, but not in the US reforms. The shape of these reforms has also affected subsequent corporate law debates in the US, UK and Australia that address quite different policy concerns.

Scholars have noted that, even where similar motivations underpin various reforms, it is unlikely that their long-term effects will coincide.<sup>6</sup> Another aspect of this long-term regulatory unpredictability is the impact of backlash, recently

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<sup>4</sup> Jeffrey N Gordon and Mark J Roe (eds), *Convergence and the Persistence in Corporate Governance* (2004) pose the question: 'Is the Anglo-American model of shareholder capitalism destined to become standard or will sharp differences persist?'

<sup>5</sup> Jennifer G Hill, 'Regulatory Responses to Global Corporate Scandals' (2005) 23 *Wisconsin International Law Journal* 367.

<sup>6</sup> Donald C Langevoort, 'The Social Construction of *Sarbanes-Oxley*' (2006) *Michigan Law Review* (forthcoming), available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=930642](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=930642)>.

exemplified by the Report of the Committee on Capital Markets Regulation ('Paulson Committee Report').<sup>7</sup>

One criticism of convergence theory is that it engaged in over-generalisation, which could obscure significant differences within the common law world.<sup>8</sup> The post-scandal developments discussed in this chapter support the view that interesting differences in regulatory approach exist within the common law world itself, and challenge any assumption of an orderly, seamless progression towards a uniform model of good corporate governance. As in Renoir's famous film, the regulatory picture they present is a more complex, dynamic and unpredictable one.

## I BACKGROUND ISSUES IN COMPARATIVE CORPORATE GOVERNANCE

Although in the early 1990s, a central issue in comparative corporate governance was whether the US should adopt governance mechanisms from other jurisdictions, such as Germany and Japan,<sup>9</sup> the comparative corporate governance debate did a u-turn later in the decade. With interest in globalisation then at its peak, the new focus of debate became the export of US style corporate governance principles internationally.<sup>10</sup>

Comparative corporate governance literature posits a divide between jurisdictions with dispersed ownership structures, such as the US, and those with concentrated ownership structures, traditionally found in continental Europe and

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<sup>7</sup> Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Market Regulation* (2006).

<sup>8</sup> Steven Toms and Mike Wright, 'Divergence and Convergence within Anglo-American Corporate Governance Systems: Evidence from the US and UK, 1950–2000' (2005) 47 *Business History* 267, 267.

<sup>9</sup> Cf Roe (1993); Roberta Romano (1993).

<sup>10</sup> Arthur R Pinto, 'Globalization and the Study of Comparative Corporate Governance' (2005) 23 *Wisconsin International Law Journal* 477; Jennifer G Hill, 'The Persistent Debate about Convergence in Comparative Corporate Governance' (2005) 27 *Sydney Law Review* 743.

Asia.<sup>11</sup> This formed the backdrop to the convergence–divergence debate, in which the scholarship of La Porta, Lopez-de-Silanes, Shleifer and Vishny proved so influential.<sup>12</sup> La Porta et al argued that jurisdictions with a high level of minority shareholder protection would develop dispersed ownership structures, such as those existing in the US and UK. According to the study, law, and indeed legal origins, matter. The normative subtext was that common law legal protections were superior to those found in civil law legal systems.<sup>13</sup> This message provided strong support for a convergence theory of corporate governance, via a quasi-evolutionary progression towards the superior legal rules, presumed to exist in the common law world.<sup>14</sup>

Not all commentators were convinced of La Porta et al’s hypothesis. Comparative law scholarship contains a long tradition of scepticism about the feasibility of transplanting elements of one legal system to another.<sup>15</sup> Within this general theoretical tradition, contemporary scholars such as Mark Roe have identified historical, political and social ‘path dependence’ factors, which may create, or perpetuate, differences in legal regimes.<sup>16</sup>

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<sup>11</sup> William W Bratton and Joseph A McCahery, ‘Comparative Corporate Governance and the Theory of the Firm: The Case against Global Cross Reference’ (1999) 38 *Columbia Journal of Transnational Law* 213; Brian R Cheffins, ‘Does Law Matter? The Separation of Ownership and Control in the United Kingdom’ (2001) 30 *Journal of Legal Studies* 459; John C Coffee, ‘The Future as History: The Prospects for Global Convergence of Corporate Governance and Its Implications’ (1999) 93 *Northwestern University Law Review* 641, 707; Gustavo Visentini, ‘Compatibility and Competition between European and American Corporate Governance: Which Model of Capitalism?’ (1998) 23 *Brooklyn Journal of International Law* 833.

<sup>12</sup> Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, ‘Corporate Ownership around the World’ (1999) 54 *Journal of Finance* 471; Rafael La Porta et al, ‘Law and Finance’ (1998) 106 *Journal of Political Economy* 1113.

<sup>13</sup> David A Skeel, ‘Corporate Anatomy Lessons’ (2004) 113 *Yale Law Journal* 1519, 1544–5.

<sup>14</sup> Cally Jordan, ‘The Conundrum of Corporate Governance’ (2005) 30 *Brooklyn Journal of International Law* 983, 985–90.

<sup>15</sup> O Kahn-Freund, ‘On Uses and Misuses of Comparative Law’ (1974) 37 *Modern Law Review* 1; Amir N Licht, ‘Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform’ (2004) 22 *Berkeley Journal of International Law* 195; Troy A Paredes, ‘A Systems Approach to Corporate Governance Reform: Why Importing US Corporate Law Isn’t the Answer’ (2004) 45 *William and Mary Law Review* 1055; Gunter Teubner, ‘Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences’ (1998) 61 *Modern Law Review* 11.

<sup>16</sup> Roe, ‘Path Dependence, Political Options and Governance Systems’, above n 3.

The convergence and ‘law matters’ hypotheses have been challenged from a range of perspectives. Some commentators, while accepting the strong homogenising influences of globalisation, challenged the view that convergence would be a continuous and steady process.<sup>17</sup> Indeed, it has been argued that the very concept of ‘convergence’ is ambiguous, in that it is sometimes unclear whether it relates to form or substance.<sup>18</sup> Other commentators disputed the presumed link between transplantation and efficiency gains, warning that transplantation may disrupt the internal balance and consistency of a regulatory system, creating a newly minted, but now dysfunctional, governance system.<sup>19</sup> Also, the intended consequences of regulation are often subverted by the underlying social environment.<sup>20</sup>

Finally, the methodology and background assumptions in the ‘law matters’ study have been criticised. One strand of criticism focuses on the broad generalisations underlying the ‘law matters’ hypothesis, some scholars arguing that the presumed differences between civil law and common law systems adopted by many convergence theorists are too sharply defined and often inaccurate.<sup>21</sup> On the other hand, regulatory differences that sometimes exist between common law countries are simply obscured or ignored.<sup>22</sup> Takeover law, where fundamental

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<sup>17</sup> Curtis J Milhaupt, ‘Property Rights in Firms’, in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (2004) 210, 213.

<sup>18</sup> Ronald J Gilson, ‘Globalizing Corporate Governance: Convergence of Form or Function’ in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (2004) 128, 158.

<sup>19</sup> Bratton and McCahery, above n 11, 219; Reinhard H Schmidt and Gerald Spindler, ‘Path Dependence and Complementarity in Corporate Governance’ in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (2004) 114, 119, 122.

<sup>20</sup> Langevoort, above n 6; Christine Parker et al, ‘Introduction’ in Christine Parker et al (eds), *Regulating Law* (2004) 1, 7.

<sup>21</sup> Jordan, ‘The Conundrum of Corporate Governance’, above n 14, 1005; Katharina Pistor et al, ‘The Evolution of Corporate Law: A Cross-Country Comparison’ (2002) 23 *University of Pennsylvania Journal of International Economic Law* 791, 799; Skeel, above n 13, 1546.

<sup>22</sup> Ruth V Aguilera et al, ‘Corporate Governance and Social Responsibility: A Comparative Analysis of the UK and the US’ (2006) 14 *Corporate Governance: An International Review* 147, 147–8; Paul Davies and Klaus Hopt, ‘Control Transactions’ in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2004) 157, 172; Toms and Wright, above n 8.

differences exist between, for example, US, UK and Australian law, is a good example of this problem.<sup>23</sup> It has also been argued that the primary focus in La Porta et al's study on 'law on the books'<sup>24</sup> was misguided, since it ignored or concealed important dynamic features of legal systems, such as the operation of social norms<sup>25</sup> and enforcement intensity.<sup>26</sup>

Alternative, and arguably more nuanced, approaches to regulatory difference than the convergence and 'law matters' hypotheses have emerged in recent times. Thus, for example, Kraakman et al's 2004 book, *The Anatomy of Corporate Law*, identifies a wide range of regulatory and governance strategies used to control opportunism and conflicts of interest between corporate participants.<sup>27</sup> In contrast to the approach of La Porta et al, the methodology adopted in *The Anatomy of Corporate Law* focuses on 'substantive results rather than on mere legal origin',<sup>28</sup> avoiding the normative subtext of the convergence debate. The vision of comparative corporate governance adopted in this book is, therefore, one in which different jurisdictions address common corporate governance problems with the aid of a diverse range of regulatory tools. It is a picture that allows us to see regulatory paradigm shifts both within, and between, common law and civil law jurisdictions.

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<sup>23</sup> John Armour and David A Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) *Georgetown Law Journal* (forthcoming); Davies and Hopt, 'Control Transactions', above n 22, 172.

<sup>24</sup> Katharina Pistor and Chenggang Xu, 'Incomplete Law' (2003) 35 *New York University Journal of International Law and Policy* 931; Skeel, above n 13, 1543.

<sup>25</sup> John C Coffee, 'Do Norms Matter? A Cross-Country Evaluation' (2001) 149 *University of Pennsylvania Law Review* 2151.

<sup>26</sup> Gerard Hertig, 'Convergence of Substantive Law and Convergence of Enforcement: A Comparison' in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (2004) 328, 328; John C Coffee, 'Law and the Market: The Impact of Enforcement' (Working Paper No 304, Centre for Law and Economic Studies, Columbia University School of Law, 2007).

<sup>27</sup> Skeel, above n 13.

<sup>28</sup> Paul Davis, Gerard Hertig and Klaus Hopt, 'Beyond the Anatomy' in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2004) 215, 221.

## II THE POST-SCANDAL REGULATORY RESPONSES: LAWS, PRINCIPLES AND POLITICS

The international corporate scandals elicited a range of regulatory responses in common law jurisdictions, such as the US, UK, Australia and Canada. These included legislative reforms<sup>29</sup> and governance changes by self-regulatory organisations.<sup>30</sup>

At one level, the corporate law reforms addressed similar governance concerns, particularly with respect to gatekeeper conflicts of interest,<sup>31</sup> and potentially provided more evidence of the convergence hypothesis at work.<sup>32</sup> Although similar concerns and motivations prompted the reforms, there are several matters that challenge such an ordered regulatory picture and highlight significant differences between the various regulatory responses.

First, in spite of globalising influences, many of the reforms responded specifically to local issues. In the US, *Sarbanes-Oxley* closely tracked the contours of Enron.<sup>33</sup> Local issues were also prominent in UK reforms<sup>34</sup> and, in Australia, aspects

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<sup>29</sup> These legislative reforms include the *Sarbanes-Oxley Act of 2002*, Pub L No 107–204, 116 Stat 745 (2002) ('*Sarbanes-Oxley*'); the *Combined Code on Corporate Governance (2003)* (UK) ('*Combined Code*') (an updated version of the *Combined Code*, with limited amendments, was released in June 2006 and is available at <<http://www.frc.org.uk/corporate/combinedcode.cfm>>); the *Companies Act 2006* (UK); the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) ('*CLERP 9 Act*').

<sup>30</sup> Eg, New York Stock Exchange, Inc, *Listed Company Manual* (2003) § 303A (corporate governance rules approved by the Securities and Exchange Commission ('SEC') on 4 November 2003); ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations* (2003), available at <<http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=ASX>>.

<sup>31</sup> John C Coffee, (2002); John C Coffee, (2004); Jeffrey N Gordon, 'What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections' (2002) 69 *University of Chicago Law Review* 1233.

<sup>32</sup> Paul Von Nesson, 'Corporate Governance in Australia: Converging with International Developments' (2003) 15 *Australian Journal of Corporate Law* 1.

<sup>33</sup> Larry E Ribstein, 'Market vs Regulatory Responses to Corporate Fraud: A Critique of the *Sarbanes-Oxley Act of 2002*' (2002) 28 *Journal of Corporation Law* 1, 4–18.

<sup>34</sup> Eilis Ferran, 'Company Law Reform in the UK: A Progress Report' (Working Paper No 27/2005, European Corporate Governance Institute, Cambridge, 2005) 25.

of the *CLERP 9 Act 2004* were directly linked to the failure of HIH Insurance, which was the largest collapse in Australian corporate history.<sup>35</sup>

Convergence sceptics have highlighted the importance of politics, and the fact that ‘corporate law rules are the products of collective action’, in support of the proposition that convergence is highly unlikely.<sup>36</sup> Localised political pressures are revealed in several aspects of the post-scandal reforms, including their timing and evolution. The most immediate legislative response to the corporate scandals occurred in the US, where a full-scale regulatory overhaul was achieved in 2002.<sup>37</sup> The speed with which the reforms were introduced became a focal point in academic discussion. It has been argued that the real impetus for reforms emanated not from Enron, but from the US political climate that developed after the WorldCom scandal, when investor protection became a major issue in looming elections.<sup>38</sup> Unusual bipartisan cooperation enabled the swift passage of reforms that effectively reshaped the allocation of regulatory power between the states and federal law in the US.<sup>39</sup> Critics of the *Sarbanes-Oxley* have linked the perceived defects of the legislation to its hasty passage, describing it as ‘emergency legislation’,<sup>40</sup> which was enacted in an overheated political environment without the benefit of careful deliberation and policy assessment.<sup>41</sup> Others, while acknowledging that the Act came into existence

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<sup>35</sup> Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance* (2003) vol 1 (‘HIH Royal Commission’).

<sup>36</sup> David Charny, ‘The Politics of Corporate Convergence’ in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (2004) 293, 296.

<sup>37</sup> Via the *Sarbanes-Oxley* and the NYSE Corporate Governance Rules and NASDAQ listing requirements.

<sup>38</sup> Langevoort, above n 6, 6.

<sup>39</sup> William B Chandler and Leo E Strine, ‘The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State’ (2003) 152 *University of Pennsylvania Law Review* 953, 973; Robert B Thompson, ‘Corporate Governance after Enron’ (2003) 40 *Houston Law Review* 99, 100.

<sup>40</sup> Roberta Romano, ‘The *Sarbanes-Oxley Act* and the Making of Quack Corporate Governance’ (2005) 114 *Yale Law Journal* 1521, 1528.

<sup>41</sup> *Ibid* 1549ff, 1602.

quickly as a result of political expediency, argue that it delivered real benefits and improvements in the corporate governance process.<sup>42</sup>

Reforms in other common law jurisdictions were enacted at a slower pace and with broad consultation. Australia's parallel legislative response, the *CLERP 9 Act*, which commenced operation in mid-2004, was the subject of extensive public debate. Furthermore, it integrated the recommendations of the HIH Royal Commission, which itself lasted for 18 months.<sup>43</sup> In the UK, reform processes were already underway several years prior to the corporate scandals and advanced by degrees,<sup>44</sup> only recently culminating in the passage of the massive *Companies Act 2006* (UK).<sup>45</sup>

There are also philosophical differences between the US reforms and those introduced in the UK and Australia, in terms of reliance on rules and principles, or standards, as regulatory techniques. Scholars have long debated the respective merits of rules and principles as regulatory mechanisms.<sup>46</sup> Rules are generally perceived to promote certainty — they have clear, determinate boundaries defining *ex ante* whether conduct is or is not permissible, and allow for little discretion in the decision-maker.<sup>47</sup> Principles (or standards), on the other hand, are often viewed as promoting substantive equality and fairness, as opposed to formal equality under rules. Their very lack of precision requires the *ex post* exercise of discretion based on a variety of

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<sup>42</sup> J Robert Brown, 'Criticizing the Critics: *Sarbanes-Oxley* and Quack Corporate Governance' (2006) 90 *Marquette Law Review* 309.

<sup>43</sup> HIH Royal Commission, above n 35.

<sup>44</sup> Ferran, above n 34.

<sup>45</sup> The *Companies Act 2006* (UK) received Royal Assent on 8 November 2006. All parts of the Act will be operational by October 2008 (UK Department of Trade and Industry, 'Bill to Save Business Millions Receives Royal Assent' (Press Release, 8 November 2006).

<sup>46</sup> Carol M Rose, 'Crystals and Mud in Property Law' (1988) 40 *Stanford Law Review* 577; Cass R Sunstein, 'Problems with Rules' (1995) 83 *California Law Review* 953; Duncan Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685.

<sup>47</sup> Christie Ford, 'New Governance, Compliance and Principles-Based Securities Regulation' (2007) *American Business Law Journal* 1, 8–9 (forthcoming), available at <<http://ssrn.com/abstract=970130>>; Kathleen M Sullivan, 'The Supreme Court 1991 Term — Foreword: The Justices of Rules and Standards' (1992) 106 *Harvard Law Review* 22.

specific factual and contextual matters, and embedded social values.<sup>48</sup> Classic criticism of rules relates to their perceived inflexibility and the increased scope for evasion of, or ‘creative compliance’ with, rules that have precise and determinate contours.<sup>49</sup> Rules are also often reactive and thereby subject to over- or under-inclusion, while standards avoid this problem by conferring greater discretion on the decision-maker.<sup>50</sup> It has been argued that there is a decline in the ability of rules to provide certainty, commensurate with an increase in the complexity of the matter regulated.<sup>51</sup> In many situations, however, the line between rules and principles may be somewhat blurred, with regulation comprising hybrids of the two.

The dynamics and interplay between rules and principles have become more complex due to greater fragmentation and internalisation of contemporary corporate governance practices.<sup>52</sup> Principles and norms, embodied in self-regulatory codes of corporate governance,<sup>53</sup> have become an increasingly important regulatory tool. As in the case of legal rules, enforcement of self-regulatory codes is obviously an important issue, and one that will vary depending on the relevant legal and social culture.<sup>54</sup>

The international scandals resulted in a hardening of norms in both Australia and the UK. There has also been a global trend for stock exchanges to be more involved in corporate governance regulation. Although the Australian Securities Exchange (‘ASX’) had been tangentially involved in corporate governance regulation since 1996, that involvement intensified after the corporate collapses. In 2003,

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<sup>48</sup> Kennedy, above n 46.

<sup>49</sup> Doreen McBarnet and Christopher Whelan, ‘The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control’ (1991) 54 *Modern Law Review* 848, 849.

<sup>50</sup> Ford, above n 47, 8, footnote 26; Sullivan, above n 47, 58–9.

<sup>51</sup> John B Braithwaite, ‘Rules and Principles: A Theory of Legal Certainty’ (2002) 27 *Journal of Legal Philosophy* 47.

<sup>52</sup> Parker, (2006).

<sup>53</sup> For a comprehensive guide to international corporate governance codes, see the European Corporate Governance Institute website <[http://www.ecgi.org/codes/all\\_codes.php](http://www.ecgi.org/codes/all_codes.php)>.

<sup>54</sup> Eddy Wymeersch, ‘Implementation of the Corporate Governance Codes’ in Klaus Hopt et al (eds), *Corporate Governance in Context: Corporations, States and Markets in Europe, Japan, and the US* (2005) 403, 408.

following public pressure and criticism about its credibility as a regulatory body, the ASX introduced its *Principles of Good Corporate Governance and Best Practice Recommendations* ('ASX corporate governance principles'),<sup>55</sup> which adopted a UK-style 'comply or explain'<sup>56</sup> regulatory model that was more stringent than the previous disclosure requirement in Australia.<sup>57</sup>

Corporate governance norms were also enhanced in the United Kingdom as a result of the *Review of the Role and Effectiveness of Non-Executive Directors*.<sup>58</sup> The Higgs Report recommended strengthening the independence of the board from management within the pre-existing 'comply or explain' regulatory framework, and these recommendations were subsequently incorporated into the UK *Combined Code*.

Traditionally, the development of self-regulatory codes has tended to be either a response to the lack of specific governmental regulation in particular areas, or, in some cases, a justification for the absence of such regulation. A number of the post-scandal reforms in Australia and the UK fall into the latter category. They also reflect a strong preference for the flexibility offered via regulation by principles rather than mandatory legal rules, and recognition that inadequate enforcement of good governance practices could result in the imposition of onerous government regulation.<sup>59</sup>

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<sup>55</sup> ASX Corporate Governance Council, *Principles of Good Corporate Governance* (2003), above n 30.

<sup>56</sup> The preferred terminology under the Australian model, however, appears to be an 'if not, why not' model: ASX Corporate Governance Council, *Response to the Implementation Review Group Report* (2004).

<sup>57</sup> Joanna Bird and Jennifer Hill, 'Regulatory Rooms in Australian Corporate Law' (1999) 25 *Brooklyn Journal of International Law* 555, 598–600. Previously, it had only been necessary for a company to disclose in the annual report its main corporate governance practices, if any.

<sup>58</sup> Derek Higgs, Report to the UK Department of Trade and Industry, *Review of the Role and Effectiveness of Non-Executive Directors* (2003).

<sup>59</sup> Richard Humphry, 'If Not, Why Not?' (Speech delivered to the Australian Institute of Company Directors Forum, Sydney, 2 April 2003) 3.

In contrast to the reforms in Australia and the UK, the US reforms appear to reflect the process of ‘juridification’,<sup>60</sup> in their conspicuous shift towards a rules-based approach to corporate governance with a higher level of mandatory governance standards. The final NYSE corporate governance rules, for example, introduced a range of mandatory requirements concerning board structure to reflect generally accepted best practice in corporate governance,<sup>61</sup> the substance of which is often stricter than its counterparts in other jurisdictions, such as Australia.<sup>62</sup> The *Sarbanes-Oxley* also imposed many new prescriptive rules, thereby affecting the balance of regulatory power between the states and federal law. However, not all of the reforms under the *Sarbanes-Oxley* are of this ilk. Sections 406 and 407 respectively direct the SEC to issue rules requiring a company to disclose whether it has adopted a code of ethics for senior financial officers (and if not, why not), and whether at least one member of the audit committee is a financial expert (and if not, why not). While these provisions are framed as disclosure provisions only, they have been described as ‘disguised substance’, the likely contextual effect of which will be to mandate compliance.<sup>63</sup>

The *Sarbanes-Oxley* has been depicted as creating a ‘shadow corporation law’,<sup>64</sup> and criticised for deviating from the traditional US model of corporate law, under which state-based law is viewed as facilitative and competitive.<sup>65</sup> The *Sarbanes-Oxley* also laid greater emphasis on criminal liability in corporate governance<sup>66</sup> than reforms in Australia and the UK. Nonetheless, some commentators

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<sup>60</sup> Wymeersch, ‘Implementation of the Corporate Governance Codes’, above n 54, 418.

<sup>61</sup> NYSE, above n 30, § 303A.

<sup>62</sup> Hill, ‘Regulatory Responses to Global Corporate Scandals’, above n 5, 383.

<sup>63</sup> Thompson, above n 39, 104.

<sup>64</sup> Chandler and Strine, above n 39, 973.

<sup>65</sup> Romano, above n 40, 1523, 1528–9.

<sup>66</sup> See, eg, the *Sarbanes-Oxley Act*, Title VIII (‘Corporate and Criminal Fraud Accountability’); Title IX (‘White Collar Crime Penalty Enhancements’); Title XI (‘Corporate Fraud and Accountability’).

have viewed the Act's criminal provisions as adding little to pre-existing US law, and unlikely to be an effective form of deterrence.<sup>67</sup>

While some countries in continental Europe, such as France and Germany, adopted reforms based on the *Sarbanes-Oxley*,<sup>68</sup> there was an explicit rejection in Australia and the UK of the rules-based regulatory approach to corporate governance that underpinned the Act. At the time the ASX corporate governance principles were introduced in Australia, for example, the then Managing Director and CEO of the Australian Stock Exchange stated that '[t]hrough a disclosure based approach, the ASX is keen to avoid a US style *Sarbanes-Oxley Act* legislative solution'.<sup>69</sup> The Chair of the Higgs Committee, Derek Higgs, was similarly direct in his preference for regulation by principles over rules, commenting that the 'brittleness and rigidity of legislation cannot dictate the behaviour, or foster the trust, I believe is fundamental to the effective unitary board and to superior corporate performance'.<sup>70</sup> The Chief Executive of the London Stock Exchange has recently confirmed this regulatory preference.<sup>71</sup>

The Canadian post-scandal approach to corporate governance and securities regulation, led by British Columbia, also appears to favour a principles-based approach, focusing on voluntary compliance over regulatory enforcement.<sup>72</sup> Canada's

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<sup>67</sup> Michael A Perino, 'Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the *Sarbanes-Oxley Act of 2002*' (2002) 76 *St John's Law Review* 671.

<sup>68</sup> Luca Enriques, 'Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms' (2003) 38 *Wake Forest Law Review* 911, 918ff.

<sup>69</sup> Humphry, above n 59, 3.

<sup>70</sup> Higgs, above n 58, 3.

<sup>71</sup> Clara Furse, 'Comment: SOX Is Not to Blame — London Is Just Better as a Market', *Financial Times* (London), 17 September 2006, 19.

<sup>72</sup> Ford, above n 47; Erinn B Broshko and Kai Li, 'Corporate Governance Requirements in Canada and the United States: A Legal and Empirical Comparison of the Principles-Based and the Rules-Based Approaches' (Working Paper, Sauder School of Business, University of British Columbia, 2006), available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=892708](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=892708)>.

publicly listed corporate sector, like that of Australia,<sup>73</sup> contains a high level of controlling blockholder ownership structures and many ‘small-cap’ firms, and it has been suggested that principles-based regulation may be better suited to this kind of market profile.<sup>74</sup>

The presumed dichotomy between rules and principles, and between rigidity and flexibility, is relevant to the issue of regulatory amendment. Romano, in her critique of the *Sarbanes-Oxley Act*, notes that ‘legislation drafted in a perceived state of emergency can be difficult to undo’.<sup>75</sup> By contrast, the norms embodied in the ASX corporate governance principles appear to be extremely fluid. The principles have been the subject of almost continual assessment and consultation since their introduction in 2003, including two reports by the Implementation Review Group (‘IRG’).<sup>76</sup> Following a twelve month review, in November 2006 the ASX Corporate Governance Council released an Explanatory Paper and Consultation Paper on proposed changes to the principles.<sup>77</sup> A consistent message in these reviews has been the inherent flexibility and non-prescriptive nature of the ASX corporate governance principles. The reviews have stressed the fact that ‘the only *compliance* required is disclosure’<sup>78</sup> and that corporations are free to depart from the principles, provided they explain why.<sup>79</sup> Reflecting this underlying philosophy, the reviews have also recommended removal of the term ‘best practice’ from the title of the ASX corporate governance principles, on the basis that it might imply that other practices are

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<sup>73</sup> Asjeet S Lamba and Geoffrey Stapledon, ‘The Determinants of Corporate Ownership Structure: Australian Evidence’ (Public Law Research Paper No 20, University of Melbourne, 2001), available at <<http://ssrn.com/abstract=279015>>.

<sup>74</sup> Ford, above n 47.

<sup>75</sup> Romano, above n 40, 1602.

<sup>76</sup> ASX Corporate Governance Council IRG, *Principles of Good Corporate Governance and Best Practice Recommendations: Report to the ASX Corporate Governance Council* (2004); ASX Corporate Governance Council IRG, *Second Report to the ASX Corporate Governance Council* (2005).

<sup>77</sup> ASX Corporate Governance Council, *Explanatory Paper and Consultation Paper* (2006).

<sup>78</sup> ASX Corporate Governance Council IRG, *Principles of Good Corporate Governance* (2004), above n 76, 1.

<sup>79</sup> ASX Corporate Governance Council, *Explanatory Paper*, above n 77, 6.

inferior.<sup>80</sup> This is a theme which also resonates in the Canadian securities regulation context.<sup>81</sup>

In its Explanatory and Consultation Paper, the ASX emphasises the evolving nature of the corporate governance debate, and the interrelation of the principles with other parts of the corporate governance ecosystem.<sup>82</sup> Several proposed changes to the ASX corporate governance principles are due to the need to update them in light of recent progress in related areas, such as risk management and corporate responsibility and sustainability. For example, the ASX Corporate Governance Council notes that recent developments have emphasised the broad scope of the term ‘risk’ and explicitly incorporates this expansive interpretation into the concept of ‘material business risks’ in its revised draft of the principles.<sup>83</sup> This new emphasis on risk represents a further point of linkage between developments in corporate governance and regulation theory more broadly, given that risk management has taken an increasingly central role in the regulation debate.<sup>84</sup>

In the wake of the growing popularity of principles-based regulation, some commentators have become wary of the rhetoric associated with it, and of the corresponding denigration of rules-based regulation.<sup>85</sup> Cunningham, for example, rejects the standard dichotomy between rules and principles-based regulation, arguing that most complex regulatory systems cannot be meaningfully characterised as falling

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<sup>80</sup> ASX Corporate Governance Council IRG, *Principles of Good Corporate Governance* (2004), above n 76, 1; ASX Corporate Governance Council, *Explanatory Paper*, above n 77, 9.

<sup>81</sup> Ford, above n 47, 38–9.

<sup>82</sup> ASX Corporate Governance Council, *Explanatory Paper*, above n 77, 5.

<sup>83</sup> *Ibid* 17ff.

<sup>84</sup> Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1, 9–10; Julia Black, ‘The Emergence of Risk Based Regulation and the New Public Management in the UK’ (2005) *Public Law* 512.

<sup>85</sup> Lawrence A Cunningham, ‘A Prescription to Retire the Rhetoric of “Principles-Based Systems” in Corporate Law, Securities Regulation and Accounting’ (2007) *Vanderbilt Law Review* (forthcoming), available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=970646](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=970646)>; David Kershaw, ‘Evading Enron: Taking Principles Too Seriously in Accounting Regulation’ (2005) 68 *Modern Law Review* 594.

within one or the other category.<sup>86</sup> He suggests that the rhetoric surrounding principles-based regulation may have flourished primarily as a form of product-differentiation.<sup>87</sup> A prime example of this is the post-*Sarbanes-Oxley-Act* power struggle between US state and federal corporate law. Given that the *Sarbanes-Oxley Act* has been widely criticised as overly-prescriptive, Delaware judges and lawyers have sought to assert the supremacy of Delaware law by emphasising its flexible, principles-based nature.<sup>88</sup> Claims that the UK avoided any Enron-style financial fiascos due to its principles-based accounting system have also attracted criticism.<sup>89</sup>

### III SHAREHOLDER INTERESTS *VERSUS* PARTICIPATORY RIGHTS — WHAT THE POST-SCANDAL REFORMS DID AND DID NOT ADDRESS

Enhancing managerial accountability for the benefit of shareholders was a common goal in various reforms adopted following the international corporate scandals. On one interpretation, gatekeepers, such as auditors, and boards of directors, bore much responsibility for the scandals,<sup>90</sup> with shareholders seen as innocent victims.<sup>91</sup> Although not all commentators accept this benign view of shareholder involvement in the scandals,<sup>92</sup> it is an image that underlies many of the post-scandal reforms in common law countries. However, the reforms differ in the manner in which they seek to achieve the goal of enhanced managerial accountability vis-à-vis

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<sup>86</sup> Cunningham, above n 85, 13–20.

<sup>87</sup> Ibid 54–62.

<sup>88</sup> Ibid 55–7.

<sup>89</sup> Kershaw, above n 85.

<sup>90</sup> Coffee 2002?; Coffee 2004?; Gordon, above n 31.

<sup>91</sup> John C Coffee, 'A Theory of Corporate Scandals: Why the US and Europe Differ' (Working Paper No 274, Centre for Law and Economic Studies, Columbia University School of Law, 2005) 2, 15. Although cf his statements at 9–10, where he identifies the preference of institutional investors for equity-based executive compensation as indirectly influencing the US corporate scandals.

<sup>92</sup> Roberta S Karmel, 'Should a Duty to the Corporation be Imposed on Institutional Shareholders?' (2004) 60 *Business Lawyer* 1, 4; Leo E Strine, 'Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America' (2006) 119 *Harvard Law Review* 1759, 1764, 1772–3.

shareholders. Specifically, there is an intriguing dichotomy between strengthening of shareholder participatory rights versus protection of shareholder interests.

Strengthening shareholder participatory rights in corporate governance was an explicit governance objective in the Australian reforms.<sup>93</sup> The Explanatory Memorandum to the *CLERP 9 Act* contains numerous references to the desirability of increasing shareholder activism<sup>94</sup> and improving shareholder participation and influence in the companies in which they invest.<sup>95</sup> A clear example of this is in the reforms relating to executive remuneration.<sup>96</sup> The *CLERP 9 Act* permits greater shareholder participation in remuneration issues by requiring shareholders of a listed company to pass an advisory resolution at the annual general meeting approving the directors' remuneration report.<sup>97</sup> Although non-binding, the explicit goals of the procedure are to provide shareholders with greater voice in relation to remuneration issues,<sup>98</sup> and encourage greater consultation and information flow concerning remuneration policies between directors and shareholders.<sup>99</sup> The reform also seeks to constrain excessive compensation by 'shaming' and censure, and from this perspective may be a potentially powerful governance mechanism.<sup>100</sup>

Nonetheless, the Australian government's professed enthusiasm for shareholder activism is not unqualified, and in one particular respect, the government

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<sup>93</sup> James McConvill and Mirko Bagaric, 'Towards Mandatory Shareholder Committees in Australian Companies' (2004) 28 *Melbourne University Law Review* 125, 131.

<sup>94</sup> See, eg, Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [1.4], [4.71].

<sup>95</sup> Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [4.174], [4.271]–[4.280].

<sup>96</sup> Jennifer G Hill, 'Regulating Executive Remuneration: International Developments in the Post-Scandal Era' (2006) 3 *European Company Law* 64, 67–8.

<sup>97</sup> Larelle Chapple and Blake Christensen, 'The Non-Binding Vote on Executive Pay: A Review of the *CLERP 9* Reform' (2005) 18 *Australian Journal of Corporate Law* 263; see *Corporations Act* 2001 (Cth) ss 250R(2), 249L.

<sup>98</sup> Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [5.434]–[5.435].

<sup>99</sup> Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [4.353], [5.413].

<sup>100</sup> Hill, 'Regulating Executive Remuneration', above n 96, 69–71.

has attempted to restrict shareholder participation in corporate governance. This is in relation to the so-called '100 member rule', which permits 100 shareholders to convene a general meeting of the company.<sup>101</sup> The rule, which is remarkably generous to shareholders compared to many other jurisdictions, has attracted criticism as being open to possible abuse by activist shareholders with a social agenda.<sup>102</sup> In 2005, the federal government announced that it intended to remove the 100 member rule,<sup>103</sup> however its proposal to this effect was rejected by state leaders at a meeting of the Ministerial Council for Corporations in July 2006.<sup>104</sup>

Increased shareholder participation and influence was a theme in the UK reforms (which included a version of the non-binding shareholder vote on the directors' remuneration report)<sup>105</sup> and the UK government has issued strong rhetoric about the need to encourage greater shareholder democracy and activism.<sup>106</sup> This policy goal was also reflected in the UK *Combined Code*, which included recommendations of the Higgs Report specifically aimed at strengthening the position of both institutional investors and independent directors, through a range of techniques designed to establish a close relationship between the two groups.<sup>107</sup> The UK *Combined Code* stressed the need for the board to communicate with investors generally and to encourage their participation in the annual general meeting.<sup>108</sup>

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<sup>101</sup> *Corporations Act 2001* (Cth) s 249D.

<sup>102</sup> Corporations and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Public Company: Final Report* (2000) 15.

<sup>103</sup> Chris Pearce, 'Government Consults on Proposed Corporate Governance Reforms' (Press Release, 7 February 2005); see also Explanatory Memorandum, Exposure Draft, Corporations Amendment Bill (No 2) 2005 (Cth).

<sup>104</sup> Leon Gettler, 'IFSA Censures States over 100-Member Rule', *Sydney Morning Herald* (Sydney), 21 June 2006, 37; Chris Pearce, 'Key Corporate Governance Reforms' (Press Release, 27 July 2006).

<sup>105</sup> *The Directors' Remuneration Report Regulations 2002* (SI 2002/1986). The provision requiring shareholder approval of the directors' remuneration report is now found in s 439 of the recently passed *Companies Act 2006* (UK).

<sup>106</sup> Ferran, above n 34, 27–8.

<sup>107</sup> Hill, 'Regulatory Responses to Global Corporate Scandals', above n 5, 391.

<sup>108</sup> See generally *Combined Code*, Principle D2 ('Constructive Use of the AGM').

The US reforms present an interesting contrast in this regard. Protection of shareholder interests was a clear priority<sup>109</sup> and part of the legislative intent of the reforms. The preamble to the *Sarbanes-Oxley Act* states, for example, that the aim of the Act is ‘[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes’. Yet, in spite of this focus on protection of shareholder interests, enhancement of shareholder participatory rights and power vis-à-vis management was conspicuously absent in the US reforms.<sup>110</sup>

Commentators have described the refusal of the *Sarbanes-Oxley Act* to grant shareholders greater governance power and participatory rights in, for example, the director election process, as ‘notable’<sup>111</sup> and ‘the forgotten element’ of the Act.<sup>112</sup>

Another potentially forgotten element in the US reforms was the issue of executive compensation. Executive compensation was deeply implicated in Enron and other corporate scandals. Conflicts of interest were evident in the structure of many executive compensation packages, which, rather than aligning managerial and shareholder interests, often appeared to create perverse incentives for executives to manage earnings and share price to enhance the value of options and pursue short-term goals.<sup>113</sup> Indeed, this misalignment of interests in executive pay is one possible

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<sup>109</sup> Karmel, above n 92, 2.

<sup>110</sup> Hill, ‘Regulatory Responses to Global Corporate Scandals’, above n 5, 392.

<sup>111</sup> Langevoort, above n 6, 16.

<sup>112</sup> Chandler and Strine, above n 39, 999.

<sup>113</sup> Iman Anabtawi, ‘Secret Compensation’ (2004) 82 *North Carolina Law Review* 835, 839ff; Patrick Bolton, Jose A Scheinkman and Wei Xiong, ‘Executive Compensation and Short-Termist Behavior in Speculative Markets’ (2006) 73 *Review of Economic Studies* 577; Janice K McClendon, ‘Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders’ Interests and Promote Corporate Long-Term Productivity’ (2004) 39 *Wake Forest Law Review* 971; Charles M Yablon and Jennifer G Hill, ‘Timing Corporate Disclosures to Maximize Performance-Based Remuneration: A Case of Misaligned Incentives?’ (2000) 35 *Wake Forest Law Review* 83, 86–8.

interpretation of the corporate collapses.<sup>114</sup> Yet, in spite of its prominence in the scandals, executive compensation received virtually no attention in the US reforms.<sup>115</sup>

Also, US reforms on board independence arguably had quite different implications for shareholder power than parallel reforms in the UK. The UK *Combined Code* sought to strengthen the position not only of independent directors, but also institutional investors, by fostering active dialogue between the two groups and encouraging greater participation in governance issues by institutional investors. However, the strict definition of director ‘independence’ under the US 2002 reforms suggests that US directors should generally be independent, not only from management, but also from major shareholders.<sup>116</sup> It has been argued that this aspect of the US reforms can be seen as contributing to an emerging concept of independent directors as ‘public’ directors in America, potentially shifting the *Sarbanes-Oxley Act* towards a model of public accountability rather than its stated intent of shareholder protection.<sup>117</sup>

Thus, even where reforms are unified by similar goals, this is no guarantee that their ultimate effects will coincide. Langevoort has recently noted this gap between motivation and regulatory outcome, due to variability in compliance and enforcement decisions, in relation to the *Sarbanes-Oxley Act*.<sup>118</sup> Unpredictability in the long-term effects of legislation is compounded in the case of an array of international legislation, where ‘legal irritants’ and underlying differences in regulatory ecosystems can create new divergences.<sup>119</sup>

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<sup>114</sup> John C Coffee, ‘What Caused Enron? A Capsule Social and Economic History of the 1990s’ (2004) 89 *Cornell Law Review* 269.

<sup>115</sup> Hill, ‘Regulatory Responses to Global Corporate Scandals’, above n 5, 412.

<sup>116</sup> *Ibid* 388–90.

<sup>117</sup> Langevoort, above n 6, 18; Cary Coglianese, ‘Legitimacy and Corporate Governance’ (2007) 32 *Delaware Journal of Corporate Law* 159, 163–4.

<sup>118</sup> Langevoort, above n 6.

<sup>119</sup> Teubner, above n 15.

#### IV CURRENT POLICY DEBATES AND REGULATORY BACKLASH

The shape of current academic and policy debates in the US, UK and Australia has been determined to a considerable degree by what was, and what was not, incorporated into the various post-scandal reforms. These recent policy debates, like the earlier regulatory responses themselves, have a distinctly local flavour.

Thus, for example, the lacuna in the US reforms concerning shareholder participation rights has had a clear influence on the direction of subsequent academic debate on the need to enhance shareholder power in the US. Bebchuk, a leading proponent of increased shareholder power and participation, has identified two key areas of corporate governance need. First, he has argued strongly for the reform of US proxy rules to allow shareholders greater influence over the director nomination process,<sup>120</sup> a reform for which the SEC originally exhibited some enthusiasm.<sup>121</sup> Bebchuk's second set of reform proposals focuses on increasing shareholder power, by permitting shareholders to initiate and effect changes to the corporate charter.<sup>122</sup>

These reform proposals would significantly alter the current balance of power between shareholders and the board of directors in the US. It is, as yet, unclear how much traction the proposals will ultimately gain. They have provoked intense debate in academic circles.<sup>123</sup> While few US scholars doubt that there is plenty of scope for increasing shareholder power,<sup>124</sup> many doubt the wisdom of doing so, particularly

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<sup>120</sup> Lucian Bebchuk, 'The Case for Shareholder Access to the Ballot' (2003) 59 *Business Lawyer* 43.

<sup>121</sup> US Securities and Exchange Commission, *Review of the Proxy Process Regarding the Nomination and Election of Directors* (2003).

<sup>122</sup> Lucian Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 *Harvard Law Review* 833; Lucian Bebchuk, 'Letting Shareholders Set the Rules' (2006) 119 *Harvard Law Review* 1784.

<sup>123</sup> Eg, a recent issue of the *Harvard Law Review* is devoted to the issue of shareholder empowerment: see Stephen M Bainbridge, 'Director Primacy and Shareholder Disempowerment' (2006) 119 *Harvard Law Review* 1735; Bebchuk, 'The Case for Increasing Shareholder Power', above n 122; Strine, above n 92.

<sup>124</sup> Iman Anabtawi, 'Some Skepticism about Increasing Shareholder Power' (2006) 53 *University of California Los Angeles Law Review* 561, 569.

when it would be at the expense of managerial autonomy and power.<sup>125</sup> In addition, the SEC's reformatory zeal concerning the director nomination process has waned.<sup>126</sup>

However, the issues raised by this academic debate are now undeniably in the US corporate ether. One example of this attitudinal shift is in relation to the issue of executive compensation. In spite of the surprising lack of attention given to executive compensation in the 2002 US reforms, regulatory momentum on this issue has gathered pace since that time. In early 2006, the SEC announced that it would conduct a significant overhaul of its disclosure rules on executive compensation<sup>127</sup> and political rhetoric on the topic of excessive executive pay has recently intensified.<sup>128</sup> Activist investors, such as the AFSCME,<sup>129</sup> submitted shareholder proposals seeking an advisory vote on executive pay comparable to the non-binding shareholder vote introduced in the Australian and UK post-scandal reforms. Proposals to this effect were successful at some companies, such as Blockbuster and Verizon Communications, during the 2007 proxy season.<sup>130</sup> The issue of an advisory vote for shareholders on executive remuneration also became the subject of Democrat-instigated congressional consideration.<sup>131</sup> In April 2007, the House of Representatives overwhelmingly passed a Bill that would accord US shareholders an advisory vote on executive remuneration, however, ultimate translation of the Bill into legislation is in doubt, due to White House opposition.<sup>132</sup>

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<sup>125</sup> Ibid; Bainbridge, above n 123; Strine, above n 92.

<sup>126</sup> Strine, above n 92, 1776–7.

<sup>127</sup> US Securities and Exchange Commission, 'SEC Votes to Propose Change to Disclose Requirements Concerning Executive Compensation and Related Matters' (Press Release, 17 January 2006).

<sup>128</sup> J Rutenberg, 'Bush Tells Wall St to Rethink Pay Practices', *New York Times* (New York), 1 February 2007, 11.

<sup>129</sup> American Federation of State, County and Municipal Employees.

<sup>130</sup> Gretchen Morgenson, 'Investors Get Voice on Pay at Verizon', *New York Times* (New York), 19 May 2007, 1.

<sup>131</sup> Erin White and Aaron O Patrick, 'Shareholders Push for Vote on Executive Pay', *Wall Street Journal* (New York), 26 February 2007, B1.

<sup>132</sup> Kara Scannell and Siobhan Hughes, 'House Clears an Executive-Pay Measure', *Wall Street Journal* (New York), 21 April 2007, A3.

Another aspect of long-term regulatory unpredictability is the impact of backlash.<sup>133</sup> Backlash can operate in either direction on a convergence-divergence axis. A recent example of backlash is the Paulson Committee Report,<sup>134</sup> which lays to rest any interpretation of common law post-scandal legislation as representing a unified, homogeneous regulatory response. Rather, a central tenet of the Paulson Committee Report is that the regulatory approach of the *Sarbanes-Oxley Act* was idiosyncratic and unduly stringent by international standards, and has reduced the competitiveness of US markets.<sup>135</sup> Similar concerns regarding the declining pre-eminence of New York and US financial markets are evident in another report: *Sustaining New York's and the US' Global Financial Services Leadership*.<sup>136</sup>

This feature of the Paulson Committee Report is interesting from the perspective of the debate on cross-listing, which emerged at the high-point of the convergence-divergence controversy in comparative corporate governance. At that time, it was often assumed that the marked trend towards cross-listing of foreign firms in the US during the 1990s constituted a desirable form of regulatory competition,<sup>137</sup> in which companies incorporated in jurisdictions with weak minority shareholder protection could voluntarily adopt higher standards. This trend was seen as further possible evidence for the convergence of corporate governance practices towards a US model.<sup>138</sup> The Paulson Committee Report, however, suggests that the stringency

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<sup>133</sup> On the political role of backlash generally, see Roe (1998).

<sup>134</sup> Committee on Capital Markets Regulation, above n 7.

<sup>135</sup> Ibid xi.

<sup>136</sup> McKinsey & Company, Report to M R Bloomberg and C E Schumer, *Sustaining New York's and the US' Global Financial Services and Leadership* (2007), available at <[http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special\\_reports/2007/NY\\_REPORT%20\\_FINAL.pdf](http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf)>; see also Jenny Anderson, 'US Financial Sector Is Losing Its Edge, Report Says', *New York Times* (New York), 22 January 2007, 3.

<sup>137</sup> John C Coffee, 'Racing towards the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' (2002) 102 *Columbia Law Review* 1757.

<sup>138</sup> Cally Jordan, 'The Chameleon Effect: Beyond the Bonding of Hypothesis for Cross-Listing Securities' (2007) *New York University Journal of Law and Business* (forthcoming), available at <<http://ssrn.com/abstract=907130>>; Licht, above n 15, 196–8.

of the *Sarbanes-Oxley Act* and increased associated compliance costs<sup>139</sup> have resulted in the opposite phenomenon, whereby foreign companies are now avoiding cross-listing on US markets.<sup>140</sup>

Whereas a central goal of the *Sarbanes-Oxley Act* was to restore investor confidence via rule-based regulation,<sup>141</sup> the Paulson Committee Report stresses the need to protect shareholders *from* excessive regulation that may impair the competitiveness of US markets.<sup>142</sup> This shift in the regulatory pendulum is arguably reflected in the recent rejection of greater oversight for hedge funds in the US.<sup>143</sup>

However, some commentators have questioned the supposed nexus between the prescriptive tenor of the post-Enron reforms and any loss of competitiveness in US capital markets. Coffee, for example, notes that much of the decline in the listing premium associated with foreign cross-listings occurred *prior* to the introduction of the *Sarbanes-Oxley Act*, and argues that foreign firms continue to list on US markets because of their higher regulatory standards.<sup>144</sup> He also observes that firms which do cross-list on a US exchange appear to gain a significant valuation premium.<sup>145</sup> Davidoff, while acknowledging the decline in foreign listings on US markets, has

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<sup>139</sup> Stephen K Asare, Lawrence A Cunningham and Arnold Wright, 'The *Sarbanes-Oxley Act*: Legal Implications and Research Opportunities' (2007) 19 *Research in Accounting Regulation* 81.

<sup>140</sup> Nicholas Lew and Ian Ramsay, 'Corporate Governance Law Reform and Delisting in Australia' (Research Paper No 202, Centre for Corporate Law and Securities Law Regulation, University of Melbourne, 2006) 9–12; Amir N Licht, 'Cross-Listing and Corporate Governance: Bonding or Avoiding?' (2003) 4 *Chicago Journal of International Law* 141; Alison Maitland, 'BT Chairman Criticises US Governance', *Financial Times* (London), 23 November 2004, 22; Joseph D Piotroski and Suraj Srinivasan, 'The *Sarbanes-Oxley Act* and the Flow of International Listings', available at <<http://ssrn.com/abstract=956987>>.

<sup>141</sup> Asare, Cunningham and Wright, above n 139, 82.

<sup>142</sup> Committee on Capital Markets Regulation, above n 7, xi.

<sup>143</sup> Stephen Labaton, 'Officials Reject More Oversight of Hedge Funds', *New York Times* (New York), 23 February 2007, 1.

<sup>144</sup> Coffee, 'Law and the Market', above n 26, 7–8, 57–8. Coffee acknowledges that foreign issuers have migrated from US markets, however attributes this to the development of a 'separating equilibrium'. According to this explanation, firms that wish to reap the high valuation premium available in US markets, or who require shareholder support, will accept the higher costs of regulation associated with a US listing. In contrast, those firms with a 'control group' of managers or shareholders who are interested in maintaining private access to the benefits of that control will choose to list on less-regulated markets: at 7–10.

<sup>145</sup> *Ibid* 8–9.

suggested that this decline is primarily due to ‘the inevitable maturation of non-US capital markets rather than ... to the *Sarbanes-Oxley Act* or any other recent change in US regulation’.<sup>146</sup>

The issue of shareholder empowerment, prevalent in recent US academic debate, is also a subtext in the Paulson Committee Report. The Committee suggests that increased shareholder rights could themselves achieve greater board accountability, thereby reducing the need for heavy-handed formal regulation<sup>147</sup> and recommends enhancement of shareholder rights across several areas.<sup>148</sup> While issues of efficiency and firm value underpin much of the Paulson Committee Report’s discussion, the fundamental power imbalance between managers and shareholders is also a clear concern.<sup>149</sup>

Shareholder empowerment, now permeating the US corporate law debate, provides an interesting contrast to current policy concerns in Australia and the UK, which are strongly focused not on shareholder rights, but on the interests of stakeholders.

The plight of stakeholders, such as employees, and corporate responsibility generally, were major themes of the corporate scandals.<sup>150</sup> Nonetheless, the *Sarbanes-Oxley Act* in the US and the *CLERP 9 Act* in Australia were mainly concerned with

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<sup>146</sup> Steven M Davidoff, ‘Regulating, Listings in a Global Market’ (Research Paper No 07–02, Wayne State University Law School, 2007) 9–23.

<sup>147</sup> Committee on Capital Markets Regulation, above n 7, xi–xii.

<sup>148</sup> Key proposals of the Paulson Committee Report relating to enhancement of shareholder rights include: (i) the requirement that classified boards gain the approval of shareholders prior to implementing a poison pill; (ii) the adoption of majority, rather than plurality, voting for board directors; (iii) clarification of the rights of shareholders with respect to gaining access to the company proxy to nominate directors for election; and (iv) enhancing shareholders’ ability to access alternative means of dispute resolution: *ibid* xii–xiii, 93–114).

<sup>149</sup> According to the Committee, ‘When firms have a choice of legal regime, any policy proposal should adopt as a default the option most favorable to shareholders, given the fundamental asymmetry of power between managers and shareholders’: *ibid* 103.

<sup>150</sup> Langevoort, above n 6, 15.

protection of shareholders and their interests.<sup>151</sup> In the UK, however, ‘a third way’, advocating a long-term, enlightened shareholder value approach to corporate governance issues, was already gaining momentum.<sup>152</sup> Political issues, including concern by the EU to harmonise the laws of member states, contributed to this development in the UK.<sup>153</sup> This enlightened shareholder value principle has been given legislative force under s 172 of the recently enacted UK *Companies Act 2006*, which imposes a new duty on directors to ‘promote the success of the company’, requiring them to consider stakeholder interests and the long-term effects of their decisions.<sup>154</sup>

Corporate social responsibility has also become a major issue in Australia, largely as a result of two high-profile local corporate scandals. The first was the James Hardie saga. This involved a corporate reconstruction whereby asbestos-related liabilities were separated from other assets in the company through the creation of a foundation,<sup>155</sup> which was subsequently found to have insufficient funds to meet legitimate compensation claims.<sup>156</sup> The second concerned the Australian Wheat Board Ltd, one of the world’s largest wheat marketing and management companies, which was found to have made corrupt payments to Iraq under the Oil-for-Food Program. These scandals were responsible for generating not only heated public debate about corporate social responsibility, but also two governmental reports on the topic —

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<sup>151</sup> Cf, however, *ibid* 15, 20, claiming that, although *Sarbanes-Oxley* was by its terms about investor protection, its long-term effects may ultimately be about public accountability.

<sup>152</sup> Cynthia A Williams and John M Conley, ‘An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct’ (2005) 38 *Cornell International Law Journal* 493.

<sup>153</sup> *Ibid* 498–9.

<sup>154</sup> Robert P Austin, *Company Directors and Corporate Social Responsibility: UK and Australian Perspectives* (2007).

<sup>155</sup> The Medical Research and Compensation Foundation.

<sup>156</sup> Edwina Dunn, ‘James Hardie: No Soul to Be Damned and No Body to Be Kicked’ (2005) 27 *Sydney Law Review* 339.

reports by the Parliamentary Joint Committee ('PJC Report')<sup>157</sup> and the Corporations and Markets Advisory Committee ('CAMAC Report').<sup>158</sup>

A central issue in these reports was the scope of directors' duties, and the extent to which the current Australian legal framework permits directors to consider the interests of stakeholders or the broader community. This issue arose directly from the James Hardie matter, where James Hardie executives and directors sought to justify their conduct by arguing that current law essentially required them to privilege shareholder interests 'at all costs'.<sup>159</sup> The PJC Report observed, however, that 'rampant corporate irresponsibility certainly decreases shareholder value'.<sup>160</sup> Scrutiny of the actions of the James Hardie directors will inevitably persist, with the Australian Securities and Investments Commission announcing in mid-February 2007 that it would bring civil penalty proceedings against the entire board of directors.<sup>161</sup>

Both the PJC Report and the CAMAC Report rejected legislative change to directors' duties in Australia to explicitly embody 'enlightened shareholder value', as in s 172 of the *Companies Act 2006* (UK). The PJC Report was critical of the U.K. amendment to directors' duties,<sup>162</sup> on the basis that it was overly prescriptive and would result in confusion, while the CAMAC Report considered that a comparable statutory amendment in Australia would provide 'no worthwhile benefit'.<sup>163</sup> Overall, there is a degree of overlap between the tone and ultimate conclusions of the PJC

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<sup>157</sup> The PJC announced its Inquiry into Corporate Responsibility in June 2005 and released its Report in June 2006: PJC on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006).

<sup>158</sup> CAMAC received a reference in March 2005 and issued its Discussion Paper in November 2005: CAMAC, *Corporate Social Responsibility: Discussion Paper* (2005). Its Final Report was released in December 2006: CAMAC, *The Social Responsibility of Corporations: Report* (2006).

<sup>159</sup> PJC Report, above n 157, 47, 181.

<sup>160</sup> *Ibid* 19.

<sup>161</sup> John Durie, 'ASIC Treads Fine Line on Hardie', *Australian Financial Review* (Sydney), 16 February 2007, 84; Marcus Priest and M Skulley, 'ASIC Seeks Bans for Hardie Asbestos Directors', *Australian Financial Review* (Sydney), 16 February 2007, 1.

<sup>162</sup> PJC Report, above n 157, 54–6.

<sup>163</sup> CAMAC, *The Social Responsibility of Corporations: Report*, above n 158, 111.

Report and the CAMAC Report, with both demonstrating a preference for industry-based regulation and initiatives, rather than formal legislative change, to address corporate social responsibility issues. The CAMAC Report, in particular, acknowledged the limits to the law's ability to control corporate decision-making by prescription, portraying corporate responsibility as a fluid part of a company's operations, not a legislative 'add-on'.<sup>164</sup>

### CONCLUSION

While post-scandal reforms in the US, UK and Australia were prompted by similar motivations, interesting differences in terms of their focus and structure still resonate in current corporate governance debate. The unique contours of the various regulatory responses challenge not only the traditional convergence hypothesis, but also the idea that a unified common law corporate governance model exists. Rather, a fluid, dynamic and increasingly fragmented picture of corporate governance has emerged. Within this developing corporate governance framework, various jurisdictions are able to test regulatory techniques and learn by their own trial and error, and that of other jurisdictions. If any evidence of long-term convergence can be gleaned from these developments, paradoxically, it would appear to be away from the US post-scandal regulatory model. These developments reflect a complex and interesting picture of contemporary corporate governance, worthy of *La Règle du Jeu*.

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<sup>164</sup> Ibid 3–4.

2 Evolving Rules of the Game in Corporate Governance Reform Jennifer Hill. 29. The Endogeneity of Law Lauren B Edelman. 55. 4 The Significance of Relative Autonomy in How Regulation of the Financial Services Sector Evolves George Gilligan. 91. Investment Banks Conflicts of Interest and Chinese Walls Pamela F Hanrahan. Globalization , Governance reform , Investor protection More from: Lucian Bebchuk. Professor Lucian Bebchuk will be writing a monthly column for Project Syndicate , an international association of 425 newspapers in 150 countries, with a total circulation of about 56 million copies. The series of columns sponsored by the association seeks to bring distinguished voices from across the world to audiences in member newspapersâ€™ countries. Professor Bebchukâ€™s series of monthly commentaries, titled â€œ The Rules of the Game ,â€ will focus on finance and corporate governance. His commentaries, which will