Committee Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
Canberra ACT 2600

13 September 2021

Dear Madam / Sir

Submission: Inquiry into the Implications of Common Ownership and Capital Concentration in Australia

We appreciate the opportunity to make a submission to the Inquiry.

We are members of the Faculty of Law at Monash University and its Centre for Commercial Law and Regulatory Studies. We have both researched and written extensively on the regulatory implications of institutional investor ownership of publicly-traded equity securities.

The 'common ownership' issue is a reaction to the growing significance of institutional investors. In Australia and other markets, these investors now hold material shareholdings in a broad range of publicly-traded entities. This may include shareholdings in entities that are competitors within a particular market. Critics of common ownership argue that investors' common shareholdings in competing entities may adversely affect competition within markets.

Common ownership concerns originated, and have been explored in detail, in the United States. It is important that the Committee appreciate, however, that there is no consensus in the United States that common ownership is problematic. Indeed, U.S. research has identified significant theoretical and empirical shortcomings in the arguments of common ownership critics.

Moreover, even if common ownership were ultimately shown to be problematic in the U.S. context, it is far from evident that it would be an issue in the Australian context, owing to distinctive features of the Australian equity capital market.

We explain these points below.

Theoretical and Empirical Shortcomings of 'Common Ownership' Concerns

- **Common Ownership is a Disputed Theory That Raises Causation Versus Correlation Issues:** It is important to recognise that the common ownership theory is just that - a theory - and that it is highly controversial. There is a growing body of literature in both law and finance, which disputes the theory's basic assumptions. Some scholars have criticised common ownership critics for seeking solutions to a 'non-problem'.[1] Also, recent finance literature

[1] Edward B. Rock and Daniel L. Rubinfeld, 'Defusing the Antitrust Threat to Institutional Involvement in Corporate Governance', Law & Economics Research Paper Series Working Paper No. 17-05, Mar. 2017 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925855).

challenges the view that common ownership causes reduced competition, and finds that some of the effects identified by common ownership critics are attributable to a range of other factors.[2] This raises the possibility that the common ownership theory may reflect correlation, rather than causation.

- **Different Versions of the Common Ownership Theory Exist:** The arguments advanced by common ownership critics are not always consistent. Some arguments suggest that the central problem is that institutional investors may, by virtue of their powerful position and material shareholdings across a sector, misuse their position and pressure corporate management to engage in anti-competitive conduct.

  However, another version of the theory, what one of us has described as 'the mindreading model',[3] goes considerably further and eliminates the need to show any misuse of share ownership rights by institutional investors. This version of the common ownership theory suggests that the mere presence of institutional investors as shareholders provides corporate managers with incentives to engage in anticompetitive conduct. According to this version of the theory, it would be irrelevant, for example, that institutional investors hold minority positions; that they have not engaged in any form of cooperation or collusion to achieve anticompetitive ends; that there has been no attempted contact by institutional investors to communicate with, or influence, managers of a portfolio company; and that there is no coordination or collusion by managers of competing companies.[4] This is a very extreme argument indeed.

- **The Common Ownership Theory is Inconsistent with Many Modern Corporate Governance Principles:** Any view that the mere holding of shares by institutional investors in concentrated industries can *ipso facto* breach competition laws subverts many fundamental tenets of contemporary corporate governance concerning the desirability of increased shareholder engagement as a check and balance on centralised managerial power. Shareholder stewardship codes, for example, are based on the premise that investor stewardship is a desirable and beneficial feature of contemporary corporate governance.

- **The Common Ownership Theory is U.S.-centric and Industry Specific; It does not Take Account of Broader Economic Context:** The common ownership debate is U.S.-centric and industry specific. It often does not take account of broader economic context. For example, whereas some of the industry clusters considered in U.S. common ownership literature, such as the banking and the airline industries, may be national oligopolies, others, such as technology and pharmaceutical sectors, are now global markets. It is far from clear whether (or how) common ownership affects competition within global markets.

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[2] See, e.g., Katharina Llewellyn and Michelle Lowry, 'Does Common Ownership Really Increase Firm Coordination?', *European Corporate Governance Institute – Finance Working Paper No. 741/2021* (forthcoming, *Journal of Financial Economics (JFE)* (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3336343). See also Eric P. Gilje, Todd A. Gormley and Doron Levit, 'Who's Paying Attention? Measuring Common Ownership and its Impact on Managers' Incentives' (2020) 137 *Journal of Financial Economics (JFE)* 152.

[3] Jennifer G. Hill, 'The Conundrum of Common Ownership' (2020) 53 *Vanderbilt Journal of Transnational Law* 881, 893.

[4] Ibid.

Even in those industries that are concentrated in the U.S., spillover effects in other industries and other markets, in which highly diversified shareholders are invested, will necessarily complicate any assessment of institutional investor incentives for the purposes of the common ownership debate.[5]

- **The Rise of Megacompanies:** In focusing on institutional ownership, common ownership critics effectively ignore the rise in market power of the firms in which institutions invest. In some sectors, such as the technology sector, companies have become 'powerful megacompanies'[6] in their own right. For some economists, industry concentration is far more problematic in relation to wage inequality and consumer welfare than common ownership by institutional investors.[7] The Australian Government Productivity Commission has previously expressed concerns of this kind in relation to Australia's extremely concentrated financial sector.[8] Common ownership critics do not adequately account for the possibility that the market behaviour of large public companies may be attributable to the market power they have accumulated as opposed to their ownership structure.

- **ESG Issues:** Common ownership theory focuses almost exclusively on the goal of profit maximisation of individual firms. Such an approach to corporate law runs counter to many of the recommendations of the 2019 Australian Australian Royal Commission into Banking, Superannuation and Financial Services.[9] It also effectively ignores the growing significance of ESG factors in corporate governance and the role that institutional investors can play in ensuring that companies act in a socially responsible manner. It is possible, for example, that portfolio-wide interventions by the largest institutional investors, in response to issues such as climate change risk, could have beneficial outcomes from a social welfare perspective.[10]

- **Common Ownership Critics' Extreme Regulatory Prescriptions**: Common ownership critics have proposed an array of Draconian regulatory responses to common ownership by institutional investors. These include depriving index funds of their voting rights; restricting institutional investor share ownership to no more than one company in an oligarchy; and allowing institutional investors to hold shares in competing companies, only if those holdings do not exceed 1 percent, with forced divestiture in the case of noncompliance.

  These proposals would constitute discrimination against a particular group of shareholders. They would be inconsistent with the principles of Australian corporate law, which are firmly

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[5] See Madison Condon, 'Externalities and the Common Owner' (2020) 95 *Washington Law* Review 1; Alessandro Romano, 'Horizontal Shareholding and Network Theory' (2021) 38 *Yale Journal on Regulation* 363.

[6] Matt Phillips, 'Apple's $1 Trillion Milestone Reflects Rise of Powerful Megacompanies', *New York Times*, 2 August 2018.

[7] Gustavo Grullon, Yelena Larkin and Roni Michaely, 'Are US Industries Becoming More Concentrated?' (2019) 23 *Review of Finance* 697.

[8] Australian Government Productivity Commission, *Competition in the Australian Financial System: Productivity Commission Inquiry Report: Overview and* Recommendations, No. 89 (2018). The Commission acknowledged that these huge financial institutions 'have the ability to exercise market power over their competitors and consumers'. *Id*, 2.

[9] Final Report, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (2019).

[10] Madison Condon, 'Externalities and the Common Owner' (2020) 95 *Washington Law Review* 1.

based on equality of shareholders in public companies.[11] The proposals could also be very damaging to Australia's superannuation system. This system has been credited not only with creating 'a nation of capitalists'[12] but also with playing a key protective role during the global financial crisis.[13] The severe reform prescriptions advanced by U.S. common ownership critics would risk undermining the economic benefits that Australians have enjoyed as a result of the superannuation system.

Theoretical and empirical shortcomings of common ownership concerns are discussed in further detail in the article included in Appendix 1 of this submission.

Important Differences in the Australian Context

Owing to distinctive features of the Australian equity capital market, common ownership concerns originating in the United States may be inapplicable in the Australian context.

- **High Levels of Institutional Investor Ownership Are Not an Economy-wide Phenomenon:** Although institutional investor ownership has increased in Australia, it tends to be confined to the largest publicly traded entities, for reasons such as economies of scale and the greater liquidity of such entities' equity securities.[14] Empirical studies note that institutional investors tend to focus their investments in the largest 10% of listed entities,[15] with one recent study reporting a dramatic rise in institutional ownership in the top 50 ASX listed companies over the last two decades.[16] Although these large listed entities are economically significant, they do not, however, constitute the entire Australian economy. Significant economic enterprises are conducted by a range of other entities, including entities privately owned by Australian or foreign owners.[17] Accordingly, even if common ownership concerns were ultimately shown to have some validity in the Australian context, they would directly affect only a subset of Australian enterprises – that is, the large, listed entities in which

[11] E.g. the principle of one share/one-vote and non-discrimination. See also *Australian Fixed Trusts Ltd. v Clyde Indus. Ltd.* (1959) 59 SR (NSW) 33 (where the court struck down an attempt to alter the corporation's constitution to disenfranchise institutional investors on the ground of fraud on the minority).

[12] 'Super-duper supers: In Australia's superannuation scheme, everyone's a winner', *The Economist*, 28 May 2011, 6.

[13] The Allen Consulting Group, Report to the Association of Superannuation Funds of Australia (ASFA) Enhancing Financial Stability and Economic Growth: The Contribution of Superannuation, August 2011, pp. v, 7-16.

[14] Ian M Ramsay and Mark Blair, 'Ownership Concentration, Institutional Investment and Corporate Governance: An Empirical Investigation of 100 Australian Companies' (1993) 19 *Melbourne University Law Review* 153, 186.

[15] See, eg, Shelley D Marshall, Kirsten Anderson and Ian Ramsay, 'Are Superannuation Funds and Other Institutional Investors in Australia Acting Like "Universal Investors"?' (2009) 51 *Journal of Industrial Relations* 439, 454; Carole Comerton-Forde and James Rydge, 'Director Holdings, Shareholder Concentration and Illiquidity' (2006) https://ssrn.com/abstract=713181.

[16] Jennifer Varzaly, 'The Dynamics of Shareholder Dispersion and Control in Australia' (Research Paper No. 5/2021, University of Cambridge Faculty of Law, January 2021) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3768856>

[17] Vivien Chen, Ian Ramsay and Michelle Welsh, 'Corporate Law Reform in Australia: An Analysis of the Influence of Ownership Structures and Corporate Failure' (2016) 44 *Australian Business Law Review* 18, 22 (reporting that, in comparison with the United States and the United Kingdom, Australia has a substantially smaller proportion of its largest companies listed on the stock exchange).

institutional investors invest. Significant additional research would be required in order to understand to what extent, if any, this would affect competition across the broader economy.[18]

- **Interventionist Forms of Shareholder Activism are not Common in Australia**: An important premise of common ownership concerns is that institutional investors exert influence over the commercial and strategic decisions of managers of listed entities. However, in Australia, interventionist forms of shareholder activism, such as attempts to replace directors or high-profile media campaigns against companies, are not prevalent. For example, industry research reports an average of approximately 75 activist campaigns a year in the period 2013–17.[19] This is in the context of a market comprised of more than 2000 listed entities. Significantly, these campaigns predominantly targeted small-capitalisation companies;[20] that is, companies in which institutional investors tend not to invest. We discuss this issue further in soon to-be-published research, which is included in Appendix 2 of this submission.

- **Instead, Institutional Investors Exert Influence in More Nuanced Ways.** Research indicates that, insofar as institutional investors participate in corporate governance, they primarily do so by casting votes on resolutions at listed entities' annual general meetings[21] or through private interactions (often referred to as 'engagement') with directors and managers of listed entities.[22]

  Research also indicates that institutional investors rely, to a material extent, on intermediary organisations to assist with their corporate governance activities. This includes industry associations such as the Financial Services Council and the Australian Council of Superannuation Investors, as well as service providers such as engagement firms and proxy advisers. We discuss the role of these intermediaries our research included in Appendix 2 of this submission.

  Although these intermediaries play a role in 'collectivising' the influence of institutional investors, it is far from clear whether their activities involve any of the risks identified by critics of common ownership. There are multiple such organisations active in the Australian

[18] For example, in the airline industry, Qantas is a large ASX-listed entity, however, Virgin is not. If common ownership concerns were shown to have some validity, it is unclear how they would affect competition in the Australian airline sector in circumstances where Virgin is not a publicly traded entity.

[19] JP Morgan, 'Shareholder Activism in Australia: Navigating the Evolving Landscape' (April 2017) <https://www.jpmorgan.com/pdfdoc/Shareholder-Activism-in-Australia.pdf>; FTI Consulting, *Australia* (31 December 2017) <https://ftiactivism.com/map/countries/australia/>.

[20] JP Morgan (n 19 above) 6 (reporting that 77% of campaigns targeted companies with a market capitalisation of less than AUD$100 million). A 2018 report by Activist Insight and Schulte Roth & Zabel reports that nearly two-thirds of Australian companies targeted in 2018 had a market capitalisation of less than US$50 million, which they describe as a 'historical pattern': Activist Insight and Schulte Roth & Zabel, 'The Activist Investing Annual Review 2019' (2019) 6, 23 <https://www.srz.com/images/content/1/6/v14/162469/TheActivistInvestingAnnualReview-2019-compressed.pdf>.

[21] For example, the share registry services provider, Computershare, reports that for entities included in S&P/ASX 50 and S&P/ASX 300 indices, voting levels had increased continually over the period 2014-17, which was not the case for companies outside of the S&P/ASX 300 index. Computershare attributes higher voting levels in the upper strata of the market to the significant presence of institutional investors in those companies: Computershare, *Intelligence Report: Insights from Annual General Meetings Held in 2017*, March 2018, 18, 27.

[22] See, e.g., Australian Securities and Investments Commission, 'Consultation Paper 228 Collective Action by Investors: Update to RG 128' (February 2015) 10 <http://download.asic.gov.au/media/2962782/cp228-published-17-february-2015.pdf>.

market. It cannot be assumed, in the absence of further detailed research, that they collectively speak with a common voice in relation to the commercial and strategic behaviour of public companies which common ownership critics argue are influenced by institutional investors. Moreover, overseas scholars argue that these intermediary organisations are less likely to become involved in issues of corporate financial performance or commercial strategy as it may be difficult for them to distil a consensus position amongst the investors whose interests they represent on such issues. Instead, these intermediaries may be more likely to focus on broad, 'thematic' issues of corporate governance practice such as board diversity and independence.[23]

- **Important Institutional Features of the Australian Market**: Common ownership concerns have a tendency to regard institutional investors as a 'monolithic bloc', which has a common viewpoint and exerts influence in a concerted manner. Institutional investors in Australia, however, are a diverse group comprised of, among others, Australian and international fund managers, active and passive managers, for-profit superannuation funds and industry superannuation funds. As the previous point noted, these investors are represented by multiple industry organisations and are serviced by various service providers. In these circumstances, it is far from clear that institutional investors in Australia would have common or a predominant view regarding how Australian listed entities should conduct their businesses. This raises an important question regarding the relevance of common ownership concerns in the Australian context.

  The relationship between for-profit financial services organisations and the industry superannuation funds highlights this point. Industry superannuation funds are represented by their own industry bodies, the Australian Council of Superannuation Investors (ACSI). For-profit fund managers, on the other hand, are represented by a separate industry body, the Financial Services Council. This 'institutional divide' can result in the respective sectors charting their own course on important issues of corporate governance. For example, FSC and ACSI have issued their own respective, and distinct, versions of 'investor stewardship codes', marking Australia out from a number of other jurisdictions which have only a single stewardship code applying to institutional investors generally. Committee members may also recall the controversial 'fox in the henhouse' television advertisement aired in 2018 on behalf of industry superannuation funds. This campaign reflected competitive tensions between the industry superannuation funds and the for-profit superannuation funds.[24]

  In these circumstances, it is unclear whether there is enough commonality of interest amongst institutional investors in Australia to exert the type of concerted influence on companies alleged by critics of common ownership.

* * *

For the reasons outlined above, it is far from evident that 'common ownership' concerns are relevant in the Australian context. Significantly more research is required into the patterns of institutional investor share ownership in Australia, the nature of investors' influence on the companies they invest in, and the impact of such influence on the affairs of publicly traded entities in the Australian market.

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[23] See, in this regard, the discussion on pages 23-24 of our research in Appendix 2.

[24] For further details, see the discussion on pages 5-8 of our research in Appendix 2.

In the absence of such research, we submit that any regulatory response to perceived common ownership concerns would be premature at this time.

Yours faithfully,

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Appendices attached:

1 *Jennifer G Hill, 'The Conundrum of Common Ownership'* (2020) 53 *Vanderbilt Journal of Transnational Law* 881 *(see also Post, The Columbia Law School Blue Sky Blog, 11 June 2020 (https://clsbluesky.law.columbia.edu/2020/06/11/the-conundrum-of-common-ownership/).*

2 *Tim Bowley and Jennifer Hill, 'Stewardship and Collective Action: The Australian Experience', ECGI Working Paper 491/2020, 30 March 2020 (forthcoming in D Katelouzou and D Puchniak eds, Global Shareholder Stewardship: Complexities, Challenges and Possibilities (Cambridge University Press)).*

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The Conundrum of Common Ownership

Jennifer G. Hill[*]

ABSTRACT

The common ownership debate has become one of the most contentious issues in corporate law today. This debate is a by-product of major changes to capital market ownership structure, which have triggered concerns about the rise of institutional investors, the growth of index investing, and the rapid concentration of ownership in major international financial markets.

The common ownership theory focuses on concerns about the incentives of large financial institutions holding widely diversified portfolios of shares in competing companies within a particular economic sector. Proponents of the common ownership theory argue that, even where institutional investors have relatively small ownership stakes, their collective holdings in competing companies produce anticompetitive effects. Other scholars, however, have challenged both the common ownership theory and its regulatory prescriptions. Although the common ownership theory began in the United States, it is now being discussed around the world.

This Article examines three conflicting narratives that emerge in this literature concerning institutional investors and the common ownership theory. The Article seeks to position these narratives within the context of the rising influence of institutional investors since the early 1990s and its relation to major international corporate governance developments. It analyzes aspects of the common ownership theory in light of these

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contemporary corporate governance developments and argues that drawing regulatory and policy conclusions from the current body of conflicting empirical findings on the effects of common ownership is premature.

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I. INTRODUCTION

One of the most contentious issues in corporate law today is the common ownership debate. This debate is a by-product of major changes to capital market structure over the last few decades. It reflects concern about the rise of institutional investors, the growth of index investing, and increasing ownership concentration in financial markets.[1]

1. *See, e.g.*, Eric Posner et al., *A Monopoly Trump Can Pop*, N.Y. TIMES, Dec. 7, 2016, at A29; Eric Posner & E. Glen Weyl, *Mutual Funds' Dark Side: Why Airlines and Other Industries Keep Prices Too High*, SLATE (Apr. 16, 2015), https://slate.com/news-and-politics/2015/04/mutual-funds-make-air-travel-more-expensive-institutional-

"Common ownership" (which is sometimes used synonymously with the terms "horizontal shareholding" or "overlapping shareholding")[2] describes the situation where large financial institutions with widely diversified portfolios own shares in competing companies within a particular economic sector.[3] A number of scholars (described in this Article as "anti–common ownership scholars") have argued that, even where these institutions have relatively small ownership stakes, their collective holdings in competing companies produce anticompetitive effects in a range of corporate governance contexts, such as mergers and acquisitions (M&A)[4] and executive compensation.[5] The basis for this claim is that, in such circumstances, the institutions are interested in the financial performance of their portfolios as a whole, rather than the performance of individual companies in that sector.[6]

Although the common ownership debate began in the United States, it is now attracting attention around the world.[7] For example, European intergovernmental and regulatory organizations have focused on the debate,[8] which also has clear relevance to certain jurisdictions in the Asia-Pacific region.[9] This is particularly true of Australia, given the distinctive role and large size of

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investors-reduce-competition.html [https://perma.cc/8GCS-8W6E] (archived Feb. 10, 2020).

2. *Cf.* Einer Elhauge, New Evidence, Proofs, and Legal Theories on Horizontal Shareholding 4–6 (Jan. 4, 2018) (unpublished manuscript) (on file with SSRN) [hereinafter Elhauge, New Evidence].

3. *See, e.g.*, José Azar et al., *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1514 (2018).

4. *See, e.g.*, Miguel Antón et al., *Does Common Ownership Increase Incentives for Mergers and Acquisitions?*, 2 COMPETITION POL'Y INT'L, ANTITRUST CHRON. (2019); Miguel Antón et al., Beyond the Target: M&A Decisions and Rival Ownership (Jan. 19, 2019) (unpublished manuscript) (on file with SSRN).

5. *See, e.g.*, Einer Elhauge, *How Horizontal Shareholding Harms Our Economy – And Why Antitrust Law Can Fix It*, HARV. BUS. L. REV. (forthcoming 2020) (manuscript at 8–9) (on file with author) [hereinafter Elhauge, *Antitrust Law*].

6. *See, e.g.*, Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1268 (2016) (describing lessened effects of individual companies' performance) [hereinafter Elhauge, *Horizontal Shareholding*]; Azar et al., *supra* note 3, at 1514.

7. *See* Brooke Fox & Robin Wigglesworth, *Common Ownership of Shares Faces Regulatory Scrutiny*, FIN. TIMES (Jan. 22, 2019), https://www.ft.com/content/59325462-fe57-11e8-aebf-99e208d3e521 [https://perma.cc/CNH4-X688] (archived Mar. 16, 2020).

8. *See generally* Competition Division, *Common Ownership by Institutional Investors and its Impact on Competition*, ORG. FOR ECON. CO-OPERATION & DEV. 10 (Dec. 5–6, 2017), https://one.oecd.org/document/DAF/COMP(2017)10/en/pdf [https://perma.cc/4JU5-UPHE] (archived Feb. 22, 2020); MONOPOLKOMMISSION, *Common Ownership: Excerpt from Ch II of the XXII Biennial Report of the Monopolies Commission* (2018), https://www.monopolkommission.de/images/HG22/Main_Report_XXII_Common_Ownership.pdf [https://perma.cc/2EQ4-BX2K] (archived Feb. 10, 2020).

9. *See, e.g.*, Ben Charoenwong, *The Cost of Common Ownership to the Singapore Government*, MEDIUM: THE STARTUP (May 20, 2019), https://medium.com/swlh/the-cost-of-common-ownership-to-the-singapore-government-f6b519b567eb [https://perma.cc/LK79-HJ2C] (archived Feb. 10, 2020).

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superannuation/pension funds in Australian capital markets[10] and the concentration of certain industries, such as the banking and finance sector.[11]

The aim of this Article is to contextualize the common ownership theory within a broad range of international corporate governance developments relating to institutional investment since the early 1990s. The structure of the Article is as follows. Part II discusses the impact on legal scholarship of the common ownership theory, which commenced in the field of financial economics. Part III examines three possible narratives that exist in the literature relating to institutional investors and common ownership. Part IV analyzes certain aspects of the common ownership theory in the light of contemporary corporate governance developments and debate, and Part V concludes the Article and argues that drawing regulatory and policy conclusions from current mixed empirical evidence is premature.

II. LAW'S DISCOVERY OF AN "ECONOMIC BLOCKBUSTER"

At the turn of the twenty-first century, a team of financial economists, Professor Rafael La Porta *et al.*, postulated that "law matters" when it comes to the structure of capital markets.[12] The hypothesis claimed that jurisdictions with high levels of legal protection for minority shareholders would develop deep liquid capital markets like those in the United States and the United Kingdom.[13] The "law matters" hypothesis had significant policy implications for regulation and law reform[14] and proved highly influential in both economics and law.[15]

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10. *See generally* Rob Nichols & Deniz Kayis, Common Corporate Owners, Concerted Corporate Actions? (Working Paper, 2019).

11. *See* Jennifer G. Hill, *Why Did Australia Fare So Well in the Global Financial Crisis?*, *in* THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS 203, 291–92 (Eilís Ferran et al., 2012).

12. *See, e.g.*, Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1116 (1998) (describing effects of different legal regimes on financial markets); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FINANCE 471, 472 (1999) (stating that countries with more legal protections provide more security for minority shareholders).

13. *Id.*

14. The "law matters" hypothesis also had strong normative overtones, viewing the legal protections offered by common law legal systems as superior to those found in civil law legal systems. *See* David A. Skeel Jnr, *Corporate Anatomy Lessons*, 113 YALE L.J. 1519, 1544–45 (2004).

15. *See, e.g.*, Steve Kaplan & Luigi Zingales, *How "Law and Finance" Transformed Scholarship, Debate*, CHI. BOOTH REV. (Mar. 5, 2014), https://review.chicagobooth.edu/magazine/spring-2014/how-law-and-finance-transformed-scholarship-debate [https://perma.cc/DN4R-CQAR] (archived Feb. 22, 2020). Nonetheless, many legal scholars were extremely critical of certain aspects of the "law matters" hypothesis. For an overview of this criticism, *see generally* Jennifer G. Hill,

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Almost twenty years on, recent scholarship concerning common ownership provides a strong counterpoint to the "law matters" hypothesis in terms of its policy implications for capital market regulation. According to anti–common ownership scholars, the problem today is that fund flows to deep capital markets occur via a small number of increasingly powerful financial intermediaries with highly diversified portfolios.[16]

Like the "law matters" hypothesis, the common ownership theory originated in economic literature, but subsequently emerged in legal scholarship, where it has had a major impact. In a high profile 2016 *Harvard Law Review* article, Professor Einer Elhauge described the argument that common ownership has anticompetitive effects as a recently exposed "economic blockbuster."[17] Anti–common ownership scholars have referred to the rise of institutional investors as "[t]he great, but mostly unknown, antitrust story of our time,"[18] and "a smoking gun."[19]

There have been major changes to capital market structure over the last few decades, and these changes lie at the heart of the common ownership theory. Today, the dominant shareholders of public companies in many, but by no means all,[20] jurisdictions are institutional intermediaries. The growth in financial intermediation in savings and investment decisions was foreseen from at least the 1970s by commentators, such as Peter Drucker[21] and Professor Robert Clark.[22] As anti–common ownership scholars have noted, however, financial intermediation investment channels are now highly concentrated.[23] The alleged culprits behind the common ownership theory are major financial institutions, such as BlackRock, Vanguard,

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The Persistent Debate About Convergence in Comparative Corporate Governance, 27 SYDNEY L. REV. 743 (2005).

16. *See* Azar et al., *supra* note 3, at 1514 n.2 (citing Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298 (2017)).

17. *See* Einer Elhauge, *The Growing Problem of Horizontal Shareholding*, 3 COMPETITION POL'Y INT'L, ANTITRUST CHRON. 1 (2017) [hereinafter Elhauge, *Growing Problem*]; Elhauge, New Evidence, *supra* note 2, at 1; Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1267.

18. Posner et al., *supra* note 1; *see also* Eric Posner et al., *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 669 (2017) (arguing that the rise of the institutional investor is new to recent decades).

19. Posner & Weyl, *supra* note 1, at 1.

20. India, for example, is a case in point. *See* George S. Geis, *Shareholder Power in India*, *in* RESEARCH HANDBOOK OF SHAREHOLDER POWER 592 (Jennifer G. Hill & Randall S. Thomas eds., 2015) (arguing that institutional investor power in India is either static or dwindling).

21. *See* Peter F. Drucker, THE UNSEEN REVOLUTION: HOW PENSION FUND SOCIALISM CAME TO AMERICA 130 (1st ed. 1976).

22. *See* Robert C. Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561, 561 (1981).

23. *See* Azar et al., *supra* note 3, at 1514 n.2.

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and State Street Global Advisors.[24] A frequently cited statistic is that the combined holdings of these institutions (the so-called Big Three)[25] constitute the largest investment group in 88 percent of all S&P 500 firms,[26] and this concentration is increasing.[27]

The common ownership theory is linked not only to institutional investors but also to a particular type of investment—index investing.[28] There has been massive growth in index funds, including both index-based mutual funds and exchange-traded funds (ETFs),[29] which has led some commentators to ask whether index funds are "eating the world."[30] Index investing, which relies upon wide stock performance diversification,[31] has become the new default investment option for major financial institutions. According to BlackRock, for example, index investing is now a "cornerstone" of modern investment practice.[32]

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24. *See* Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1268; *see also* Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 298 (2017).

25. *See* Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 COLUM. L. REV. 2029, 2033 (2019); Fichtner et al., *supra* note 24, at 298.

26. *See* Azar et al., *supra* note 3, at 1514 n.2.

27. It has been predicted that, by 2024, index funds will hold more than 50% of the US stock market. Jill Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 20 (2019).

28. *See, e.g.*, *Index Investing and Common Ownership Theories*, BLACKROCK (Mar. 2017), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-index-investing-and-common-ownership-theories-eng-march.pdf [https://perma.cc/5TTH-X3HE] (archived Feb. 10, 2020) [hereinafter BLACKROCK]; Bebchuk & Hirst, *supra* note 25.

29. At the end of 2017, assets of US mutual funds and exchange traded funds (ETFs) totaled over $18 trillion, compared with $5.5 trillion nine years earlier. *See* Timothy Strauts, *5 Charts on U.S. Fund Flows That Show the Shift to Passive Investing*, MORNINGSTAR (Mar. 12, 2018), https://www.morningstar.com/blog/2018/03/12/fund-flows-charts.html [https://perma.cc/MHD8-6KPK] (archived Feb. 10, 2020).

30. Jason Zweig, *Are Index Funds Eating the World?*, WALL ST. J.: THE INTELLIGENT INVESTOR (Aug. 26, 2016), https://blogs.wsj.com/moneybeat/2016/08/26/are-index-funds-eating-the-world/ [https://perma.cc/6SA4-6DXS] (archived Feb. 10, 2020). *See also* Louis Navellier, *The Index Monster That Ate the Stock Market*, SEEKING ALPHA (Sept. 8, 2016), https://seekingalpha.com/article/4004842-index-monster-ate-stock-market [https://perma.cc/76HM-M7DG] (archived Apr. 7, 2020).

31. *See* BLACKROCK, *supra* note 28, at 4.

32. *Id.* at 1. *See also* Sarah Krouse et al., *Meet the New Corporate Power Brokers: Passive Investors*, WALL ST. J. (Oct. 24, 2016), https://www.wsj.com/articles/the-new-corporate-power-brokers-passive-investors-1477320101 [https://perma.cc/JT5E-LGHM] (archived Feb. 10, 2020); Fisch et al., *supra* note 27, at 17.

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Index funds, which have been described as "autopilot portfolios,"[33] track stock indices[34] rather than attempting to beat the market.[35] They feature prominently in the literature discussing common ownership; however, it is important to note the implications of the common ownership theory are, in fact, far broader than this form of investing and also include actively managed funds.[36]

In contrast to the "law matters" hypothesis, which regarded deep capital markets propelled by institutional investment as a desirable corporate governance outcome, anti–common ownership scholars view this form of diversified shareholding across concentrated product markets as deeply problematic.[37] They claim that there is empirical evidence to show that common ownership results in reduced competition and higher consumer prices in certain sectors.[38] The sectors targeted for academic scrutiny to date are the technology, airline, banking, and pharmaceutical industries.[39] An influential economics paper by Professor José Azar *et al.*, for example, claims that common ownership by the largest institutional investors in the US airline sector resulted in reduced competition and higher airline ticket prices for customers.[40] Yet, according to Elhauge, the industries identified so far are merely the tip of the iceberg, and numerous other sectors are equally "plagued" by common ownership.[41]

Anti–common ownership scholars warn that the growth of shareholder diversification could have a variety of dire consequences,[42] potentially undermining the entire economy,[43] with harmful effects on

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33. Zweig, *supra* note 30.

34. *See* Gabriel Rauterberg & Andrew Verstein, *Index Theory: The Law, Promise and Failure of Financial Indices*, 30 YALE J. ON REG. 1, 1 (2013); *Adriana Z. Robertson, Passive in Name Only: Delegated Management and "Index" Investing*, 36 YALE J. ON REG. 795, 797 (2019) (for discussion of the nature of securities indices, which underpin index investing).

35. *See* BLACKROCK, *supra* note 28, at 1 (for a description of modern index investing practice).

36. *Id.*; Elhauge, New Evidence, *supra* note 2, at 27.

37. *See* Frank Partnoy, *Are Index Funds Evil?*, ATLANTIC (Sept. 2017), https://www.theatlantic.com/magazine/archive/2017/09/are-index-funds-evil/534183/ [https://perma.cc/LTN9-LTVH] (archived Feb. 10, 2020).

38. *Id.*

39. *See, e.g.*, José Azar et al., Ultimate Ownership and Bank Competition (May 4, 2019) (unpublished manuscript) (on file with SSRN) [hereinafter Azar et al., Ultimate Ownership] (banking and finance); Yesha Yadav, Common Agency in Bank Regulation (2018) (unpublished presentation) (on file in the UC Berkeley Law Library Catalog); Azar et al., *supra* note 3, at 1513 (airline industry).

40. Azar et al., *supra* note 3, at 1513.

41. Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1268; *see also* Elhauge, *Growing Problem*, *supra* note 17, at 1–2.

42. *See, e.g.*, Bebchuk & Hirst, *supra* note 25, at 2133 (describing such warnings as "alarmism over common ownership").

43. *See* Elhauge, *Antitrust Law*, *supra* note 5, at 1.

consumer welfare and equality,[44] employment and wages,[45] and society as a whole.[46] The regulatory solutions suggested by some scholars to the supposed problems of the growth of institutional investors and common ownership are suitably Draconian.[47] They include depriving index funds of their voting rights;[48] restricting institutional investor share ownership to no more than one company in an oligarchy; and allowing institutional investors to hold shares in competing companies, only if those holdings do not exceed 1 percent, with forced divestiture in the case of noncompliance.[49]

III. THREE POSSIBLE NARRATIVES CONCERNING COMMON OWNERSHIP

At least three possible narratives might be derived from increased portfolio diversification by institutional investors, which is frequently in the form of common ownership across the same industry. Scholarship concerning the phenomenon of common ownership often shifts between these narratives, without necessarily specifying which version it is addressing.[50]

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44. *See, e.g.*, Partnoy, *supra* note 37 (stating that "[u]ltimately, the new theory of common ownership is a theory about inequality: To the extent that passive investing shifts costs to consumers, it makes the rich richer, and the poor poorer."); *see also* Elhauge, *Growing Problem*, *supra* note 17, at 10; Posner & Weyl, *supra* note 1.

45. Anti-common ownership literature also raises the issue of inequality, not only between shareholders and consumers, but also between shareholders and employees. *See, e.g.*, Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1292–93; Elhauge, New Evidence, *supra* note 2, at 15–16; Elhauge, *Antitrust Law*, *supra* note 5, at 11 (claiming that common ownership advantages shareholders, who are "disproportionately wealthy" and "depresses employment and wages in a way that further disproportionately harms the non-wealthy").

46. *See, e.g.*, Azar et al., Ultimate Ownership, *supra* note 39, at 35 ("[u]nfortunately, the benefits to shareholders from diversification and good governance may come at a cost to consumers: efficient capital markets with perfect diversification and "good governance" imply deadweight losses in input and output markets") (an earlier version of this article argued that diversification and good governance harmed "society at large"); *see also* Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 494 (2018) (arguing that the likely result of index investing is serious economic harm); Elhauge, New Evidence, *supra* note 2, at 26 (arguing that "enormous harm" of this kind is already occurring as a result of common ownership).

47. *See* Edward B. Rock & Daniel L. Rubinfeld, *Defusing the Antitrust Threat to Institutional Involvement in Corporate Governance* 24–27 (Law & Econ. Research Paper Series Working Paper No. 17–05, 2017) (outlining the various solutions to what the authors regard as a "non-problem").

48. Lund, *supra* note 46, at 497.

49. *See* Rock & Rubinfeld, *supra* note 47, at 26.

50. *See generally* Lund, *supra* note 46. At times, Professor Lund argues that "passive" index investors lack the financial incentive to monitor their portfolio companies to ensure that they are managed effectively, which appears to be a variant of Version 1 below. *Id.* at 495, 511, 512. She also argues, however, that these investors will "increasingly influence and even control the outcome of shareholder interventions", which suggests either Version 2 or Version 3 below. *Id.* at 493.

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Version 1, which might be labelled "the lazy investor narrative," focuses on the general incentives and behavior of fund managers. The argument here is that portfolio diversification, particularly across companies in the same economic sector, may result in perverse or inadequate incentives for institutional investors to engage in strong monitoring.[51] This narrative suggests that, particularly from a cost–benefit analysis, it may not make sense for fund managers to adopt a private investor/owner–like stance toward individual companies in a widely diversified portfolio[52] and that rational apathy will therefore prevail.[53]

This narrative assumes that lack of interest by institutional investors in the performance of individual portfolio firms will be harmful to the company's performance. It suggests that lazy investors inevitably breed lazy managers,[54] whose desire to enjoy "the quiet life"[55] will override their responsibilities to the company and its shareholders. In this narrative, lack of attention by institutional investors enables the portfolio firm's managers to call the shots in favor of their own preferences and self-interest.

This was a familiar part of the so-called passivity story of the 1990s.[56] The underlying presumption in corporate governance literature during this period was that monitoring by institutional investors is a positive feature of corporate governance, and nonparticipation by such investors is a corporate governance problem in need of a solution.[57] Academic literature during the 1990s sought to

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51. *See, e.g.*, Edward Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 373–74 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Jill Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009, 1009 (1994); *see also* Bebchuk & Hirst, *supra* note 25, at 2075 (discussing a range of disincentives for index funds to invest adequately in stewardship or to challenge corporate management).

52. *See* Alfred F. Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J.L. REFORM 117, 146–48 (1988).

53. *See, e.g.*, Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 473–74 (1991).

54. *See, e.g.*, Azar et al., *supra* note 3 (suggesting that failure by institutional investors to demand or provide incentives for greater competition between portfolio firms may allow managers of those firms "to enjoy the 'quiet life'"); Azar et al., Ultimate Ownership, *supra* note 39, at 5.

55. *See* Marianne Bertrand & Sendhill Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111 J. POL. ECON. 1043, 1043 (2003); Elhauge, *Growing Problem*, *supra* note 17, at 5 (stating that "because competing vigorously is hard work for managers, they are less likely to do it unless their shareholders are actively pressing them to compete").

56. Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 522 (1990) [hereinafter Black, *Shareholder Passivity*].

57. *See, e.g.*, G.P. Stapledon, *Disincentives to Activism by Institutional Investors in Listed Australian Companies*, 18 SYDNEY L. REV. 152, 154, 165 (1996); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 821 (1992) [hereinafter Black, *Agents Watching Agents*]; Conard, *supra* note 52.

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find ways to overcome the legal and economic barriers to greater institutional investor engagement in corporate governance.[58]

Recent articles, by Professor Dorothy Lund and Professors Lucian Bebchuk and Scott Hirst, represent modern incarnations of this narrative.[59] Lund, for example, has argued within this paradigm that index funds are quintessentially passive and ignorant investors, with inadequate incentives to monitor management.[60] Bebchuk and Hirst are also concerned that index fund managers have incentives to underinvest in stewardship and to be overly deferential to the managers of portfolio companies.[61]

Yet, although the articles by these scholars reveal similar concerns, their regulatory prescriptions are quite different. Lund effectively adopts a punitive approach, arguing that index funds, as innately lazy investors, should therefore be deprived of their voting rights.[62] Bebchuk and Hirst, on the other hand, are more sanguine, suggesting reforms to counteract current incentives that nudge index fund managers toward passivity.[63] Their goal is to make index fund voting better informed and meaningful.[64]

Bebchuk and Hirst's approach is consistent with the policy goals in many parts of the world, where the aim is to increase, not decrease, corporate governance engagement by institutional investors, including index funds.[65] Lund's proposal, however, directly conflicts with those policy goals.[66] Furthermore, discrimination of the kind advocated by Lund could be unlawful in jurisdictions where a one-vote-per-share policy prevails.[67] It is interesting to note, for example, that, in Australia, an attempt to alter the corporate constitution of a company to disenfranchise institutional investors was struck down by the court

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58. Black, *Agents Watching Agents*, *supra* note 57, 830–35; Black, *Shareholder Passivity*, *supra* note 56, at 521.

59. *See generally* Bebchuk & Hirst, *supra* note 25; Lund, *supra* note 46.

60. Lund, *supra* note 46, at 512–13. *See also* Bill Ackman, *Capitalism's Unlikely Heroes: Why Activist Investors are Good for the Public Company*, ECONOMIST (Feb. 5, 2015), https://www.economist.com/leaders/2015/02/05/capitalisms-unlikely-heroes [https://perma.cc/33HX-Q5XY] (archived Feb. 10 2020). *Cf.* Elhauge, New Evidence, *supra* note 2, at 3.

61. Bebchuk & Hirst, *supra* note 25, 2035, 2050, 2059.

62. Lund, *supra* note 46, at 528–30, 536.

63. Bebchuk & Hirst, *supra* note 25, at 2118.

64. *Id.*

65. *See generally* Jennifer G. Hill, *The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering Combat*, 2019 U. ILL. L. REV. 507 (2019) [hereinafter Hill, *Trajectory*]; Giovanni Strampelli, *Are Passive Index Funds Active Owners? Corporate Governance Consequences of Active Investing*, 55 SAN DIEGO L. REV. 803 (2018).

66. *See generally* Lund, *supra* note 46.

67. *See, e.g.*, Douglas Appell, *'One Share, One Vote' Remains Gold Standard Despite Challenges*, PENSIONS & INVESTMENTS (Aug. 7, 2017), https://www.pionline.com/article/20170807/PRINT/170809923/one-share-one-vote-remains-gold-standard-despite-challenges [https://perma.cc/3APZ-SQKT] (archived Mar. 16, 2020).

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on the basis that such inherent discrimination between different shareholder groups constituted fraud on the minority.[68]

Versions 2 and 3 of the possible common ownership narratives differ significantly from Version 1. Whereas Version 1 raises concerns about lack of engagement by institutional investors, Version 2 suggests that they are too involved in corporate governance. Also, whereas Version 1 focuses on the danger of uncontrolled power by corporate managers, Versions 2 and 3 are underpinned by concern about the behavior and/or power of institutional investors themselves.

According to Version 2, which might be described as "the anticompetitive pressure model," where common ownership occurs across the same economic sector, institutional investors will have skewed incentives, leading them to abuse their ownership rights by pressuring managers of investee firms to act in an anticompetitive or collusive fashion. This narrative would seem to suggest that common ownership involves situations where institutional investors pressure managers of investee companies to engage in anticompetitive conduct.[69]

This interpretation of Version 2 appears to require active conduct by institutional investors to subvert competition between portfolio companies in the same sector. Such an interpretation accords with Professor Richard Buxbaum's suggestion almost twenty years ago that "a totally passive investor . . . may be easier to accept than an active one."[70]

At first sight, this interpretation of Version 2 would seem to exclude index funds on the basis that they are passive investors only. Nonetheless, there is a broader interpretation of Version 2, which is capable of including index funds, by challenging the accuracy of their depiction as "passive investors."[71] It has been argued, for example, that, although index investors cannot vote on, or influence, the

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68. *See Australian Fixed Trusts Ltd. v Clyde Indus. Ltd.* (1959) 59 SR (NSW) 33 (Austl.).

69. *See* Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1269 (arguing that "institutional investors usually . . . communicate with and actively seek to influence" their portfolio companies, although Elhauge, relying on Version 3 of the common ownership narrative, denies that this is a precondition to anticompetitive outcomes). Note also that some anti-common ownership theorists rely on negative, rather than positive, pressure by institutional investors—interpreting *failure to pressure* management to compete aggressively as having an equivalent anticompetitive effect. *See* Azar et al., Ultimate Ownership, *supra* note 39, at 5–6; Elhauge, New Evidence, *supra* note 2, at 28–29 (stating that "reduction in pressure itself will likely have anti-competitive effects").

70. Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 BROOK. L. REV. 1, 21 (1991).

71. *See generally* Ian R. Appel et al., *Passive Investors, Not Passive Owners*, 121 J. FIN. ECON. 111 (2016).

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competitive strategies of their portfolio firms,[72] they, nonetheless, behave as active investors when they exercise rights attached to their shares with respect to governance matters (such as nomination of board members, executive compensation) and engage in dialogue with management.[73]

Indeed, large asset managers themselves reject the notion that they are "passive." Vanguard has stated, for example, "[w]e believe that our active engagement demonstrates that passive investors don't need to be passive owners."[74] Similarly, BlackRock has criticized the supposed dichotomy between active and passive shareholders as superficial, suggesting that most traditional asset managers adopt an approach midway between these two outer points.[75] Also, the majority of index funds are not stand-alone funds.[76] Rather, they are part of investment fund families, which will include active funds, and this may provide index funds with incentives to improve the corporate governance of a given company, in circumstances where that would improve performance of the fund family as a whole.[77] Moreover, even when index funds track a particular index, fund managers will have some discretion in terms of the relative weighting they give to stock in that index.[78]

Institutional investors have also stressed that, since they are effectively locked into their investment for the long term, they need to engage with the managers of the companies in which they invest.[79]

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72. *See, e.g.*, Azar et al., *supra* note 3, at 1557 (stating "[w]e do not mean to suggest here that shareholders vote directly on competitive strategies"); *see also* BLACKROCK, *supra* note 28, at 8; Rock & Rubinfeld, *supra* note 47, at 9.

73. *See, e.g.*, Azar et al., *supra* note 3 at 1553.

74. VANGUARD, http://www.vanguard.com (last visited Feb. 5, 2020) [https://perma.cc/DC65-C8YL] (archived Mar. 16, 2020) (cited in Posner et al., *supra* note 1, at A29). *See also* Charles Stein, *McNabb Says Firm is Not Passive on Governance*, BLOOMBERG (Mar. 4, 2015), https://www.bloomberg.com/news/articles/2015-03-04/vanguard-s-mcnabb-says-firm-is-not-passive-on-governance [https://perma.cc/5QWW-KPXU] (archived Feb. 10, 2020). *Cf.* Lund, *supra* note 46, at 497 (who makes a sharp distinction between institutional investors that adopt an active corporate governance engagement strategy and "passive" index funds).

75. *See* Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuk–Strine Debate*, 12 N.Y.U. J.L. & BUS. 385, 386 (2016); BLACKROCK, *supra* note 28, at 8; Bebchuk & Hirst, *supra* note 25; Fisch et al., *supra* note 27, at 48.

76. *See* Marcel Kahan & Edward Rock, *Index Funds and Corporate Governance: Let Shareholders be Shareholders* (N.Y.U. Law & Econ. Research, Working Paper No. 18–39, 2019) (on file with SSRN).

77. *Id.*

78. *See, e.g.*, *What Affects Index Tracking*, VANGUARD, https://advisors.vanguard.com/VGApp/iip/site/advisor/etfcenter/article/ETF_IndexTracking (last visited Mar. 16, 2020) [https://perma.cc/T35F-T738] (archived Mar. 16, 2020).

79. *See* Vanessa Desloires, *BlackRock, Vanguard, State Street are Not Passive on Corporate Governance*, SYDNEY MORNING HERALD (Nov. 1, 2016), https://www.smh.com.au/business/markets/blackrock-vanguard-state-street-are-not-passive-on-corporate-governance-20161031-gseb74.html [https://perma.cc/CAJ4-4SR3] (archived Feb. 10, 2020).

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Under Version 1 of the common ownership narrative, increased engagement in corporate governance by large institutional investors reflects good corporate governance.[80] Under the more expansive interpretation of Version 2, it is dangerous, in that it potentially involves transmission of anticompetitive incentives to portfolio firms.[81]

Version 3 of the common ownership narrative does a significant pivot in terms of perspective. Unlike Version 2, which examines the incentives and behavior of institutional investors, Version 3 instead focuses solely on the incentives and behavior of corporate managers of the investee firms, albeit under the shadow of institutional investor power. In so doing, Version 3 eliminates the need to show any misuse of share ownership rights by institutional investors; it is immaterial whether investors are active or passive. Under Version 3, which might be called "the mindreading model," it is sufficient that the corporate managers of the portfolio firm are aware that common ownership exists in their sector, on the basis that this awareness allows them to discern, and follow, the presumed anticompetitive preferences of large diversified investors.[82] Adopting the mindreading model, some anti–common ownership scholars have predicted that managers who correctly divine institutional investor preferences by "either conscious calculation, intuition, or pure luck"[83] will tend to be selected to run the firm.[84] In evolutionary terms, this would appear to be a variant of natural selection.[85]

Version 3 of the common ownership narrative goes substantially further than Version 2. Under Version 3, the allegedly anticompetitive incentives are "purely structural,"[86] deriving from the mere fact of common ownership. Indeed, under this version of the common ownership narrative, it is irrelevant that: all the financial interests are merely minority shareholdings;[87] the institutional investors have not themselves engaged in any conduct to achieve anticompetitive ends;[88] there has been no attempt by institutional investors to communicate

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80. *See* Bebchuk & Hirst, *supra* note 25, at 2034.

81. *See* Azar et al., *supra* note 3 at 1560; Azar et al., Ultimate Ownership, *supra* note 39, at 5.

82. *See, e.g.*, Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1270 (suggesting active communication is not necessary for common ownership to have anticompetitive effects).

83. Azar et al., Ultimate Ownership, *supra* note 39, at 5.

84. *Id.*

85. *See, e.g.*, Emily Osterloff, *What is Natural Selection?*, NAT. HISTORY MUSEUM (Mar. 18, 2019), https://www.nhm.ac.uk/discover/what-is-natural-selection.html [https://perma.cc/HB7N-WDJA] (archived Feb. 4, 2020) (describing "natural selection" as an evolutionary mechanism by which "[o]rganisms that are more adapted to their environment are more likely to survive . . . .").

86. Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1270; *see also* Elhauge, *Growing Problem*, *supra* note 17, at 2 (declaring that the problem of horizontal shareholding is structural).

87. *See generally* Azar et al., *supra* note 3.

88. Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1270.

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with, or influence, managers of the portfolio company;[89] and there is no coordination or collusion between managers of competing companies.[90]

According to Elhauge, who adopts Version 3 of the common ownership narrative, where institutional investors own shares in competing companies, those investors are liable under US antitrust law if their pattern of ownership lessens competition, regardless of whether they have undertaken any positive actions to contribute to such an outcome.[91] This is a startling proposition. It is reminiscent of Justice Louis Brandeis's comment more than a hundred years ago that "[t]here is no such thing . . . as an innocent stockholder."[92]

IV. THE THEORY OF COMMON OWNERSHIP FROM A CORPORATE GOVERNANCE PERSPECTIVE

The common ownership theory subverts many fundamental tenets of contemporary corporate governance concerning the desirability of increased shareholder engagement. Version 3 of the common ownership narrative posits that mere ownership of shares by institutional investors across concentrated industries can *ipso facto* breach competition laws. This is a sufficiently disquieting proposition as to warrant close scrutiny of the common ownership theory from a corporate governance perspective. There are a number of points that

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89. *See* Elhauge, *Antitrust Law*, *supra* note 5, at 9 (arguing that shareholder communications become irrelevant in lessening competition when incentives in executive compensation achieve that aim); Elhauge, New Evidence, *supra* note 2, at 2 (horizontal shareholding/common ownership does not require communication between shareholders and managers); *see also* Elhauge, *Growing Problem*, *supra* note 17, at 2 (arguing that anticompetitive effects of horizontal shareholding do not depend on communication between managers); Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1269 (stating anticompetitive effect does not require communication between managers and shareholders). Elhauge notes, however, that communication by institutional investors to managers, in fact, often occurs. *Id.* at 1269–70.

90. *See* Azar et al., Ultimate Ownership, *supra* note 39, at 4–5 ("the fact that concentrated ownership is related to higher prices for banking products need not be driven by collusion, i.e., coordinated price-setting between banks."); Elhauge, *Antitrust Law*, *supra* note 5, at 1–2 (stating that horizontal shareholding/common ownership does not require coordination between managers of different companies); Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1269 (stating that horizontal shareholding does not depend on managers coordinating with each other); *see also* Elhauge, *Growing Problem*, *supra* note 17, at 2 (stating anticompetitive effect does not depend on coordination between managers); Elhauge, New Evidence, *supra* note 2, at 2 (horizontal shareholding/common ownership does not require communication between managers of different companies); Posner & Weyl, *supra* note 1 (arguing that there is no requirement for managers to conspire with each other).

91. *See generally* Elhauge, *Horizontal Shareholding*, *supra* note 6 (arguing that stocks which create anticompetitive common ownership are illegal under current antitrust law).

92. *Big Corporations Dangerous to Workers, Says Brandeis*, READING EAGLE, Jan. 23, 1915, at 6.

can be made about the common ownership theory, which suggest possible weaknesses in its conclusions.

A. *Common Ownership Is a Controversial and Broad-Brush Theory*

In spite of its early academic impact, it is worth remembering that the common ownership theory is just that—a theory—and that theorizing about the possible anticompetitive effects of common ownership on managerial incentives does not prove that those effects occur in practice.[93] Nor does it prove that any anticompetitive behavior which does exist is caused by common ownership.[94] A recent empirical study by Professor Erik Gilje, *et al.*,[95] for example, provides data to assess the extent to which the theory represents reality, and its findings suggest that in many instances, the empirical evidence does not conform to theory in relation to common ownership.[96]

Not only is the common ownership argument just a theory, it is also a very broad-brush theory, which contains several puzzling elements. For example, one curious aspect of the mindreading model, Version 3 of the common ownership narrative, is why corporate managers would, without any pressure or direction, act in the presumed interests of institutional investors with diversified portfolios. Elhauge suggests that corporate managers might behave in this way for a litany of possible reasons—"out of a sense of fiduciary duty or gratitude, to gain support in future elections, to enhance future job prospects, because executive compensation methods align with shareholder interests, or so their shareholders will fend off takeover threats."[97] Also, discerning institutional investors' presumed preferences under Version 3 will be no easy task. Those interests and preferences are heterogeneous and constantly in flux, rendering the assessment that corporate managers are required to make difficult and prone to miscalculation.[98]

Such far-reaching suppositions about the means by which anticompetitive incentives might be transmitted from institutional investors to corporate managers suggest the need for further empirical

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93. *See* BLACKROCK, *supra* note 28, at 2, 6–7, 15 (arguing that some of the assumptions made in existing literature examining economics theory are based on misconceptions of reality).

94. *Id.*

95. *See* Erik P. Gilje et al., *Who's Paying Attention? Measuring Common Ownership and Its Impact on Managerial Incentives* 4 (Nat'l Bureau of Econ. Research Working Paper No. 25644, 2019) (doubting that common ownership significantly affects managerial incentives).

96. *Id.*

97. Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1270.

98. *See* Rock & Rubinfeld, *supra* note 47, at 4–5 (demonstrating the heterogeneity of the holdings of the largest shareholders).

research, like the Gilje *et al.* study,[99] to bring greater clarity to the investigation of whether corporate managers actually behave in this way and, if they do, why this occurs and under what circumstances. A growing number of studies have challenged the empirical underpinnings of the common ownership theory,[100] and the mechanisms, including executive remuneration,[101] which have been suggested might provide the necessary conduit for transmission of anticompetitive incentives to corporate management.[102]

B. *The Common Ownership Theory Includes Some Questionable Underlying Presumptions*

The common ownership argument also includes several questionable presumptions in reaching its conclusion that corporate managers will behave in an anticompetitive way. As already noted, Version 2 of the common ownership narrative surmises that institutional investors will exert anticompetitive pressure on corporate managers of investee firms. Version 3 goes further, by suggesting that institutional investors, including index funds, are so powerful that the corporate managers will do their presumed bidding, even in the absence of such pressure. Shareholder power and participation in corporate governance in the United States has undoubtedly increased in recent years,[103] but are institutional investors as formidable as anti–common ownership scholars suggest?

Versions 2 and 3 of the common ownership narrative contradict the traditional image of the institutional investor as passive[104] and a

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99. Gilje et al., *supra* note 95 (casting doubt on the theory that common ownership significantly affects managerial incentives).

100. *See, e.g.*, Patrick Dennis et al., *Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry* (Fed. Reserve Bank of Atl., Working Paper 2019–15, 2019) (arguing that correlation between high prices and common ownership is caused by the endogenous market share component, rather than ownership); PAULINE KENNEDY ET AL., THE COMPETITIVE EFFECTS OF COMMON OWNERSHIP: ECONOMIC FOUNDATIONS AND EMPIRICAL EVIDENCE (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3008331 [https://perma.cc/XNQ5-5Z4E] (archived Feb. 4, 2020) (finding no evidence that common ownership raises airline prices).

101. *See generally* David I. Walker, *Common Ownership and Executive Incentives: The Implausibility of Compensation as an Anticompetitive Mechanism*, 99 B.U. L. REV. 2373 (2019).

102. *See, e.g.*, C. Scott Hemphill & Marcel Kahan, *The Strategies of Anticompetitive Common Ownership* (Eur. Corp. Governance Inst., Working Paper No. 423, 2018) (arguing that most of the offered mechanisms are not supported empirically).

103. *See generally* Hill, *Trajectory*, *supra* note 65 (discussing evolving shareholder governance rights acquired by private ordering).

104. *See* Black, *Shareholder Passivity*, *supra* note 56, at 520, 567–70 (arguing recent developments in institutional stock ownership and voting behavior make the passivity story obsolete).

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"paper colossus,"[105] since they presume high levels of institutional investor influence. In fact, US shareholders have far fewer statutorily guaranteed corporate governance participatory rights than shareholders in other common law jurisdictions, including the United Kingdom and Australia.[106] Also, recent studies highlight the fact that institutional investors direct relatively limited resources towards corporate monitoring.[107] These studies show that investment managers of mutual funds, both indexed and actively managed, have incentives to spend negligible amounts on stewardship,[108] and to side excessively with managers of corporations.[109] These studies suggest that, rather than corporate managers bending to institutional investors' pressure (Version 2) or presumed preferences (Version 3), institutional investors, in fact, generally follow the lead of the corporate managers.[110] Also, even when investors do flex their muscles by, for example, seeking stronger governance rights, management often responds by engaging in "private ordering combat,"[111] to try to modify or dilute the rights sought by shareholders.[112]

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105. Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 863 (1991).

106. *See* Jennifer G. Hill, *Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware*, 63 VAND. L. REV. 1 (2010) (explaining why News Corp. moved from Australia to Delaware); Hill, *Trajectory*, *supra* note 65, at 514 (including majority voting, convening shareholder meetings, and nominating and removing directors).

107. *See* Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017) (arguing that agency costs disincentivize fully investing in stewardship of company); Bebchuk & Hirst, *supra* note 25, at 2050 (arguing that index fund managers have strong incentives to underinvest in stewardship); *see* also Strampelli, *supra* note 65 (arguing that policy makers need to encourage index fund managers and institutional investors to play a greater oversight role).

108. *See* Bebchuk et al., *supra* note 107, at 100 (citing several companies that spent negligible amounts on stewardship).

109. *See id.* at 96 (arguing agency costs disincentivize proxy fights with managers); Bebchuk & Hirst, *supra* note 25 (arguing that index fund managers have strong incentives to side with corporate managers); *see also* Lund, *supra* note 46, at 523–26 (discussing the rise of passive investing).

110. This conclusion accords with the findings of the Gilje, Gormley and Levit study on the impact of index investing on managerial incentives. *See* Gilje et al., *supra* note 95 (arguing that some investors do not pay much attention to the actions of managers); *see also* Bebchuk & Hirst, *supra* note 25; Lund *supra* note 46 at 512–13.

111. Hill, *Trajectory*, *supra* note 65, at 524–40.

112. *See id.* (demonstrating that managers changed the interpretation of regulations and amended bylaws to weaken shareholder mechanisms of managerial control).

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C. *Recognition of the Link Between Concentrated Ownership and Antitrust Law Is Not New*

The references to common ownership by institutional investors as a "blockbuster" discovery,[113] and its description as the "great, but mostly unknown, antitrust story of our time"[114] suggest that the link between the growing concentration of share ownership and antitrust issues has only recently been uncovered. This is not, in fact, the case. Corporate governance literature from the early 1990s onwards focused on the implications of concentration of share ownership associated with the rise of institutional investment.[115] Buxbaum, for example, highlighted the fact that a broadening of portfolio distribution was the inevitable consequence of the absolute growth of institutional investment pools,[116] while Professor Bernard Black sought ways of ensuring increased "institutional voice,"[117] in accordance with Version 1 of the common ownership narrative discussed above.

These scholars also explicitly considered the growth in concentrated ownership and portfolio diversification from a competition law perspective.[118] Yet, they concluded that antitrust law constituted a very weak constraint on institutional investors.[119] Although Buxbaum acknowledged the theoretical possibility that institutional investors could contravene antitrust laws, the potential scenarios in which he thought this might occur went well beyond mere common ownership, as envisaged under Version 3.[120] Rather, Buxbaum's examples involved coordinated forms of institutional investor activism,[121] such as a targeted collective boycott against a particular firm.[122] Black also considered this issue,[123] and, like Buxbaum, viewed the risk at that time to be "entirely theoretical," and subject to countervailing factors that reduced the likelihood of antitrust violations.[124] The approach of Buxbaum and Black is consistent with a narrow reading of Version 2 of the common

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113. *See* Elhauge, *Horizontal Shareholding*, *supra* note 6, at 1283 (arguing that antitrust enforcement has historically been lacking because the link between horizontal shareholding and anticompetition issues has only recently been recognized).

114. Posner et al., *supra* note 1, at A29.

115. *See also* Partnoy, *supra* note 37 (tracing the origins of the common ownership argument back to a 1984 paper by Julio Rotemberg).

116. Buxbaum, *supra* note 70, at 3.

117. Black, *Agents Watching Agents*, *supra* note 57, at 815–16.

118. *See* Black, *Agents Watching Agents*, *supra* note 57; Buxbaum, *supra* note 70.

119. Buxbaum, *supra* note 70, at 25.

120. *Id.*

121. *Id.*

122. *Id.*

123. Black, *Agents Watching Agents*, *supra* note 57, at 870–71.

124. *Id.*; *see also* Black, *Shareholder Passivity*, *supra* note 56, at 558–60 (describing several regulatory obstacles to antitrust violations).

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ownership narrative, which would require actual misuse of ownership rights by institutional investors to achieve anticompetitive ends.[125]

Professors Rock and Rubinfeld have addressed this issue more recently and come to a similar conclusion.[126] Although acknowledging that common ownership by institutional investors could in certain circumstances have anticompetitive effects, Rock and Rubinfeld find no persuasive evidence that this state of affairs currently exists.[127] BlackRock has similarly criticized the common ownership theory as based on "fragile evidence" in this regard.[128]

D. *Common Ownership Is a US-Centric and Industry-Specific Debate*

Although the common ownership debate is now spreading around the world, its origins are inherently US-centric in their focus on particular American industries. Nonetheless, the market for capital is now global and there are developments, both in the United States and elsewhere in the world, which potentially affect that investment ecosystem and the common ownership debate. For example, in recent years there has been a striking reduction in the number of public companies in the United States,[129] which has increased the importance of global investment opportunities for US institutional investors.

American companies are not always competing with each other. Indeed, they are not always competing with companies that have the same governance structures, as is shown by the rise of Chinese State-Owned Enterprises (SOEs).[130] Whereas some of the industry clusters

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125. In the Australian competition law context, it is interesting to note that amendments were introduced in November 2017, which prohibit "a concerted practice that has the purpose, or has or is likely to have the effect, of substantially lessening competition"; Competition and Consumer Act § 45 (2010); *see generally* Nichols & Kayis, *supra* note 10.

126. *See* Rock & Rubinfeld, *supra* note 47 (suggesting that, in proposing guidelines to prevent anticompetitive behavior, it is still important to protect investors' involvement in corporate governance).

127. *Id.* Rock and Rubinfeld dismiss the common ownership argument, by stating, "[w]e have considered the antitrust attack on widely diversified institutional investor ownership, and found it lacking." *Id.* at 37.

128. BLACKROCK, *supra* note 28, at 2, 6–7; *see also* Hemphill & Kahan, *supra* note 102, at 46 (arguing that there is there is "no strong theoretical basis" for the assumptions that underlie the common ownership theory).

129. *See generally* IRA M. MILLSTEIN CENTER FOR GLOBAL MARKETS AND CORPORATE OWNERSHIP, PRIVATE OWNERSHIP AT A PUBLIC CROSSROADS: STUDYING THE RAPIDLY EVOLVING WORLD OF CORPORATE OWNERSHIP (2019) (arguing that ownership and control of companies has shifted from individuals in public markets to individuals in private markets).

130. *See* Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013) (explaining the importance of SOEs for China's model of state capitalism). High levels of state control are also found in a number of other jurisdictions, such as Singapore. *See, e.g.*, Luh Luh Lan & Umakanth Varottil, *Shareholder Empowerment in*

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considered in the common ownership literature, such as the banking and the airline industries, may be US oligopolies, others, such as technology and pharmaceutical sectors, are now global markets. Even in concentrated industries, spillover effects in other industries and other markets, in which highly diversified shareholders are invested, will necessarily complicate any assessment of investor incentives.[131]

From a global investment perspective, it is interesting to examine The Norwegian Government Pension Fund Global (the Norwegian oil fund),[132] which is the world's largest sovereign wealth fund, with over $1 trillion in assets.[133] In 2015, the fund announced that it was moving from passive investment to adopting an active owner stance.[134] It now has stakes in over nine thousand companies in seventy three countries, and owns an average of 1.4 percent of every company listed on any stock market around the world.[135] The Norwegian oil fund's record breaking 2017 annual return of $131 billion[136] was largely attributable to its broad investment strategy, coupled with the strong performance of technology stocks in its global portfolio, including Apple and Microsoft in the United States and Tencent in China.[137]

Controlled Companies: The Case of Singapore, *in* RESEARCH HANDBOOK OF SHAREHOLDER POWER, *supra* note 20, at 572.

131. *See, e.g.*, Madison Condon, *Externalities and the Common Owner* (N.Y.U. Law & Econ. Working Paper No.19-07, 2019) (arguing that diversified investors should rationally be motivated to internalize negative externalities within their portfolio); Alessandro Romano, *Horizontal Shareholding: The End of Markets and the Rise of Networks* (Working Paper, Sept. 2018) (proposing Network Sensitive Regulations to analyze effects of diffuse institutional ownership).

132. The Norwegian oil fund is managed by Norges Bank Investment Management, which is the asset management arm of Norway's central bank, Norges Bank. *About Us*, NORGES BANK INV. MGMT., https://www.nbim.no/en/organisation/about-us/ (last visited Feb. 4, 2020) [https://perma.cc/WGU2-LBBM] (archived Feb. 4, 2020).

133. *A Trillion Dollar Fund*, NORGES BANK INV. MGMT, (Sept. 19, 2017), https://www.nbim.no/en/transparency/news-list/2017/a-trillion-dollar-fund/ [https://perma.cc/JC54-T7RC] (archived Feb. 4, 2020).

134. Richard Milne, *Norway Oil Fund Chief Jettisons Passivity*, FIN. TIMES (Aug. 9, 2015), https://www.ft.com/content/4ea976d0-26d6-11e5-9c4e-a775d2b173ca [https://perma.cc/Y5TM-W32C] (archived Mar. 16, 2020).

135. NORGES BANK INVESTMENT MANAGEMENT, GOVERNMENT PENSION FUND GLOBAL 28 (2018) [hereinafter NORGES BANK PENSION FUND]; *About Us*, *supra* note 132.

136. Note, however, that in 2018 the Norwegian oil fund returned -6.1 percent, its worst result since 2008, during the global financial crisis, as a result of financial volatility. *See Norway's Oil Fund Reports Worst Annual Results Since 2008*, CENTRAL BANKING (Feb. 27, 2019), https://www.centralbanking.com/central-banks/sovereign-wealth/4056801/norways-oil-fund-reports-worst-annual-results-since-2008 [https://perma.cc/Z24W-NVK6] (archived Apr. 18, 2020); NORGES BANK PENSION FUND, *supra* note 135 (explaining that year-to-year fluctuations are common).

137. Richard Milne, *Norway Oil Fund Posts $131 Billion Return for 2017*, FIN. TIMES (Feb. 27, 2018), https://www.ft.com/content/48cec082-1ba0-11e8-aaca-4574d7dabfb [https://perma.cc/V5AL-N2TP] (archived Mar. 16, 2020); Eshe Nelson, *How Norway's Sovereign Wealth Fund Made $130 Billion Dollars in One Year*, WORLD ECON. FORUM (Mar. 5, 2018), https://www.weforum.org/agenda/2018/03/apple-tencent-and-microsoft-how-norway-s-massive-oil-fund-made-130-billion-in-one-year [https://perma.cc/2F3C-5U7C] (archived Feb. 4, 2020); *see* Mark Sweeney, *Tencent, the*

As noted, the largest US institutional investors are also increasingly involved in international markets. Although they tend to have investments in far fewer companies than the Norwegian oil fund, their investment levels are, on average, higher. For example, it is estimated that BlackRock owns at least 5 percent of over 2,600 companies worldwide and Vanguard owns around the same level of 1,800 companies worldwide.[138]

The investment strategy of the Norwegian oil fund is based on the objective of "maximising return with moderate risk."[139] The kinds of restrictions that are suggested by anti–common ownership scholars would seriously undermine the investment strategies of US institutional investors which, like the Norwegian oil fund, seek to use broad portfolio diversification as a risk management tool.

E. *Common Ownership in Megacompanies*

Another problematic aspect of the common ownership hypothesis is its focus on institutional investors, rather than on the rise in market power of the investee firms themselves. If these firms have indeed engaged in anticompetitive behavior, it might be thought that they would be more obvious targets for competition law than their shareholders.[140] Yet, by targeting investment patterns, the common ownership literature obscures the fact that the firms in some sectors, such as the technology sector, have themselves become "powerful megacompanies."[141] This is reflected in Apple's 2018 market valuation of $1 trillion,[142] and in Senator Elizabeth Warren's proposal to break up companies, such as Amazon, Facebook, and Google.[143]

$500bn Chinese Tech Firm You May Have Never Heard of, GUARDIAN (Jan. 13, 2018), https://www.theguardian.com/business/2018/jan/13/tencent-the-500bn-chinese-tech-firm-you-may-never-have-heard-of [https://perma.cc/JKR9-9USX] (archived Feb. 4, 2020). The Norwegian Oil Fund's returns on its equity holdings were significantly reduced in 2018, due to global political and trade instability. Katie Martin, *Norway Oil Fund Returns Narrowly Miss Benchmark in Second Quarter*, FIN. TIMES (Aug. 21, 2018), https://www.ft.com/content/9e081c44-a519-11e8-926a-7342fe5e173f [https://perma.cc/4NEL-6FPC] (archived Mar. 16, 2020).

138. Fichtner et al., *supra* note 24, at 312 tbl.2.

139. Letter from Øystein Olsen & Yngve Slyngstad, Norges Bank Investment Management, to the Ministry of Finance, Investment Strategy for the Government Pension Fund Global 1 (Nov. 16, 2017) (on file with Norges Bank Inv. Mgmt.).

140. Partnoy, *supra* note 37.

141. Matt Phillips, *Apple's $1 Trillion Milestone Reflects Rise of Powerful Megacompanies*, N.Y. TIMES (Aug. 2, 2018), https://www.nytimes.com/2018/08/02/business/apple-trillion.html [https://perma.cc/9WG4-YGW2] (archived Feb. 4, 2020).

142. *Id.*

143. *See* David Smith, *Elizabeth Warren Vows to Break Up Amazon, Facebook and Google if Elected President*, GUARDIAN (Mar. 8, 2019), https://www.theguardian.com/us-news/2019/mar/08/elizabeth-warren-amazon-facebook-google-big-tech-break-up-blogpost [https://perma.cc/JQQ7-XA5J] (archived Feb. 4, 2020) (explaining that Warren wants to rein in the tech giants).

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Several recent studies have shown a dramatic increase in the size and concentration levels of companies in some industries, including in the banking sector and airlines sector, which feature so prominently in the common ownership debate.[144] For some economists, it is the corporate consolidation and concentration of power in a small number of megacompanies, rather than their capital structure, which has created problems relating to wage inequality[145] and consumer welfare.[146] This suggests the possibility that the common ownership theory may reflect correlation, rather than causation.[147]

The regulatory implications of this approach are that the law should target the companies that engage in anticompetitive conduct, rather than targeting institutional investors, by restricting their ability to own shares in competing companies.[148] A recent report of the Australian Government Productivity Commission adopts this approach in relation to Australia's extremely concentrated financial sector.[149] Acknowledging that these huge financial institutions "have the ability to exercise market power over their competitors and consumers,"[150] the report adopts a targeted approach to

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144. *See, e.g.*, Gustavo Grullon et al., *Are US Industries Becoming More Concentrated?*, 23 REV. FIN. 697 (2019) (finding that over seventy-five percent of companies saw an increase in their concentration); *see also* Kathleen Kahle & René M. Stulz, *The Shrinking Number of Public Corporations in the US*, LONDON SCH. OF ECON. & POL. SCI. US CENTRE (Oct. 21, 2017), http://bit.ly/2yWc6El [https://perma.cc/9YXQ-N7SG] (archived Feb. 4, 2020) (noting the massive increase in market concentration in the United States between 1975 and 2015, in which "the winners have done well"); IRA M. MILLSTEIN CENTER, *supra* note 129 (highlighting the dramatic decline in the number of public companies).

145. *See* Rachel Abrams, *7 Fast-Food Chains to End "No Poach" Deals that Lock Down Low Wage Workers*, N.Y. TIMES (July 12, 2018), https://www.nytimes.com/2018/07/12/business/fast-food-wages-no-poach-deal.html [https://perma.cc/HTE5-U4ED] (archived Feb. 22, 2020); *see* also Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise Sector* (Working Paper, 2017), http://conference.nber.org/confer//2017/SI2017/LS/Krueger_Ashenfelter.pdf [https://perma.cc/6VBM-NNKX] (archived Feb. 4, 2020) (examining use of market power and collusive actions by employers to suppress wages and restrict competition).

146. *See* Grullon et al., *supra* note 144 (explaining that firms enjoy higher profit margins, but it is unclear whether consumers benefit from higher quality products).

147. *See* BLACKROCK, *supra* note 28, at 2 (arguing that the common ownership research in the economics literature does not provide a "plausible causal explanation of how common ownership can lead to higher prices"); *see also id.* at 6–7, 15.

148. *See, e.g.*, Krueger & Ashenfelter, *supra* note 145, at 2–3.

149. *See* AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, COMPETITION IN THE AUSTRALIAN FINANCIAL SYSTEM: PRODUCTIVITY COMMISSION INQUIRY REPORT: OVERVIEW & RECOMMENDATIONS, No. 89 (2018) (recommending fostering and protecting competition to improve consumer outcomes, enhance the productivity and international competitiveness of the financial system and the broader economy, and support ongoing innovation).

150. *Id.* at 2.

anticompetitive conduct by such firms that may exploit their customers.[151]

In an era of megacompanies, the presence of large powerful institutional investors as a counterweight is not necessarily an undesirable corporate governance development.

F. *Investee Firm Managers and Their Fiduciary Duties*

The common ownership theory not only diverts attention from potentially anticompetitive conduct of portfolio companies themselves, but it also diverts attention from the conduct of directors and officers of those firms.[152] As Commissioner Hayne stressed in Australia's recent high profile Banking Royal Commission,[153] directors and officers are required to exercise their duties for the benefit of their corporation, which involves more than considering merely financial returns to shareholders.[154] Furthermore, Commissioner Hayne disputed the idea that the interests of shareholders and customers are opposed,[155] noting that the interests of both groups will generally converge when directors and officers act in the long-term financial best interests of the corporation.[156]

The Banking Royal Commission's Final Report took the view that, in addition to the banks themselves, their boards and senior managers bore responsibility for misconduct, which enhanced corporate profits by exploiting customers.[157] This raises the possibility that corporate managers could themselves be liable for breach of either the duty of care or the duty to act in good faith in the best interests of the company as a whole. Although liability for breach of the duty of care is unlikely

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151. *See* James Frost, *Productivity Commission's Final Report Lashes Banks for Exploiting Customers*, AUSTL. FIN. REV. (Aug. 3, 2018), https://www.afr.com/companies/financial-services/productivity-commissions-final-report-lashes-banks-for-exploiting-customers-20180803-h13in7 [https://perma.cc/YNW5-Z6WJ] (archived Feb. 4, 2020) (recommending appointing a Principal Integrity Officer to oversee banks); AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, *supra* note 149, at 2, 16–17, 24–25, 45, 53 (explaining that targeted approach includes the Australian Competition and Consumer Commission and mandating a Principal Integrity Officer for all banks). As the report notes, an extremely profitable financial system is "not necessarily a bad thing," provided it is "workably competitive." *Id.* at 12.

152. *See* Daniel P. O'Brien & Keith Waehrer, *The Competitive Effects of Common Ownership: We Know Less Than We Think*, 81 ANTITRUST L.J. 729, 765–66 (discussing the role of directors' and officers' fiduciary duties in the context of the common ownership debate); AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, *supra* note 149, at 2, 24–25, 45 (recommending Principal Integrity Officers in parent financial entities).

153. ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY, COMMONWEALTH OF AUSTRL. (2019).

154. *Id.* at 402.

155. *Id.* at 403.

156. *Id.*

157. *Id.* at 4.

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under US corporate law,[158] due to the capacious protection offered by the business judgment rule and exculpatory clauses, directors and officers face a much greater risk of liability under Australian law.[159] It is, therefore, arguable that if, under Version 2 or Version 3 of the common ownership narrative, directors and managers of investee firms engaged in anticompetitive conduct (based on the actual or presumed preferences of a segment of the body of shareholders), those directors and officers would breach their statutory duties to the company under Australian law.[160]

G. *Institutional Investors and the Growing Importance of ESG*

The common ownership theory is focused almost exclusively on the goal of profit maximization.[161] It arguably ignores one of the most important developments in current international corporate governance, namely the growing importance of environmental, social, and governance (ESG) factors.[162] Large institutional investors increasingly view a diverse range of ESG factors, such as climate

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158. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch., 1996) (limiting director liability for oversight failure). *But see* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (plaintiffs successfully pleaded that the directors were not protected under the *Caremark* doctrine).

159. This is due to the availability of "stepping stone" liability under Australian law, whereby directors and officers may be personally liable for failure to prevent contraventions of the law by their corporation. *See, e.g.*, Abe Herzberg & Helen Anderson, *Stepping Stones—From Corporate Fault to Directors' Personal Civil Liability*, 40 FED. L. REV. 181 (2012) (arguing that by exposing their company to legal or reputational damage, directors violate their statutory duty of care); Tim Bednall & Pamela Hanrahan, *Officers' Liability for Mandatory Corporate Disclosure: Two Paths, Two Destinations?*, 31 COMPANY & SEC. L.J. 474 (2013); Alice Zhou, *A Step Too Far? Rethinking the Stepping Stone Approach to Officers' Liability*, 47 FED. L. REV. 151 (2019).

160. These statutory duties are primarily enforceable by the Australian securities regulator, ASIC. For a comparison of enforcement of directors' duties under US and Australian law, *see* Reneé Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343 (2012).

161. *See generally* Jennifer G. Hill, *Corporations, Directors' Duties and the Public/Private Divide*, *in* FIRM GOVERNANCE: THE ANATOMY OF FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur Laby & Jacob Russell eds., 2020) (arguing that corporate financial performance is only one of multiple problems in corporate law and that an equally important problem is the danger that corporate conduct may result in negative externalities and harm to society).

162. *See, e.g.*, BLACKROCK, *supra* note 28, at 8–9 (stating many managers are beginning to emphasize ESG factors.)

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change,[163] sustainability,[164] and gender diversity on boards,[165] as inherent aspects of risk management, and these issues now account for the majority of all shareholder proposals filed in the United States.[166] Also, a growing number of international Shareholder Stewardship Codes explicitly refer to investor stewardship responsibilities regarding ESG.[167] For example, the 2020 UK Shareholder Stewardship Code for the first time explicitly recognizes the growing importance of ESG matters to institutional investors.[168]

One recent paper effectively flips the central argument of anti–common ownership scholars on its head, by arguing that portfolio-regarding intervention by the largest institutional investors may have beneficial outcomes from a social welfare perspective.[169] The paper argues that large diversified investors are, indeed, sometimes prepared to exert their growing power over individual firms for the benefit of their portfolio companies, but that, rather than seeking to reduce competition, they do this to control the effects of firm-level negative externalities of climate change on their entire portfolio.[170] This development contradicts not only the profit-focused Versions 2 and 3 of common ownership but also Version 1, the lazy investor narrative.[171]

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163. *See, e.g.*, *Larry Fink's 2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK, https://www.blackrock.com/no/privat/larry-fink-ceo-letter (last visited Mar. 16, 2020) [https://perma.cc/YGG2-V42S] (archived Feb. 4, 2020) (urging CEOs to take climate change into account when handling investments); Heather Landy, *A $ 7 Trillion Wall Street Powerhouse is Finally Matching its Climate-Change Rhetoric with Action*, QUARTZ (Jan. 14, 2020), https://qz.com/1784949/blackrock-ceo-larry-finks-2020-letter-backs-up-climate-rhetoric-with-action/ [https://perma.cc/KLG8-5RVY] (archived Feb. 22, 2020) (discussing BlackRock's proposed exit from investments in coal producers and search for more sustainable investments).

164. *See, e.g.*, *Larry Fink's 2020 Letter to CEOs*, *supra* note 163; Landy, *supra* note 163 (discussing BlackRock's proposed exit from investments in coal producers and search for more sustainable investments).

165. *See, e.g.*, Janet Albrechtsen & Andrew White, *Chris Corrigan Attacks Business Gender Targets*, AUSTRALIAN BUS. REV. (May 19, 2018).

166. Shirley Westcott, *2019 Proxy Season Preview*, ALLIANCE ADVISORS 1 (Apr. 2019), https://allianceadvisors.com/wp-content/uploads/2019/04/Alliance-Advisors-Newsletter-Apr.-2019-2019-Proxy-Season-Preview.pdf [https://perma.cc/U832-W38T] (archived Feb. 4, 2020).

167. *See* Jennifer G. Hill, *Good Activist/Bad Activist: The Role of International Stewardship Codes*, 41 SEATTLE U. L. REV. 497 (looking at stewardship codes to examine the positive activist role of shareholders).

168. *See* FINANCIAL REPORTING COUNCIL, *THE UK STEWARDSHIP CODE* 2020, at 2, 15 (2020) (Principle 7 requires signatories to report any ESG initiatives).

169. *See* Condon, *supra* note 131 (arguing that institutional investors have become more willing to advertise their role in seeking emissions reductions commitments).

170. *See id.* (arguing that diversified investors should rationally be motivated to internalize negative externalities within their portfolio).

171. *See id.* (arguing that institutional investors can influence decisions at the firm level to benefit their portfolio, challenging the rationally reticent model of investors).

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V. CONCLUSION

Anti–common ownership scholars propose an intriguing theory, but further empirical studies are required to determine whether it accords with reality. The regulatory prescriptions offered by the more extreme versions of the common ownership narrative would have dire regulatory consequences and result in wholesale discrimination against certain shareholders. They would effectively unravel the benefits of investment diversification and democratization of wealth.[172] If further studies determine that there are indeed "hidden costs"[173] to common ownership, the role of the law should be to craft an effective, but appropriately targeted, response to that problem.

172. *See* BLACKROCK, *supra* note 28, at 1 (explaining that remedies for common ownership would negatively affect diversified investment strategies and index investing).

173. Partnoy, *supra* note 37.

Stewardship and Collective Action: The Australian Experience

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April 2020

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Abstract

Institutional shareholder stewardship codes ('stewardship codes') exist in many jurisdictions. They reflect the growing importance of institutional shareholders in capital markets, and a belief that increased engagement by institutional shareholders improves corporate decision-making and provides protection against excessive risk-taking.

In theory, there is considerable sense in shareholders undertaking their stewardship activities collectively. By acting collectively, shareholders leverage their power, pool their resources and share costs, thereby making stewardship more feasible and less speculative. Consistently, the stewardship codes of many jurisdictions refer to, and implicitly support, collective action by institutional investors.

This paper examines the role of collective action as a form of stewardship, with particular reference to the Australian context. Australia provides favourable conditions for institutional investor stewardship and is, therefore, an interesting case study concerning the potential of collective action as a stewardship tool.

This paper's examination of collective action in Australia reveals, however, a nuanced image of this governance practice. Evidence indicates that investors do not routinely engage in direct forms of collective action, such as forming a coalition for the purpose of intervening in a company's governance. Instead, investors more typically leverage their collective influence through intermediary organisations, such as industry bodies and service providers that undertake behind-the-scenes engagement activities for investors.

The nuanced image of collective action emerging from the Australian experience highlights that collective action by institutional shareholders is by no means a simple governance phenomenon. The paper explores the implications of this insight for how securities and takeover laws apply to collective action, and how the issuers of stewardship codes frame their codes' expectations regarding collective action. This analysis is relevant to policy makers, regulators and researchers who are interested in the role and regulation of collective action as a corporate governance tool.

Keywords: stewardship, institutional investors, activism, collective action, corporate governance, securities law, takeover law.

JEL Classifications: D70, G23, G30, G32, G34, K22, N20

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I. INTRODUCTION

The 2008 Global Financial Crisis (GFC) gave rise to competing narratives about shareholders and their engagement in corporate governance.[1] A common view in the United States depicted shareholders as instigators of the crisis, by placing pressure on corporate managers to engage in excessive risk-taking to increase profitability.[2] A similarly negative view of shareholders arguably underpins recent US developments, such as the common ownership debate[3] and the Business Roundtable's recently announced jettisoning of a shareholder-centred conception of corporate purpose, in favour of a stakeholder paradigm.[4]

A different interpretation of the GFC prevailed in a number of other jurisdictions, including the United Kingdom, where the real problem was perceived to be lack of shareholder participation in corporate governance.[5] This explanation of the GFC was based on a positive narrative concerning the corporate governance potential of shareholders. According to this narrative, greater engagement by institutional investors is a beneficial corporate governance technique,[6] which operates as a check on centralised

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[1] See Jennifer G Hill, 'Good Activist/Bad Activist: The Rise of International Stewardship Codes' (2018) 41 Seattle University LR 497.

[2] See, e.g., John C Coffee, 'Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight' (2011) 111 Columbia LR 795, 799.

[3] See, e.g., Einer Elhauge, 'Horizontal Shareholding' (2016) 129 Harvard LR 1267.

[4] See David Gelles and David Yaffe-Bellany, 'Feeling Heat, CEOs Pledge New Priorities' *The New York Times* (New York, 20 August 2019) A1 <https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html> accessed 11 February 2020.

[5] According to the Walker Review, a lack of institutional investor engagement with UK banks was a key governance problem in relation to the global financial crisis: 'A Review of Corporate Governance in UK Banks and Other Financial Industry Entities – Final Recommendations' (26 November 2009) [5.11] (hereinafter Walker Review) <https://www.accaglobal.com/content/dam/acca/global/PDF-technical/corporate-governance/cdr898.pdf> accessed 11 February 2020.

[6] See, e.g., Financial Reporting Council, *UK Stewardship Code* (2020) (hereinafter UK Code), 4 < https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf> accessed 11 February 2020 (referring to the potential for stewardship to 'create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society').

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managerial power.[7]

Shareholder stewardship codes (stewardship codes) embody this positive narrative. They reflect the growing importance of institutional investors in capital markets around the world,[8] and the belief that increased engagement by institutional investors improves corporate decision-making and provides protection against excessive risk-taking.[9]

From the perspective of the positive narrative, there is considerable sense in shareholders undertaking their stewardship activities collectively. By acting collectively, shareholders can leverage their power, pool their resources and share costs, thereby making stewardship more feasible and less speculative. The Walker Review, for example, encouraged 'strengthening methods of collaboration among shareholders with similar concerns', on the basis that boards of directors were more likely to be responsive to collective, as opposed to individual, shareholder pressure.[10] The stewardship codes of many jurisdictions today refer to, and implicitly support, collective action by institutional investors.[11]

In contrast, for critics of shareholder participation in corporate governance, collective action merely exacerbates the risks posed by shareholder power.[12] Activist hedge funds engaged in coordinated conduct have accordingly been described as 'locusts'[13] and 'wolf

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[7] See Walker Review (n 5) [5.11]–[5.12].

[8] See, e.g., Securities and Exchange Board of India, 'Report Submitted by the Committee on Corporate Governance' (5 October 2017) 93 <https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html> accessed 11 February 2020 (noting that, as a result of this increasing importance, institutional investors are 'expected to shoulder greater responsibility towards their clients/beneficiaries by enhancing their monitoring of and engagement with their investee companies').

[9] See, e.g., Andrew G Haldane (Chief Economist, Bank of England), 'Who Owns A Company?'(University of Edinburgh Corporate Finance Conference, Edinburgh, 22 May 2015) <https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/who-owns-a-company.pdf> accessed 22 November 2019 8, 11 (stating that 'companies tend to have higher valuations when institutional investors are a large share of cashflow, perhaps reflecting their stewardship role in protecting the firm from excessive risk-taking').

[10] Walker Review (n 5) 5.43.

[11] See below, Part III.

[12] See, e.g., Christopher M Bruner, 'Corporate Governance Reform in a Time of Crisis' (2011) 36 J Corp L 309, 309–10; Alan Dignam, 'The Future of Shareholder Democracy in the Shadow of the Financial Crisis' (2013) 36 Seattle University LR 639, 682; Leo E Strine, Jr, 'Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System' (2017) 126 Yale LJ 1870.

[13] Mark Landler and Heather Timmons, 'Poison Ink Aimed at "Locusts"' *The New York Times* (New York, 31 March 2006) C00008 < https://www.nytimes.com/2006/03/31/business/media/poison-ink-aimed-at-locusts.html> accessed 11 February 2020.

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packs'.[14]

This Chapter examines the role of collective action as a form of stewardship, with particular reference to the Australian context. This is because Australia provides favourable conditions for institutional investor stewardship and is therefore an interesting case study concerning the potential of collective action as a stewardship tool. In particular, Australian law provides shareholders with favourable shareholder rights[15] and Australia has a capital market structure that is conducive to investor stewardship, including high levels of institutional ownership and low levels of controlling stakes held by non-institutional blockholders.[16] As a result, Australia is one of only four jurisdictions — together with the United Kingdom, the United States and Canada — which the OECD classifies as having a dispersed ownership structure for listed companies.[17] Yet share ownership in Australia is concentrated in the sense that relatively small groups of shareholders tend to hold a significant proportion of a company's shares. Studies covering different periods between 1990 and 2006 have found that on average the 20 largest shareholders in an Australian listed company (a significant proportion of which are institutional investors) hold between 60–70% of the company's shares.[18]

These conditions suggest that it would make considerable sense for institutional investors in Australian listed companies to undertake their stewardship activities collectively. In many companies, the collective voting power of even a handful of institutions is likely to represent a very significant proportion of a company's issued capital, giving those institutions potentially significant collective leverage.

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[14] In the United States, 'wolf pack' refers to the situation where an intervention by an activist hedge fund against a company gains momentum as a result of other activist hedge funds buying into the target company. It is claimed that this results in activist hedge funds holding, collectively, a material proportion of the target company's shares, exerting significant pressure on the target's board to acquiesce to the lead hedge fund's demands. Commentators have expressed concerns regarding the leverage this provides hedge fund activists: see, e.g., John C Coffee and Darius Palia, 'The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance' (2016) 41 J Corp L 545.

[15] Australian corporate law, for example, provides shareholders with much stronger shareholder rights than US corporate law: Jennifer G Hill, 'Subverting Shareholder Rights: Lessons from News Corp's Migration to Delaware' (2010) 63 Vanderbilt LR 1.

[16] Ownership data reveals that institutions own significantly more than half of all publicly-traded equities: see, e.g., Susan Black and Joshua Kirkwood, 'Ownership of Australian Equities and Corporate Bonds' (RBA Bulletin, Reserve Bank of Australia, September 2010) 27 (noting that by early 2010 Australian institutional investors held approximately 40% of listed equities and foreign investors, which would include foreign institutional investors, approximately 40%).

[17] OECD, OECD Corporate Governance Factbook 2019 (11 June 2019) 17 <http://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf> accessed 11 February 2020.

[18] See, e.g., Reza M. Monem, 'Determinants of Board Structure: Evidence from Australia' (2013) 9 J Contemp Accounting and Economics 33, 38 (reporting that in 2006 the top 20 shareholders in a listed company held on average 63.68% of the company's issued shares).

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However, the reality of collective action in Australia is more complicated. Among other things, Australia's stewardship codes address collective action briefly and in very general terms only.[19] Moreover, evidence reveals that, insofar as investors seek to exert collective influence in their stewardship activities, they typically favour indirect forms of collective action. That is, rather than wielding influence by entering into *ad hoc* coalitions with fellow investors, they more routinely channel collective influence through representative organisations and industry intermediaries, such as industry bodies and engagement firms.

This Chapter examines these developments. It argues that the nuanced image of collective action emerging from the Australian experience highlights that collective action is by no means a simple governance phenomenon. This has implications for how stewardship codes frame their expectations regarding collective action and how securities and takeover laws apply to collective action. These insights are relevant, both in Australia and internationally, to policy makers, regulators and researchers who are interested in the role and regulation of collective action as a stewardship tool.

The Chapter proceeds as follows. Part II provides an overview of the development of stewardship in Australia. Part III discusses the significance of collective action within the general stewardship framework. Part IV assesses the nature and role of collective action as a stewardship tool in Australia. Parts V and VI conclude and outline key insights from the analysis.

II. STEWARDSHIP CODES IN AUSTRALIA

A. The Evolution of Stewardship Codes in Australia

By international standards, Australia was a late convert to stewardship codes.[20] According to some industry representatives, the fact that Australia had emerged relatively unscathed from the GFC meant that the crisis did not initially prompt the same degree of scrutiny of investors' role in corporate governance, as it did in other countries.[21]

As stewardship codes were spreading internationally during the early years of the

[19] See below, Part III.B.

[20] As explained below, Australian industry bodies adopted stewardship codes in 2017 and 2018. By this time, codes had already been adopted in approximately 20 other jurisdictions: Alice Klettner, 'The Impact of Stewardship Codes on Corporate Governance and Sustainability' (2017) 23 NZ Business LQ 259, 274.

[21] MSCI and Responsible Investor, *Stewardship and ESG Integration in the Asia-Pacific Region* (2016) 14–15 (quoting industry representatives to this effect).

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2010s, Australian asset owners[22] and asset managers[23] were in fact resisting the introduction of a stewardship code in Australia. In 2012, for example, the two peak industry bodies for asset owners and asset managers, the Australian Council of Superannuation Investors (ACSI) and the Financial Services Council (FSC), made submissions to a government inquiry,[24] arguing that a stewardship code was unnecessary. The industry bodies claimed that Australia already had a strong culture of company-shareholder engagement and that a number of existing industry-promulgated guidelines covered matters commonly addressed in stewardship codes.[25] One submission noted, somewhat dismissively:

> While the UK Stewardship Code is an important international precedent … ACSI does not believe that a similar instrument is necessary for Australian investors … [W]e believe that if a similar code were to be introduced in Australia, it would be somewhat inconsequential and potentially send confusing signals to companies and investors.[26]

However, the industry eventually relented. It was conscious of mounting criticism regarding the adequacy and transparency of institutions' engagement activities[27] and was

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[22] E.g., pension funds (more commonly known as 'superannuation' funds in Australia).

[23] E.g., fund managers.

[24] Corporations and Markets Advisory Committee, *The AGM and Shareholder Engagement — Discussion Paper* (September 2012) <http://www.camac.gov.au/camac/camac.nsf/byheadline/pdfdiscussion+papers/$file/agm.pdf> accessed 11 February 2020.

[25] Australian Council of Superannuation Investors (hereinafter ACSI), *Submission to Corporations and Markets Advisory Committee — The AGM and Shareholder Engagement* (21 December 2012) 3, 6, 8 (claiming that industry had already adopted broadly-equivalent governance guidelines such as UNPRI and rules requiring disclosure of voting practices by pension funds) <http://www.camac.gov.au/camac/camac.nsf/byheadline/pdfsubmissions_6/$file/bca_agm.pdf> accessed 11 February 2020; Financial Services Council (hereinafter FSC), *FSC Submission — Future of the AGM* (31 December 2012) 9 (claiming that elements of the UK Stewardship Code had already been adopted in Australia such as the FSC's guidance regarding managing conflicts of interest and disclosing proxy voting activities) <http://www.camac.gov.au/camac/camac.nsf/byheadline/pdfsubmissions_6/$file/fsc_agm.pdf> accessed 11 February 2020.

[26] ACSI (n 25).

[27] ACSI, *Asset Owner Stewardship Code Can Build Trust* (May 2018) <https://www.acsi.org.au/publications-1/acsi-articles/1514-asset-owner-stewardship-code-can-build-trust.html> accessed 11 February 2020. For an example of criticism, see Guerdon Associates, 'Pressure on Asset Managers and Proxy Advisers to Lift Their Game — But Not in Australia' (12 December 2016) <http://www.guerdonassociates.com/articles/pressure-on-asset-managers-and-proxy-advisers-to-lift-their-game-but-not-in-australia/> accessed 11 February 2020.

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also concerned that a failure to adopt a stewardship code would threaten the international standing of Australia's fund management sector.[28] The industry's two peak bodies took the initiative. The FSC issued FSC Standard 23: Principles of Internal Governance and Asset Stewardship in July 2017 (FSC Code).[29] ACSI published the Australian Asset Owner Stewardship Code in May 2018 (ACSI Code).[30]

It is not apparent from the public record why these industry bodies formulated separate codes. A likely explanation lies in the different institutional roots of the FSC and ACSI. The FSC is a representative body for asset management firms, insurance companies, financial advisers, and other financial services firms.[31] The asset managers and asset owners that are included in its membership generally form part of commercial banks, insurance companies and other financial conglomerates.

In contrast, ACSI is the peak body for particular types of asset owners; namely, public sector superannuation funds, Australia's 'industry' superannuation funds,[32] and a handful of overseas pension funds.[33] ACSI's member funds tend not to form part of commercial financial conglomerates and the sponsors of these funds do not seek to derive profits from operating them.[34] The industry superannuation funds, which comprise the majority of ACSI's fund members, have their origins in initiatives by trade unions in the 1980s to extend occupational superannuation coverage throughout the Australian workforce.[35] The industry superannuation funds have grown significantly on the back of Australia's

[28] FSC and Alliance Bernstein, 'Setting the Standard: Fund Managers Lift Their Game' (February 2018) 2–3 <https://www.alliancebernstein.com/library/fund-managers-lift-their-game.htm> accessed 11 February 2020.

[29] FSC, *FSC Standard 23: Principles of Internal Governance and Asset Stewardship* (July 2017) (hereinafter FSC Code) <https://www.fsc.org.au/web-page-resources/fsc-standards/1522-23s-internal-governance-and-asset-stewardship> accessed 11 February 2020.

[30] ACSI, *Australian Asset Owner Stewardship Code* (May 2018) (hereinafter ACSI Code) <https://www.icgn.org/sites/default/files/Australian%20Code.pdf> accessed 11 February 2020.

[31] FSC, *About the FSC's Members* <www fsc.org.au/about/membership> accessed 22 November 2019.

[32] The name 'industry' superannuation fund (hereinafter industry superannuation fund) recognises that these funds were originally established to provide retirement savings for workers in particular industries; however, most of these funds are now open to the general public: Australian Super, 'Retail or Industry Super Funds, What is the Difference?' <www.australiansuper.com/superannuation/superannuation-articles/2018/10/retail-or-industry-super-funds> accessed 3 December 2019.

[33] ACSI, *ACSI Members* <www.acsi.org.au/section-heading/acsi-members-html> (hereinafter ACSI Members) accessed 22 November 2019.

[34] Australian Securities and Investments Commission, 'Types of Super Funds' (Money Smart, 12 February 2019) <www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/types-of-super-funds> accessed 22 November 2019.

[35] See generally, Bernard Mees and Cathy Brigden, *Workers' Capital: Industry Funds and the Fight for Universal Superannuation in Australia* (Allen & Unwin 2017).

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mandatory retirement savings scheme, making them powerful participants in the funds management sector.[36] There exists commercial tension between the memberships of the FSC and ACSI because of the significant growth of industry superannuation funds relative to the superannuation funds operated by banks and other financial conglomerates which are members of the FSC. A notable example of this tension occurred in 2018 when the industry superannuation funds commissioned the 'fox in the hen house' television advertisement. The advertisement portrayed the FSC's members as foxes whose 'for profit' business model threatened the retirement savings (i.e., hens) of Australian workers.[37] It is conceivable that these distinct institutional roots and commercial tensions explain why the FSC and ACSI adopted separate approaches to the development of stewardship codes.

When they issued their respective codes, both the FSC and ACSI were self-consciously taking a different approach to the issuers of codes in other jurisdictions. The FSC Code notes that 'unlike other stewardship codes which focus on asset stewardship and conflicts of interest, the [FSC Code] takes a broader view and also includes the internal governance of the Asset Manager'.[38] In the media release announcing the publication of its code, ACSI acknowledged the existence of overseas codes but commented: 'However, this is the first stewardship code to focus exclusively on the activities of Australian asset owners'.[39] Both the FSC and ACSI had a relatively long tradition of policy formulation in relation to corporate governance matters — including in the area of institutional investors' governance activities[40] — which may explain their intentionally distinctive approaches.

In summary, stewardship codes in Australia are an industry-led initiative. Instead of being imposed by an external party to encourage changes in how investors engage in corporate governance, they have been adopted by industry bodies as a response to scrutiny of investors' governance activities. Their development has also been influenced by Australia's very particular institutional and market context.

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[36] Mees and Smith report that industry superannuation funds have tripled their market share since the mid-nineties: Bernard Mees and Sherene A Smith, 'Corporate Governance Reform in Australia: A New Institutional Approach' (2019) 30 British Journal of Management 75, 76–7.

[37] Joanna Mather, 'Union Funds call a Truce' The Australian Financial Review (Sydney, 24 September 2018) 1.

[38] FSC Code (n 29) 7.

[39] ACSI, 'Australian First Stewardship Code for Asset Owners Unveiled', (17 May 2018) <https://www.acsi.org.au/publications/media-releases/1479-australian-first-stewardship-code-for-asset-owners-unveiled html> accessed 11 February 2020.

[40] As explained by each of the organisations in their submissions to the government inquiry referred to above in n 25.

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B. Overview of the Australian Codes

1. The FSC Code

The FSC Code is applicable to institutions which undertake asset management functions and have elected to become full members of the FSC.[41] Membership of the FSC is voluntary and financial institutions can choose their preferred level of membership.[42] Full members of the FSC currently include both Australian fund managers and a substantial number of international fund managers.[43] Klettner reports that, as of 2017, the 50 full members who were bound by the FSC Code managed a large majority of total funds under management in Australia.[44]

The FSC Code addresses not only the internal governance of asset managers,[45] but also their stewardship activities.[46] In relation to stewardship, the FSC Code states that asset managers 'should' exercise effective stewardship over their investments, encourage investee companies to meet the highest standards of governance and ethical practices, and use the 'tools' available to investors to hold boards and executives accountable.[47]

The FSC Code is a designated 'FSC Standard'.[48] Compliance with FSC Standards is compulsory for full members of the FSC and non-compliance can expose full members

[41] FSC Code (n 29) 4.

[42] Financial services organisations can apply to become full members, associate members or supporting members of the FSC: see FSC, *Become a FSC Member* <https://www fsc.org.au/about/membership/become-a-member> accessed 19 February 2020.

[43] FSC, *FSC Full Members* <https://www.fsc.org.au/about/fsc-members> accessed 22 November 2019. In Australia, the distinction between 'domestic' and 'international' fund managers is complicated, however, by virtue of the fact that some large Australian fund managers have material operations in other countries.

[44] Klettner (n 20) 260.

[45] For example, the FSC Code requires asset managers to make disclosures regarding their ownership, structure, internal governance, and the experience and competencies of their key personnel: FSC Code (n 29) 8–9.

[46] ibid 7.

[47] ibid 10.

[48] FSC, *FSC Standards Fact Sheet* (September 2018) <https://fsc.org.au/resources/standards> accessed 19 February 2020.

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to disciplinary action by the FSC.[49] In this sense, the FSC Code is mandatory in nature. However, the FSC Code does not in substance oblige full members to undertake any particular stewardship activities; it merely requires them to disclose their approach towards stewardship.[50] It also provides guidance regarding matters which investors' disclosures should address, although this guidance is limited to seven brief bullet points which merely identify relevant disclosure topics.[51] These bullet points refer to monitoring of company performance; engagement with companies and escalation of issues which are not addressed through initial engagement efforts; use of ESG considerations in investment decision-making and engagement activities; approach to voting; collaborative engagement with other investors; approach to policy advocacy; and approach to engaging with clients regarding stewardship.[52] The FSC Code operates on a 'comply-or-explain' basis, which means that full members have the choice of providing disclosure in relation to these disclosure topics, or simply explaining why such stewardship activities are not relevant to them'.[53] The FSC Code takes the view, nonetheless, that requiring investors to explain publicly their approach to stewardship will encourage them to improve their approach to stewardship.[54]

An interesting feature of the FSC Code is that environmental, social and governance (ESG) considerations are not seen as a central or defining element of stewardship.[55] Instead, as noted in the previous paragraph, ESG-focused stewardship is simply listed by the code as one of several potential stewardship activities.

2. The ACSI Code

The ACSI Code applies to asset owners who choose to become signatories to the code.[56] As at March 2020, there were 16 signatories, comprised solely of Australian

[49] ibid. This fact sheet indicates (at 2) that instances of non-compliance are overseen by the FSC's Standards, Oversight and Disciplinary Committee and may result in that committee initiating 'any appropriate response which may include disciplinary action', The fact sheet does not indicate what form such disciplinary measures might take.

[50] The FSC Code requires asset managers to report against the code at the end of each financial year, commencing with the financial year ended 30 June 2019: FSC Code (n 29) 10.

[51] ibid.

[52] ibid.

[53] ibid 8.

[54] ibid (noting that 'good practice will develop organically' as a result of these disclosure requirements).

[55] See Chapter [Dionysia Katelouzou and Alice Klettner] regarding sustainable investment and stewardship.

[56] ACSI Code (n 30) 5.

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public sector and industry superannuation funds.[57] This represents almost 40 percent of ACSI's membership base.[58] The ACSI Code is principally focused on asset owners' stewardship in relation to their equity holdings, although it notes that 'asset owners may wish to extend the application of the Code across their portfolio'.[59]

The ACSI Code sets out six principles. Three of them state that investors 'should' undertake specific types of stewardship activity, namely: (i) engage with companies; (ii) monitor asset managers' stewardship activities; and (iii) encourage better alignment of the financial system and regulatory policy with the interests of long-term investors.[60] The other three principles provide that investors 'should' make certain disclosures regarding stewardship, namely: (i) disclose publicly how they approach their stewardship responsibilities; (ii) disclose publicly their policy for voting at company meetings and their voting activities; and (iii) report to beneficiaries regarding their stewardship activities.[61] Unlike the FSC Code, the ACSI Code does not address the internal governance of asset owners.[62]

The ACSI Code is effectively aspirational only. There is no obligation for asset owner members of ACSI to become signatories and the Code does not oblige signatories to undertake any particular form of stewardship. Instead, the ACSI Code operates on an 'if not, why not' basis, which requires signatories to explain how they apply the code's principles or, to the extent they do not apply any of the principles, explain why they have not done so.[63] The Code requires signatories to have published a 'stewardship statement' by 30 September 2019 which contains these explanations.[64] Signatories are 'encouraged'

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[57]ACSI, 'Australian Asset Owner Stewardship Code'<https://acsi.org.au/members/australian-asset-owner-stewardship-code/> accessed 15 March 2020. ACSI's website discloses that it has six international members (including CalPERS and the United Kingdom's Universities Superannuation Scheme). However, none of these international members are shown on ACSI's website as signatories to the ACSI Code.

[58] ACSI Members (n 33).

[59] ACSI Code (n 30) 5.

[60] ibid Principles 3, 4 and 5.

[61] ibid Principles 1, 2 and 6.

[62] A point that is specifically acknowledged by the ACSI Code: ibid 6.

[63] ibid.

[64] ibid 5–6. The ACSI Code does not indicate what consequences, if any, it might impose if a signatory fails to publish a stewardship statement. However, failure to publish a statement would potentially become a matter of public record, since ACSI's website contains a list of signatories together with hyperlinks to their stewardship statements: see ACSI, *Australian Asset Owner Stewardship Code* <https://acsi.org.au/members/australian-asset-owner-stewardship-code/> accessed 19 February 2020. As at the time of writing, this list indicates that all signatories have published stewardship statements.

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to revise their statements every two years.[65]

Whereas the FSC Code simply references ESG-focused stewardship as one of several stewardship activities, the ACSI Code envisages that ESG considerations will play a fundamental role in shaping investors' overall approach towards stewardship. The ACSI Code states that 'ACSI members … are committed to incorporating environmental, social and governance (ESG) considerations into their investment strategies and engaging collaboratively with companies to improve their ESG performance'.[66] It defines stewardship as 'the responsibility asset owners have to exercise their ownership rights to protect and enhance long-term investment value for their beneficiaries by promoting sustainable value creation'.[67]

3. Calls for a Revised Approach to Stewardship in Australia

Although they are non-prescriptive, both the ACSI Code and the FSC Code assume that they will improve stewardship practices by requiring investors to disclose their approach to stewardship.[68] However, within a year of issuing the ACSI Code, ACSI has already raised doubts regarding the efficacy of this approach and, in May 2019, published a discussion paper calling for reform of Australia's approach to stewardship.[69] The paper expresses concern about variations in investors' stewardship practices and argues for the imposition of minimum standards of stewardship, potentially as part of a regulatory, rather than industry-based, initiative.[70] Casting doubt on the existing, fragmented industry approach towards stewardship, ACSI states that one outcome of the review should be the introduction of a single stewardship code[71] that is applicable to 'all institutional

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[65] ACSI Code (n 30) 5.

[66] ibid 4.

[67] ibid 5.

[68] See FSC Code (n 29) 8. The ACSI Code states that transparency 'will lead to increased accountability for asset owners to beneficiaries and other stakeholders': ACSI Code (n 30) 5.

[69] ACSI, *Towards Stronger Investment Stewardship* (May 2019) <https://acsi.org.au/images/stories/ACSIDocuments/ACSI-Towards-Stronger-Investment-Stewardship-May-2019.pdf> accessed 22 November 2019.

[70] Specifically, ACSI argues that the review should focus on 'what effective stewardship entails, what the minimum expectations should be, and how to strike the right balance between regulation and voluntary codes': ibid 5.

[71] A similar discussion about the need to introduce a single stewardship code has taken place in India: see Chapter [India chapter].

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investors'.[72] ACSI claims that requiring all institutions to report against the requirements of a single code would facilitate comparison and assessment of the stewardship practices of different investors.[73] To date, there have been no apparent attempts by the financial sector, the government or the regulator to initiate the review called for by ACSI.

III. COLLECTIVE ACTION AND STEWARDSHIP

A. The potential of collective action as a stewardship tool

A shareholder who wishes to participate in a company's governance faces a potentially challenging cost-benefit analysis.[74] This cost-benefit analysis can be particularly challenging for institutional investors, given the large number of investments in their diversified portfolios, free-riding concerns, the pressure to seek economies in their governance activities owing to industry competition, and conflicts of interest.[75] As a result of these considerations, some commentators have queried whether institutions actually have sufficient incentives to act as stewards.[76]

Collective action, however, has the potential to make stewardship more feasible. By acting collectively, shareholders can pool their resources, share the costs of their stewardship activities, and leverage their influence.[77] Consequentially, stewardship may be significantly less speculative and more cost effective if undertaken collectively rather than individually.

The potential governance benefits of collective action mean that collective action is

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[72] ibid. ACSI's discussion paper does not explain what the phrase 'all institutional investors' contemplates. It is therefore not clear, for example, whether the phrase is intended to refer to all institutional investors operating in Australia, irrespective of whether they are domestic or international.

[73] ibid.

[74] See, e.g., Edward B Rock, 'The Logic and (Uncertain) Significance of Institutional Shareholder Activism' (1991) 79 Georgetown LJ 445.

[75] ibid. More recently, see Lucian A Bebchuk, Alma Cohen and Scott Hirst, 'The Agency Problems of Institutional Investors' (2017) 31 Journal of Economic Perspectives 89. In the Australian context, see Geof P Stapledon, 'Disincentives to Activism by Institutional Investors in Listed Australian Companies' (1996) 18 Sydney LR 152.

[76] See, e.g., Ronald J Gilson and Jeffrey N Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 Columbia LR 863, 868–9. See also Chapter [Jill Fisch's chapter], which argues that index funds have particularly limited incentives to engage in stewardship.

[77] See, e.g., Gaia Balp and Giovanni Strampelli, 'Institutional Investor Collective Engagements: Non-Activist Cooperation vs Activist Wolf Packs' (2019) 14 Ohio State Business LJ (forthcoming).

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generally recognised by stewardship codes as a desirable stewardship tool. However, the codes can differ in terms of the emphasis they place on collective action.[78] In the United States, stewardship principles were adopted in 2017 by the Investor Stewardship Group.[79] Although the principles contemplate collaboration between institutional investors, this appears to be directed at adopting and implementing corporate governance and or stewardship principles, rather than as an activity undertaken to facilitate engagement with companies.[80] The UK Stewardship Code 2020 (UK Code) is far more direct and specific about collective action than its US counterpart. For example, Principle 10 of the UK Code states that institutional investors should 'where necessary, participate in collaborative engagement to influence issuers'.[81] Principle 10 requires signatories to disclose the collaborative engagement they undertake and the reasons why.[82]

B. The Australian codes and collective action

Neither of the Australian Codes obliges, or even explicitly encourages, investors to undertake any form of collective action. This is consistent with their non-prescriptive approach towards stewardship.[83]

The FSC Code addresses collective action in only brief terms. It states that asset managers should disclose in their stewardship statement, 'where relevant,' their approach to 'collaborative engagement with other investors including involvement with industry groups and associations'.[84] Besides the reference to 'industry groups and associations', the FSC Code does not elaborate on the forms of collective action which investors could undertake.

The ACSI Code goes somewhat further. Principle 3 of the ACSI Code is headed 'Asset Owners Should Engage with Companies (Either Directly, Indirectly or Both)'.[85] Under this principle, the code acknowledges that investors can undertake engagement 'in

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[78] See further, Chapter [Katelouzou/Siems].

[79] ISG, *The Principles: Stewardship Framework for Institutional Investors* (January 2017) <https://isgframework.org/stewardship-principles/> accessed 22 November 2019. See Chapter [Jill Fisch's chapter] for further details regarding stewardship in the United States.

[80] ibid Principle F.

[81] UK Code (n 6) 19. See Chapter [x] for further details regarding stewardship in the United Kingdom.

[82] ibid.

[83] See above, Part II.B.

[84] FSC Code (n 29) 10.

[85] ACSI Code (n 30) 10.

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collaboration with other investors'.[86] It also observes that collective action may be helpful where investors wish to escalate issues of concern. It notes how, in these circumstances, investors could raise their concerns collectively with asset managers or other asset owners, or hold discussions with 'other equity, bondholders or stakeholders'.[87]

An interesting feature of the ACSI Code is that it highlights a distinction between direct and indirect forms of collective action. Specifically, it notes that collective action can be undertaken 'with other individual asset owners' or 'through a third-party service provider'.[88] As this Chapter will show, the latter form of collective influence-wielding is prominent in the Australian market.

IV. HOW INSTITUTIONAL INVESTORS USE COLLECTIVE ACTION AS A STEWARDSHIP TOOL IN AUSTRALIA[89]

A. Overtly aggressive interventions

Overtly aggressive activist interventions, such as board spills and other high-profile public campaigns, are not common in Australia. Industry research reports an average of approximately 75 activist campaigns a year in the period 2013–17.[90] This is in the context of a market comprised of more than 2000 listed entities.[91] These campaigns predominantly targeted small-capitalisation companies.[92]

Overseas hedge funds, domestic activist investors, and institutional investors did not play a prominent role in these campaigns.[93] Evidence suggests, instead, that overtly

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[86] ibid 8, 10.

[87] ibid 10–11.

[88] ibid 11.

[89] This section draws heavily on research in Tim Bowley, 'The Importance of Context: The Nature of Australian Shareholder Activism and its Regulatory Implications' (PhD thesis, University of Sydney 2019).

[90] JP Morgan, *Shareholder Activism in Australia: Navigating the Evolving Landscape* (April 2017); FTI Consulting, *Australia* <www ftiactivism.com/map/countries/australia/> accessed 22 November 2019.

[91] ASX Ltd, *Historical Market Statistics* <http://www.asx.com.au/about/historical-market-statistics.htm#No of Companies> accessed 22 November 2019 (reporting 2242 listed entities as at October 2019).

[92] JP Morgan (n 90) (reporting that 77% of campaigns targeted companies with a market capitalisation of less than AUD$100 million). A 2018 report by Activist Insight and Schulte Roth & Zabel reports that nearly two-thirds of Australian companies targeted in 2018 had a market capitalisation of less than US$50 million, which they describe as a 'historical pattern': Activist Insight and Schulte Roth & Zabel, *The Activist Investing Annual Review 2019* (2019) 6, 23.

[93] JP Morgan (n 90) 8 (reporting that dedicated activist funds accounted for only 24% of campaigns in 2016, up from 12% in 2014); Activist Insight and Arnold Bloch Leibler, *Shareholder Activism in Australia: A*

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aggressive campaigns are largely undertaken by non-institutional blockholders[94] such as company founders, trading companies, private investment vehicles and entrepreneurs.[95]

The low-levels of hedge fund activism mean that, to date, Australia has not witnessed the type of 'wolf pack' collective action seen in other jurisdictions,[96] or the interaction between activist investors and institutional investors highlighted in the United States by Gilson and Gordon.[97]

However, in recent years, environmental and social activists have begun to play a role that is somewhat analogous to the role of hedge funds described by Gilson and Gordon. At several annual shareholder meetings of large capitalisation companies in 2018, environmental and social activists tabled voting proposals addressing ESG-related concerns, such as requesting more comprehensive disclosure from companies regarding climate change risks.[98] These proposals appear to have provided an opportunity for institutional investors to escalate their ESG-related concerns.[99] A number of them received significant levels of shareholder support, including from institutional investors.[100] Although these interventions have been high-profile, in absolute terms they are, however, relatively infrequent.[101]

Review of Trends in Activist Investing (2016) 5 (reporting that the capital available for domestic activist funds is 'scarce'). As to the limited involvement of institutional investors in such campaigns, see JP Morgan (n 90) 9; Activist Insight and Arnold Bloch Leibler 5–6; Myriam Robin, 'Shareholder activism not in 'mentality' of Australian fund managers' *The Sydney Morning Herald* (Sydney, 12 May 2017) 26 (noting anecdotal evidence regarding the disinclination of institutional investors to undertake aggressive activist interventions) <https://www.smh.com.au/business/markets/shareholder-activism-not-in-mentality-of-australian-fund-managers-20170511-gw2hma html> accessed 11 February 2020.

[94] JP Morgan (n 90) 8 (reporting that the 'bulk' of campaigns identified by its research were undertaken by 'usually existing investors' in small-capitalisation companies who are 'often one-time activists'). The findings of the unpublished doctoral research by one of this paper's authors reports similar findings: see Bowley (n 89).

[95] Bowley (n 89).

[96] See Coffee and Palia (n 14).

[97] Gilson and Gordon (n 76).

[98] Noted in Australian Securities and Investments Commission, *Report 609 Annual General Meeting Season 2018* (January 2019) 8–10.

[99] Each of the companies targeted was in the S&P/ASX 200 index, which is comprised of substantial listed entities. Proxy votes in favour of the ESG resolutions represented on average 18.6% of all proxy votes; in two cases, proxy votes in favour of the resolutions exceeded 40%: ibid. As these proposals targeted large companies, in which institutional investors tend to concentrate their investments, this voting data suggests that these proposals attracted material levels of voting support from institutions.

[100] ibid.

[101] ibid 9 (noting that in 2018, in relation to the 200 largest entities included in the S&P/ASX 200 index, there were seven such interventions, involving four companies).

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B. Coordinated share voting

Institutional investors do not appear to routinely seek to coordinate their share voting. Although Australia's takeover laws constrain such behaviour,[102] this, of itself, does not appear to explain institutions' infrequent attempts to form voting blocks. This is because a safe-harbour existed for nearly 20 years, which permitted institutional investors to coordinate their share voting at shareholder meetings in precisely this way.[103] In 2015, ASIC reported that it was aware of only one instance of institutions relying on the safe-harbour during that period.[104] Based on market feedback, ASIC concluded that institutions' reluctance to use the safe-harbour was due to the fact that institutional investors primarily sought to engage with companies in behind-the-scenes interactions rather than at shareholder meetings.[105] Another possible explanation, not explored by ASIC, is whether the emergence of proxy advisers may have contributed to a degree of standardisation in institutions' voting practices, negating the need for institutions to coordinate their voting directly.[106]

In light of the apparent lack of demand from investors for a safe-harbour to permit them to coordinate their share voting, ASIC declined to renew the safe harbour.[107]

C. Behind-the-scenes engagement with companies

Consistent with ASIC's observation, evidence indicates that there is indeed a significant amount of private interaction (or 'engagement') between institutional investors and their investee companies in Australia.[108] However, it is unclear to what extent institutions seek to leverage their influence by undertaking their engagement activities collectively. Investors' stewardship disclosures made in accordance with the

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[102] See below, Part V.D.

[103] The safe-harbour was contained in Australian Securities and Investments Commission, *Class Order 00/455 Collective Action by Institutional Investors* (4 October 2013).

[104] Australian Securities and Investments Commission, *Consultation Paper 228 Collective Action by Investors: Update to RG 128* (February 2015) 7.

[105] ibid 10.

[106] See below, Part IV.D for discussion of the role of proxy advisers in Australia.

[107] Australian Securities and Investments Commission (n 104) 12.

[108] See, e.g., Productivity Commission, *Executive Remuneration in Australia* (19 December 2009) 303 (noting a submission from the representative body for company directors that 'there has been a considerable increase in active engagement by large institutional investors') <https://www.pc.gov.au/inquiries/completed/executive-remuneration/report/executive-remuneration-report.pdf> accessed 11 February 2020.

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Australian codes frequently contain only generic statements regarding investors' approach to collective engagement with companies. Examples include non-specific statements such as 'engagement can be undertaken … in collaboration with other investors'[109] and '[w]here appropriate, we will hold joint engagement meetings with other investors who share our concerns'.[110]

A number of stewardship disclosures suggest that institutions only resort to joint engagement as an escalation mechanism in relation to major governance concerns. The stewardship statement of the superannuation fund, AustralianSuper, notes that collective action may be reserved for more difficult engagements in order to 'amplify our voice and influence'.[111] Fund manager, JP Morgan, notes that, as part of its escalation approach, 'will hold joint engagement meetings with other investors who share our concerns'.[112] The fund manager, Colonial, states that '[t]he vast majority of our engagement is conducted by each team directly with companies',[113] although it acknowledges that, as part of its escalation approach, 'we might collaborate on further engagement with other like-minded investors'.[114]

In recent years, instances have come to light in the financial press of institutional investors collectively pushing for changes in the affairs of prominent listed companies.[115]

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[109] Cbus, *Cbus Stewardship Statement — For the Period Ended 30 September 2018* (2018) 2 <https://www.cbussuper.com.au/content/dam/cbus/files/governance/reporting/Stewardship-Statement.pdf> accessed 11 February 2020.

[110] JP Morgan Asset Management, *Principles of Internal Governance and Asset Stewardship* (29 November 2018) [3.2], [3.5] <https://am.jpmorgan.com/content/dam/jpm-am-aem/asiapacific/au/en/policies/principles-internal-governance-asset-stewardship.pdf> accessed 11 February 2020. See also ChristianSuper, *Stewardship Statement: 1 July 2017 to 30 June 2018* (2018) 3 (referring to their preparedness to 'work[] with likeminded investors') <https://www.christiansuper.com.au/wp-content/uploads/Christian-Super-Stewardship-Statement_2018.pdf> accessed 11 February 2020.

[111] AustralianSuper, *Stewardship Statement: 1 July 2017 to 30 June 2018* (2018) 2 <https://www.australiansuper.com/-/media/australian-super/files/about-us/financial-statements/2019-fund-financial-statements.pdf> accessed 11 February 2020.

[112] JP Morgan Asset Management (n 110) [3.2], [3.5].

[113] Colonial First State Global Asset Management, *Principles of Internal Governance and Asset Stewardship 2018* (June 2018) (hereinafter Colonial First State) 16 <https://www firststateinvestments.com/content/dam/cfsgam/about-us-files/responsible-investment/ri-policies/principles-of-internal-governance-and-asset-stewardship-2018.pdf> accessed 11 February 2020.

[114] ibid 14. See also Cbus, *Escalation Process* <https://www.cbussuper.com.au/about-us/sustainability/escalation-process> accessed 25 November 2019 (noting that escalation may include '[e]xpressing concerns … collectively with asset managers or other asset owners' and '[h]olding discussions with other equity, bondholders or stakeholders').

[115] See, e.g., Mercedes Ruehl and Robert Harley, 'How the Wild, Wild Westfield Restructure Deal Was Eventually Won' *The Australian Financial Review* (Sydney, 29 December 2014) 38 (reporting how a 'cabal of institutions' opposed a restructuring transaction involving Westfield Retail and Westfield

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However, it is not possible to establish how common this form of collective action is in practice based on this anecdotal evidence.

D. Collective influence-wielding through intermediary organisations

An interesting feature of the Australian landscape is the significant role played by intermediary organisations in facilitating institutional investors' collective influence in the governance of listed companies.

Industry bodies, in particular, are a long-established feature of the Australian governance landscape[116] and play an important role in advocating for the interests of institutional investors in Australia. As noted earlier, the two principal industry bodies are the FSC and ACSI. The FSC can trace its origins to the Australian Investment Managers Group (AIMG), which was established in 1990.[117] The AIMG's purposes included assisting investors to take action against companies where warranted.[118] ACSI was established in 2001 by industry superannuation funds to advocate for the funds' interests in matters of corporate governance.[119] Today, both ACSI and the FSC advocate for law reform, publish policies outlining investors' expectations regarding the governance practices of publicly-traded companies, and are members of the Australian Securities Exchange (ASX) Corporate Governance Council, the body which issues the 'comply or explain' corporate governance code applicable to ASX-listed entities.[120] They also occasionally engage in high-profile company-specific governance interventions.[121]

Group); Elizabeth Knight, 'Angry Shareholders Ignored Westpac's Bluff and Raised the Stakes' *The Sydney Morning Herald* (Sydney, 26 November 2019) 22 (noting how a 'wall of shareholders' demanded board change at the bank, Westpac, in light of its alleged serious breaches of money laundering laws) <https://www.watoday.com.au/business/banking-and-finance/angry-shareholders-ignored-westpac-s-bluff-and-raised-the-stakes-20191126-p53ea9.html?ref=rss&utm_medium=rss&utm_source=rss_feed> accessed 11 February 2020.

[116] See generally Jennifer G. Hill, 'Institutional Investors and Corporate Governance in Australia', in Theodor Baums, Richard M. Buxbaum and Klaus J. Hopt, eds., *Institutional Investors and Corporate Governance* (Walter de Gruyter 1994) 583.

[117] ibid 600.

[118] ibid.

[119] For an overview of the history and activities of ACSI, see Mees and Smith (n 36).

[120] ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th Edition (February 2019) <https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf> accessed 15 March 2020.

[121] See, e.g., Nassim Khadem, 'Investors Willing to Flex Muscle Against Companies', *The Sydney Morning Herald* (Sydney, 9 May 2018) 21 (noting how ACSI demanded board change at financial services group, AMP, and observing that 'this is not the first time ACSI … has moved to influence companies') <https://www.smh.com.au/business/banking-and-finance/investors-willing-to-flex-muscle-against-

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In their stewardship disclosures, investors often cite their involvement in industry bodies as a form of collective action.[122] Stewardship disclosures also refer to investors' participation in organisations which represent the collective interests of investors on specific ESG-related issues. Examples include the Investor Group on Climate Change,[123] the Climate Action 100+ Australasian Engagement Group,[124] the Carbon Disclosure Project,[125] the Workforce Disclosure Initiative,[126] and the Responsible Investment Association Australasia.[127]

Institutional investors also rely on engagement providers to facilitate their private interactions with investee companies.[128] These organisations undertake behind-the-scenes engagement assignments with companies on behalf of multiple investor clients. The principal organisations are Regnan and ACSI,[129] both of which report material levels of activity. For example, in 2018–19, ACSI held 267 meetings with 192 companies in the

companies-in-the-wake-of-amp-20180508-p4ze31 html> accessed 11 February 2020; James Eyers and Jemima Whyte, 'UniSuper, ACSI Split Over Bloodletting' *The Australian Financial Review* (Sydney, 28 November 2019) 4 (reporting ACSI's call for board change at the bank, Westpac, in light of its alleged breaches of money laundering laws).

[122] Colonial First State (n 113) 16 ('[o]ccasionally we engage with companies alongside other investors as part of an industry group'); JP Morgan Asset Management (n 110) [3.5] (disclosing that collective engagement activities include 'indirect engagement through industry bodies').

[123] Colonial First State (n 113) 16; AustralianSuper, *ESG Management and Responsible Investing* <https://www.australiansuper.com/investments/how-we-invest/esg-management> accessed 25 November 2019; UniSuper, *Responsible Investing at UniSuper* <https://www.unisuper.com.au/investments/responsible-investing/our-approach-to-responsible-investing> accessed 25 November 2019.

[124] AustralianSuper, *2017–18 Annual Report* (2018) 23 <https://www.australiansuper.com/-/media/australian-super/files/about-us/annual-reports/2018-annual-report.pdf> accessed 11 February 2020; Cbus, *Sustainability* <https://www.cbussuper.com.au/about-us/sustainability> accessed 25 November 2019.

[125] See, e.g., AustralianSuper (n 123); UniSuper (n 123).

[126] Cbus (n 124).

[127] Perpetual Investment Management, *Principles of Internal Governance and Asset Stewardship* (2018) 5 <https://www.perpetual.com.au/~/media/perpetual/pdf/corporate-trusts/pct-principles-of-internal-governance-and-asset-stewardship.ashx?la=en> accessed 11 February 2020.

[128] Investors note their use of engagement firms in their stewardship disclosures: see, e.g., Pendal Group, *Principles of Internal Governance and Asset Stewardship* (July 2018) 9 <https://www.pendalgroup.com/wp-content/uploads/2018/09/Principles-of-Internal-Governance-and-Asset-Stewardship.pdf> accessed 11 February 2020; ChristianSuper (n 110) 3 (disclosing its use of ACSI); Cbus (n 124) (disclosing that it uses ACSI for ASX 300 holdings and Hermes EOS for global shareholdings).

[129] In addition to its role as industry advocate, ACSI also provides company engagement and proxy advisory services to those of its members who subscribe for these services: ACSI, *2019 Annual Report* <https://acsi.org.au/wp-content/uploads/2020/02/19-ACSI-Annual-Report.pdf> 12–14 accessed 19 February 2020.

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S&P/ASX 300 index.[130] In 2018, Regnan undertook 86 engagements with 55 companies in the S&P/ASX 200 index, covering issues such as climate change, human capital management, ethical business conduct, board composition and independence, and ESG disclosures.[131] Hermes EOS also reports some activity in Australia.[132]

Institutions' stewardship disclosures indicate that investors use engagement firms in order to leverage their influence and achieve economies in their engagement activities. The pension fund, AustralianSuper, states that using ACSI's engagement services enables AustralianSuper to 'expand the breadth of our engagement coverage and strengthen our voice and influence'.[133] Research by the Australian Institute of Directors into institutional investor share voting and engagement practices concludes that, through their ongoing interaction with investors, engagement firms can be 'highly influential' in developing the views of institutional investors into consensus positions on corporate governance issues.[134]

Proxy advisers also play a role in facilitating institutions' collective influence.[135] By

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[130] ibid 12.

[131] Pendal Group, *Corporate Sustainability and Responsibility 2018* (2018) 2 <https://www.pendalgroup.com/wp-content/uploads/2018/11/2018-Corporate-Sustainability-Report-.pdf> accessed 11 February 2020.

[132] Hermes EOS, *Public Engagement Report Q3 2018* (2018) 2 (reporting engagement with two companies in relation to environmental concerns) <https://www.hermes-investment.com/us/insight/stewardship/public-engagement-report-q3-2018/> accessed 11 February 2020. In March 2019, ACSI and Hermes EOS announced they had entered into an agreement to pool their engagement services, giving investors access to ACSI's services in the Australian market and Hermes' services in overseas markets: ACSI, *ACSI and Hermes EOS to Share Company Engagement Expertise* (12 March 2019) <https://www.acsi.org.au/publications/media-releases/1601-acsi-and-hermes-eos-to-share-company-engagement-expertise.html> accessed 11 February 2020.

[133] AustralianSuper (n 111) 3. Similarly, the university sector pension fund notes that using ACSI for engagement services 'provides a strong unified voice on issues and widens the extent of our own direct engagement': UniSuper, *UniSuper Stewardship Statement (2018)* (2018) 2 <https://www.unisuper.com.au/~/media/files/forms%20and%20downloads/investment%20documents/unisuper-stewardship-statement.pdf?la=en> accessed 11 February 2020.

[134] Australian Institute of Company Directors, *Institutional Share Voting and Engagement: Exploring the Links between Directors, Institutional Shareholders and Proxy Advisers* (September 2011) 45.

[135] Relevantly, some institutions' stewardship disclosures note the use of proxy firms as a form of collective action. Under the heading 'Indirect Company Engagement', AustralianSuper discloses its use of the proxy advice service provided by ACSI: AustralianSuper (n 111) 3. See also, UniSuper, Responsible Investment Report — 1 July 2018–31 December 2018 (2019) 2 <https://www.unisuper.com.au/~/media/files/forms%20and%20downloads/proxy%20voting%20reports/responsible-investment-report-31-july-2018-31-december-2018.pdf> accessed 11 February 2020. Tuch has noted how proxy firms act as a form of representative body for institutional investors in the United States and United Kingdom: Andrew F Tuch, 'Proxy Adviser Influence' (2019) 99 Boston University LR 1459, 1480. Tuch suggests that proxy advisers may be 'functional substitutes' for investors' representative bodies: ibid 1488.

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analysing and providing recommendations regarding voting proposals, proxy firms make it feasible for institutional investors to exercise their voting power in relation to the significant number of voting proposals put before them each year.[136] Proxy advisers' policies and guidelines also augment institutional investor 'voice' by making clear to companies the expectations of institutional investors and the intermediaries that advise them.[137]

V. Lessons from Australia

A. Collective action is not a simple governance phenomenon

In theory, market conditions in Australia suggest that it would be both feasible and beneficial for institutions to undertake their stewardship activities collectively.[138] Nonetheless, direct forms of collective action — such as investors jointly undertaking proxy contests, coordinating their share voting or jointly engaging behind-the-scenes with corporate managers — are not common in practice. Institutional investors' stewardship statements suggest that they reserve direct forms of collective action for serious governance concerns only.

Evidence indicates instead that investors more typically wield collective influence through intermediary organisations such as industry bodies and engagement firms. In this regard, the Australian experience is not unique. Overseas commentators have also noted the role of intermediaries in leveraging institutional investor influence in corporate governance.[139]

It can make considerable sense for institutions to undertake their stewardship activities collectively through intermediary organisations, as opposed to forming *ad hoc* coalitions and directly engaging with companies. By acting through an intermediary, an investor does not need to assume the role (and directly bear the cost) of initiating and

[136] Australian Institute of Company Directors (n 134) 71 (noting that institutional investors can receive voting proposals from up to 300 companies each year, the majority of which need to be addressed within a two-month 'peak AGM season' which occurs in October and November).

[137] Ben Power, 'Proxy Music' 34 Company Director 42, 45 (quoting a Commissioner of the Australian corporate regulator who observes that proxy advisers 'play an important role … promoting a focus on corporate governance issues relevant to shareholders').

[138] See above, Part I.

[139] See, eg, Balp and Strampelli (n 77); Tuch (n 135). See also [Italy chapter], which notes the role of the investor organisation, Assogestioni, in facilitating shareholder influence-wielding in Italian corporate governance.

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coordinating an intervention.[140] Moreover, free-riding concerns are mitigated where an intermediary organisation has a significant membership or client base.[141] Intermediaries specialise in representing the interests of institutional investors and, as a result of this focus, may accumulate knowledge and expertise that enables them to achieve economies unavailable to *ad hoc* coalitions of investors. Because they are 'repeat players', intermediaries may also be able to adopt a strategic approach towards their governance activities. In the Australian context, Mees and Smith claim that ACSI has adopted a 'gradualist, due process approach… with their biannually updated corporate governance guides consistently more progressive and demanding than those issued by other key institutions'.[142]

The foregoing considerations are likely to be significant ones for institutional investors given their limited incentives to engage in corporate governance activities.[143]

There are potentially two additional explanations for the significant role played by intermediary organisations in Australia. First, the activities of intermediaries will generally fall outside of the reach of Australia's restrictive acting-in-concert takeover laws. In summary, these complex laws can expose investors who coordinate their governance activities to significant regulatory consequences, including public filing obligations, restrictions on acquiring shares in the target company, and the risk of criminal or civil sanctions for breaching Australia's 20% takeovers 'threshold'.[144] However, the law contains an exemption which applies to service providers such as engagement and proxy firms.[145] In addition, stewardship activities undertaken by an industry body will generally fall outside the reach of takeover laws provided the activities are based on the body's independent assessment of where its members' interests lie and do not involve an agreement or understanding with its investor-members regarding an intervention against a particular company.[146]

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[140] Coordinating a coalition of investors may be a difficult exercise given the potential divergence in interests and objectives of investors: Elroy Dimson, Oguzhan Karakas and Xi Li, 'Coordinated Engagements' (29 October 2019) 4 <https://ssrn.com/abstract=3209072> accessed (25 November 2019).

[141] Balp and Strampelli (n 77).

[142] Mees and Smith (n 36) 86.

[143] See above (n 74–5) and accompanying text.

[144] For an overview, see Australian Securities and Investments Commission, *Regulatory Guide 128 Collective Action by Investors* (June 2015) <https://download.asic.gov.au/media/3273670/rg128-published-23-june-2015.pdf> accessed 11 February 2020.

[145] Corporations Act 2001 (Cth), s 16(1)(a).

[146] See also Hill (n 116) 606-7 (concluding that takeover laws should not present a barrier to the activities of industry bodies).

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Second, by acting through intermediaries, individual investors are able to avoid direct confrontation with companies. Commentators have claimed that owing to the small, concentrated and interconnected nature of the Australian market, investors can be reluctant to engage in confrontational behaviour with investee companies.[147] This would suggest that investors may see an advantage in allowing intermediaries to take the lead in engaging with companies and advocating for the interests of investors.[148]

B. *Exploring the governance significance of intermediary-led stewardship*

The Australian experience highlights the governance potential of intermediary-led stewardship. Whereas Professors Gilson and Gordon emphasise the role of activist hedge funds in leveraging the governance influence of rationally reticent institutional investors,[149] experience in Australia suggests that intermediary organisations can play a similar role. It is important that both policy makers and researchers appreciate this potential governance significance of intermediaries.

That said, there is some divergence of views regarding the effectiveness of intermediary-led stewardship. Balp and Strampelli go so far as to suggest that intermediaries are a 'promising lever by which to foster a more convincing and viable corporate governance role for non-activist institutional investors' and, in particular, may 'activate passively managed funds with particularly weak financial incentives for being active'.[150] Others suggest there are limits to intermediary-led stewardship. In a 2011 report, the UK Financial Reporting Council criticised investors' apparent preference for undertaking collective action through governance intermediaries and claimed that direct collective action is preferable for addressing significant corporate governance concerns:

> [M]any statements around the principle of collective engagement focused on membership

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[147] See, eg, Paul Garvey, 'Change of Name Not Enough to Spare Sandalwood Group Quintis' *The Australian* (Sydney, 24 March 2017) 23 (quoting an Australian activist investor who claims that '[t]he number of people who operate in this market, be it at fund management level, broker level, management level, is very small … Most people here would know each other within two or three degrees of separation in the corporate world, and I think that means people here are probably more reluctant to genuinely confront [corporate] underperformance') <https://www.theaustralian.com.au/business/companies/change-of-name-not-enough-to-spare-sandalwood-group-quintis/news-story/ae9dab3ab5ce2b48269ab3c1c3833e44> accessed 11 February 2020.

[148] This consideration has also been noted outside of the Australian context: see Dimson, Karakas and Li (n 140) 11.

[149] Gilson and Gordon (n 76).

[150] Balp and Strampelli (n 77).

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> of collective bodies. While this is welcome, it skirts round the main reason for [encouraging investors to engage in collective action], which is the need for investors to be able to join forces at critical moments to ensure that boards acknowledge and respond to their concerns.[151]

Doidge et al note that intermediary-led stewardship may be less well suited for addressing company-specific issues, such as issues of commercial strategy.[152] They claim that there is likely to exist a greater variation in the views of individual investors regarding such company-specific issues, making it more costly for intermediaries to establish a common viewpoint on which to base an intervention.[153] If this is indeed correct, intermediary-led activism may not serve as a functional substitute for the role of hedge funds highlighted by Gilson and Gordon.

Jurisdiction-specific considerations are likely to be relevant to this debate. For example, the Australian investment community is relatively small,[154] has an established tradition of using industry bodies to advocate for its interests,[155] and is serviced by relatively few industry bodies and engagement firms.[156] In jurisdictions without such features, it may be unrealistic to expect intermediaries to play a significant role in mobilising investors' stewardship activities.[157] Any analysis of the governance

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[151] Financial Reporting Council, *Developments in Corporate Governance 2011: The Impact and Implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) 22 <https://www frc.org.uk/document-library/frc/2011/developments-in-corporate-governance-2011-the-imp> accessed 11 February 2020.

[152] Craig Doidge, Alexander Dyck, Hamed Mahmudi and Aazam Virani, 'Collective Action and Governance Activism' (2019) 23 Review of Finance 893, 895.

[153] According to Doidge et al, it generally makes more sense for intermediaries to pursue 'process proposals' in relation to mainstream issues of corporate governance practice. This is because such proposals can be put forward in respect of multiple companies (enabling economies of scale) and because such proposals are likely to be easier to formulate since investors' views on 'process' issues are likely to be more closely aligned than in respect of highly company-specific issues: ibid. Highlighting this point, the Australian press recently reported a divergence in views between ACSI and one of its members, the superannuation fund UniSuper, over the company-specific issue of which directors should be removed from the board of the bank, Westpac, in light of serious allegations of compliance failure at that bank: Eyers and Whyte (n 121).

[154] See Garvey (n 147) above and accompanying text.

[155] See Part IV.D above.

[156] ibid.

[157] Tuch suggests that industry bodies have played a significant role in the UK because of (i) the geographical proximity of institutional investors in that country; (ii) shareholders in English companies enjoy favourable legal rights; and (iii) policy settings have encouraged investors to participate in corporate governance. Tuch notes that, in contrast, industry organisations are less prominent in the United States and suggests this may be due to the geographical dispersion of significant investors in the

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significance of intermediaries may therefore need to pay close regard to market conditions in particular jurisdictions.

C. Recognising the varieties of collective action when developing stewardship norms

The Australian codes do not prescribe in detail what is expected of investors in terms of collective action. As explained earlier, ACSI has expressed concern regarding this approach, arguing that it may be necessary to introduce a single code containing minimum standards, in order to promote greater consistency in investors' stewardship activities.[158] Given that the Australian codes currently refer to collective action in very general terms, any such overhaul of the Australian approach to stewardship would need to consider, among other things, the extent to which collective action should be addressed in more prescriptive terms.

This Chapter's analysis indicates that formulating more prescriptive requirements regarding collective action would not necessarily be straightforward. In view of the varieties of collective action highlighted by this Chapter, a key challenge would involve determining what forms of collective should be prescribed. This would require consideration of the issues noted in the previous section regarding the feasibility, and relative effectiveness, of different forms of collective action.

This Chapter's analysis also suggests that it is necessary for investors' stewardship statements to provide more detailed disclosure concerning collective action. The generic disclosures commonly found in Australian investors' stewardship statements — such as claims that investors are prepared to act 'with other like-minded investors'[159] or utilise the services of an intermediary organisation[160] — provide little insight into what this Chapter has revealed to be a governance practice which can be quite varied in nature. In order for outsiders to appreciate fully the nature, extent and impact of investors' stewardship activities, it would seem necessary for investors to report, in more particular terms, on the forms of collective action they undertake, the circumstances in which different forms of collective action are used, and the extent to which they are used.

The recently revised UK Code illustrates a potential approach. Principle 10 of the UK

United States, weaker shareholder rights and a more management-centred approach to corporate governance. See Tuch (n 135) 1488–89.

[158] See (n 69–73) above and accompanying text.

[159] See (n 109–110, 114) above and accompanying text.

[160] See Part IV.D above.

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Code requires signatories, where necessary, to participate in collaborative engagement to influence companies. The UK Code requires signatories to disclose what forms of collaborative engagement they have participated in and why, 'including those undertaken directly or by others on their behalf'.[161] The last phrase would appear to acknowledge that collective action can be undertaken directly or through intermediaries. Consistent with the new code's approach of requiring investors' stewardship disclosures to focus on activities and outcomes,[162] Principle 10 requires investors to disclose the issues addressed by their collective action, the method of collective action used, their own role and contribution in relation to the collective action, and the outcomes of the collective action.[163] Assuming that, in practice, investors give effect to the UK Code's desire for disclosures to be 'as specific and as transparent as possible',[164] Principle 10's disclosure requirements should prompt disclosures which are more granular than the current non-specific disclosures observed, for example, in the stewardship statements of Australian investors. Such particularised disclosures should enable observers to understand better the role played by collective action and its significance as a mechanism for facilitating investors' stewardship activities.

D. Collective stewardship and acting-in-concert rules

Acting-in-concert rules ensure that persons who accumulate voting power through cooperative stake-building or the coordinated exercise of shareholder influence are subject to takeover regulation.[165] These rules can apply to shareholders who act collectively in relation to the governance of their companies[166] and are often regarded as a constraint on collective action.[167] The Australian experience suggests, however, that a more subtle analysis is required when considering the precise impact of acting-in-concert

[161] UK Code (n 6) 19.

[162] ibid 6.

[163] ibid 19.

[164] ibid 6.

[165] Reiner Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd ed, OUP 2009) 255; Martin Winner, 'Active Shareholders and European Takeover Regulation' (2014) 3 European Company and Financial LR 364, 367.

[166] The Walker Review, for example, recognised that collective shareholder action could sometimes collide with, and contravene these rules: Walker Review (n 5) [5.44].

[167] The extent to which collective action should be accommodated by acting-in-concert rules has been explored by regulators in several jurisdictions: see, e.g., Ana Taleska, 'Shareholder Proponents as Control Acquirers: A British, German and Italian Perspective on the Regulation of Collective Shareholder Activism via Takeover Rules' (2018) 19 European Business Organization LR 797.

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rules on investors' attempts to wield collective influence in corporate governance.

This point can be highlighted by reference to the attempt by the Australian regulator, the Australian Securities and Investments Commission (ASIC), to accommodate collective action under Australia's acting-in-concert rules. In *Regulatory Guide 128: Collective Action by Investors* (RG 128), issued in 2015,[168] ASIC outlined the scope which it believes exists for shareholders to engage in collective action without attracting the operation of Australian takeover law. According to RG 128, acting-in-concert rules do not apply where shareholders exchange information or views with one another, exhort each other to address issues of concern, or jointly raise 'general issues' of concern with corporate managers.[169] ASIC also indicates that it is unlikely to take enforcement action in respect of temporary collective action which seeks to promote 'the improvement of a company's corporate governance'[170] — which it defines as collective action directed at mainstream corporate governance concerns, such as better disclosure practices and more comprehensive board performance evaluation processes.[171]

However, RG 128 provides little comfort for investors who wish to use collective action to escalate their governance concerns. RG 128 cautions that 'if … conduct extends to the formulation of joint proposals to be pursued together or there is an understanding that the investors will act or vote in a particular way, then concerns may arise'.[172] It states that if shareholders threaten to pursue their objectives by coordinating their voting or collectively seeking to change the composition of a company's board, such conduct is likely to trigger the application of the acting-in-concert rules.[173]

RG 128's accommodation of low-intensity forms of collective action should provide comfort to investors who seek to engage in lower-intensity forms of stewardship — such as information sharing and non-confrontational engagement with investee companies. However, it is questionable whether RG 128 will significantly enhance the overall levels of this type of collective stewardship by investors. This is because, as this Chapter shows, these types of lower intensity collective action are already facilitated to a significant extent by intermediary organisations, including industry bodies and engagement firms,

[168] Australian Securities and Investments Commission (n 144).

[169] ibid Table 1.

[170] ibid [128.49].

[171] ibid [128.50].

[172] ibid Table 1.

[173] ibid Tables 1, 2 and 3.

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whose activities are not generally caught by acting-in-concert rules.[174]

The more significant aspect of RG 128 is arguably its hostile stance towards higher intensity forms of collection action, such as investors jointly making demands or threatening to exercise their collective voting power against the re-election of directors. As this Chapter shows, it appears that investors are more likely to engage in direct forms of collective action in order to assist them in undertaking these more difficult forms of intervention.[175] It is therefore possible that RG 128 fails to provide regulatory latitude for collective stewardship in situations where such latitude is most needed.

The Australian experience highlights, therefore, the need for any attempt to accommodate collective stewardship under acting-in-concert laws to be guided by a thorough understanding of the actual role and nature of collective action in any given jurisdiction.

VI. CONCLUSION

Australia provides an interesting case study concerning the role of collective action as a form of stewardship. It reveals collective action to be a nuanced governance practice. In particular, it highlights the significance of intermediary-led collective action and argues that this form of collective action warrants further research, as well as more detailed consideration when developing stewardship norms. The Australian experience also highlights the potential regulatory challenge of accommodating collective action under acting-in-concert rules, yielding insights which are relevant to regulators and researchers in other jurisdictions who are examining the intersection of collective action and takeover law.

[174] See (n 144-6) above and accompanying text.

[175] See above, Part IV.C.

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