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Shareholder Committees in the United States and Switzerland: Blind Alley or Vital Branch in the Evolution of Corporate Governance?

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Shareholder Committees in the United States and Switzerland: Blind Alley or Vital Branch in the Evolution of Corporate Governance?

Daniel M. Häusermann*

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Three Swiss corporate governance scholars have suggested recently that public corporations establish shareholder committees, which would have certain oversight functions and act as a communication link between shareholders and management. To assess the merits of this proposal, I review the history of shareholder committees in the United States, outline the spectrum of possibilities in designing shareholder committees, and evaluate their benefits and costs.

Shareholder committees are not going to mitigate the collective action problem of shareholders, and they are unlikely to reduce managerial agency costs to a notable extent. Moreover, their potential for savings in information and communication costs is small. The costs of shareholder committees—transaction costs and additional agency costs—are unlikely to be substantial, but they might offset the limited benefits that a shareholder committee offers. Overall, I doubt whether it is in the best interest of public companies to have a shareholder committee. Nevertheless, given that shareholders will both bear the costs and reap the benefits of a shareholder committee, it should be up to them to decide whether to adopt one or not. Accordingly, the Swiss legislature should lift the restrictions that corporate law currently places on the establishment of shareholder committees.

Keywords: Corporate law, corporate governance, widely held corporation, shareholder committee, shareholders' advisory committee, Switzerland

JEL Classification: K22

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I. Introduction

In the early 1990s, installing shareholder advisory committees in ailing companies was the *idée du jour* among shareholder activists across the United States.¹ However, the wave of shareholder proposals that sought to establish such committees quickly subsided, and corporate governance reform took a different path. Twenty years later, on the other side of the Atlantic, Switzerland is experiencing a popular backlash against the perceived mismanagement of public firms, and especially against high executive pay.² As a consequence, Professors Peter Forstmoser, Stephan Hostettler and Hans-Ueli Vogt have made a reform proposal which they hope will preempt interventionist legislation: They recommend the creation of shareholder committees.³

Professors Forstmoser, Hostettler and Vogt view shareholder committees as the “missing link” between shareholders and management, which would improve communication between the two groups and give shareholders more influence on the shaping of board decisions. The authors envision that shareholder committees either act upon any subject-matter they deem appropriate, or focus on specific issues, such as compensation, lawsuits against directors and officers, or fundamental decisions on strategy and organization. Thereby, shareholder committees shall have the power to make proposals to the board and to make recommenda-

¹ For accounts of some of the shareholder proposals that were made at that time see Jayne W. Barnard, *Institutional Investors and the New Corporate Governance*, 69 N.C.L. REV. 1135, 1144-1147 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 490-492 (1990).

² A federal ballot initiative titled “Against Fat-Cat Salaries” is currently pending, which would, among other things, mandate a binding shareholder vote on executive pay, mandate the individual election of directors and a one-year term of office, prohibit management from soliciting proxies, and restrict the permissible types of executive compensation. See Federal Chancery, *Eidgenössische Volksinitiative “Gegen die Abzockerei”* [Federal Ballot Initiative „Against Fat-Cat Salaries“] (Oct. 17, 2006), BBL 2006 8755, available at <http://www.admin.ch/ch/d/ff/2006/8755.pdf>. The Swiss parliament has been struggling for more than two years to draft a counterproposal that takes the wind out of the initiative’s sails, yet does not restrict the freedom of organization of public corporations too much. For an overview of these developments see Federal Office of Justice, Revision des Aktien- und Rechnungslegungsrechts [Revision of Corporate and Accounting Law], Dec. 3, 2010, <http://www.bj.admin.ch/content/bj/de/home/themen/wirtschaft/gesetzgebung/aktienrechtsrevision.html>.

³ As to the following see Peter Forstmoser, Stephan Hostettler & Hans-Ueli Vogt, *Aktionärsausschüsse als mögliche Neuerung in der AG* [Shareholder Committees as a Potential Innovation in Corporations], NEUE ZÜRCHER ZEITUNG [NZZ] Jan. 27, 2011, at 31.

tions to shareholders. According to the proposal, committee members could either receive confidential information and would then have the same fiduciary duties as directors, or they could be barred from receiving confidential information and in this case would not be subject to fiduciary duties.

In this paper, I evaluate the costs and benefits of shareholder committees from a policy perspective. My analysis rests on the premise that the policy goal of corporate governance is to enable actors to maximize the value of the corporation. I focus on widely-held corporations because all existing proposals to establish shareholder committees relate to this kind of company. This is not to say, though, that it would not be interesting to inquire whether minority shareholder committees could potentially protect investors against a controlling shareholder, be it a controlling family, a business foundation, or the state.

In Part II, I retrace the history of the concept of the shareholder committee as a corporate governance institution in the United States. The idea had most of its traction in the early 1990s, when institutional shareholders were trying to find their role in corporate governance. However, it has not been particularly successful, and it lost its momentum as the general focus of corporate governance reform shifted towards reforming the board.

In Part III, I outline the dimensions in which shareholder committees may vary. The spectrum of possibilities in designing shareholder committees is very broad and ranges from a board-appointed shareholder focus group to a “shadow board,” which is empowered to monitor directors and managers. All existing proposals for shareholder committees occupy the middle ground between these two extremes. Given that the spectrum of design choices for shareholder committees is so broad, it is impossible to draw a bright line between a shareholder committee and a monitoring body at board level.

In Part IV, I assess the potential benefits of shareholder committees. I conclude that we should not expect shareholder committees to mitigate the collective action problem of shareholders. Nor is it likely that a shareholder committee will reduce managerial agency costs to a notable extent. The potential for savings in information and communication costs is small. Finally, shareholder committees cannot be expected to greatly enhance the equality of shareholders’ access to information.

In Part V, I assess the potential costs of shareholder committees. I conclude that the costs of establishing and maintaining a shareholder committee may not be

overwhelming, but they are not trivial compared with the limited benefits of such a committee.

In Part VI, I conclude that shareholder committees are unlikely to have greater benefits than costs. Although I expect few companies to be willing to implement Professors Forstmoser, Hostettler and Vogt's proposal, I agree that companies should be able to experiment with different types of shareholder committees. Therefore, the restrictions that Swiss law currently places on the appointment of shareholder committees should be lifted. It should be up to shareholders to decide whether the concept of the shareholder committee is a blind alley or a vital branch in the evolution of corporate governance institutions.

II. Shareholder Committees in the United States

Shareholder committees have not been a success story in the United States. The idea's precursors can be traced back to the 1900s. Shareholder committees had a brief heyday in the 1990s, in which they also received significant scholarly attention. However, corporate governance reform went down a different path, and the idea has slipped off the radar of U.S. corporate governance scholars.

A. *Precursors*

In 1863, a medical doctor named James C. Ayer from Lowell, Massachusetts, published a pamphlet on the "Usages and Abuses in the Management of Our Manufacturing Corporations," in which he reported, among other things, that the shareholders of several companies had established special committees to investigate conflicted transactions and other instances of alleged wrongdoing by managers.⁴ Dr. Ayer was not the only alert shareholder, however. In fact, shareholder committees seem to have been common in the second half of the 19th century.⁵ More than a hundred years after Dr. Ayer's pamphlet, in 1970, a non-profit organization called the Project on Corporate Responsibility launched a campaign

⁴ James C. Ayer, *SOME OF THE USES AND ABUSES IN THE MANAGEMENT OF OUR MANUFACTURING CORPORATIONS* 5-13 (Lowell, MA, C. M. Langley & Co. 1863). In two out of the three cases cited by Dr. Ayer, the committees found wrongdoing and wrote a detailed report, but the report did not have any practical consequences (*id.* at 6-8 and 12-13). In the third case, the president of the company appointed candidates loyal to him to the committee and the investigation led nowhere (*id.* at 5).

⁵ Rock, *supra* note 1, at 491 (citing as an example a court case that involved a shareholder committee charged with winding up the company).

against General Motors (the so-called Campaign GM), in which it sought, among other things, to create a shareholder committee on social responsibility.⁶ The Campaign GM received considerable public attention, not least because consumer protection activist Ralph Nader had endorsed it.⁷

In parallel to these developments, the Bankruptcy Reform Act of 1978 introduced the so-called committee of equity securities holders. In a Chapter 11 reorganization, the bankruptcy court may order the appointment of a committee of the seven largest equity securities holders willing to serve.⁸ The functions of such a committee are to provide access to information for shareholders and to solicit comments from them.⁹

B. The Short Heyday of the Shareholder Committee

The idea of using shareholder committees to improve corporate governance was conceived in the mid-1980s, after institutional investors had become the dominant type of shareholder.¹⁰ Institutional and individual investors, apparently inspired by the Chapter 11 committee of equity securities holders,¹¹ started making shareholder proposals that sought to establish shareholder committees.¹² The tide reached its peak¹³ in the 1990 proxy season, in which California's public pension fund, Calpers, made proposals to establish shareholders' advisory committees at several companies.¹⁴ In the same year, private equity financier Carl Icahn

⁶ For an account of Campaign GM see Donald E. Schwartz, *The Public-Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. REV. 419, particularly 423-425 (1971).

⁷ *Id.* at 425.

⁸ 11 U.S.C. §1102(a) and 1102(b)(2).

⁹ 11 U.S.C. §1102(b)(3).

¹⁰ In 1965, institutions owned 16% of U.S. public stock. That figure rose to 33% in 1970, to 43% in 1975, stayed at 42% in 1980, and rose to 55% in 1985. See Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1568 (2007). For a brief description of the rise of institutional investors see, for example, Barnard, *supra* note 1, at 1140-1144. See also MICHAEL USEEM, *INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA* (1996).

¹¹ One of the first proposals, made by Mr. Travis Reed, Jr., adopted the Bankruptcy Code's formula that the committee comprise representatives of the seven largest shareholders willing to serve. See Rock, *supra* note 1, at 491. Barnard suggests that Calpers' officials were inspired by their experience in a Chapter 11 case to take the equity holders committee outside of bankruptcy law. See Barnard, *supra* note 1, at 1145.

¹² See Rock, *supra* note 1, at 490-492, for an overview and further references.

¹³ See USEEM, *supra* note 10, 227 (stating that the idea reached an "early (and not particularly high) watermark" in the early 1990s).

¹⁴ For a detailed account of the Calpers proposals see Barnard, *supra* note 1, at 1144-1147.

created a “Shareholders Enhancement Committee” for USX (as U.S. Steel was named at the time¹⁵).¹⁶ Icahn, who owned 13% of the company, appointed experts to the committee who were to conduct an analysis of the company’s business and announced that the committee members would run for the board unless USX enacted a restructuring plan and changed its corporate governance.¹⁷ In contrast to this, a typical Calpers proposal provided for a committee of nine members, a majority of whom were to be selected among the largest shareholders, and reimbursement of expenses.¹⁸ The committee would provide “nonbinding, advisory counsel” to the board on any subject it deemed appropriate, and act as a conduit between the company and its largest shareholders.¹⁹ Calpers justified its proposals by arguing that institutional investors as large and almost permanent stockholders were unable to monitor underperforming companies sufficiently as they did not have the resources to meet with all of them individually.²⁰ Two years later, in 1992, while Calpers continued making headlines with its proposals,²¹ shareholder activist Robert Monks sought to establish a three-member shareholders’ advisory committee at Exxon.²²

Despite the surge in proposals, very few shareholder advisory committees were established. Management generally opposed the proposals²³ and shareholders rejected them.²⁴ Professor Useem has explained this resistance by the fact that

¹⁵ See *History of U.S. Steel*, U.S. STEEL, <http://www.ussteel.com/corp/company/profile/history.asp>.

¹⁶ John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003, 1053-1054 (1993); L.A. TIMES, *Icahn Picks Panel to Keep an Eye on USX Board*, Nov. 15, 1990, available at http://articles.latimes.com/1990-11-15/business/fi-6091_1_steel-division.

¹⁷ Pound, *supra* note 16, at 1053-1054; L.A. TIMES, *supra* note 16.

¹⁸ Richard H. Koppes & Kayla J. Gillan, *The Shareholder Advisory Committee*, DIRECTORS & BOARDS, Spring 1991, 29, 31; see also Barnard, *supra* note 1, at 1139, for further references.

¹⁹ Koppes & Gillan, *supra* note 18, at 32.

²⁰ *Id.* at 29-30. The authors were Calpers employees at the time.

²¹ See Richard W. Stevenson, *Huge Fund Turns Up Proxy Heat*, N.Y. TIMES, Mar. 21, 1992, at D1.

²² See the account by Henry Lesser, *Shareholder Bylaw Amendment Proposals Under the Proxy Rules: The Impact of the Exxon Letter*, CORP. GOVERNANCE ADVISOR Oct./Nov. 1992 1, 11.

²³ For example, a survey of more than 800 companies by the American Society of Corporate Secretaries found that 80% of corporate secretaries opposed creating shareholder advisory committees. See The IRRC Monitor: Board Practices Survey, CORP. GOVERNANCE ADVISOR, May/June 1996, 25, 25-26, cited by John C. Coffee, Jr., *Survey of Books Relating to the Law: VII. Corporate Law: The Folklore of Investor Capitalism*, 95 MICH. L. REV. 1970, 1980 (1997).

²⁴ The data about the margins of rejection vary. Rock mentions two examples which received more than 40 % of the vote. Rock, *supra* note 1, at 491. Useem reports that most proposals received less than 20%. USEEM, *supra* note 10, at 227.

the proposals came from public pension funds, which exclusively targeted companies which they believed to be poorly managed.²⁵ Therefore, an endorsement of the proposal by the company would have meant a concession that the company was indeed poorly managed.²⁶ Moreover, few shareholder advisory committees were established due to their frequent usage as bargaining chips in negotiations over other aspects of corporate governance. This is most obvious with respect to Carl Icahn's attempt to change the strategy of USX, yet the same is true for many Calpers proposals, which it withdrew when the company had made other concessions on corporate governance.²⁷ At least in one case, at Lockheed, things played out the other way, as management agreed to establish a shareholders' advisory committee in consideration of Calpers' support at fending off a hostile tender offer.²⁸

C. *Scholarly Reactions*

In the early 1990s, shareholder committees caught the attention of corporate governance scholars. These discussions were part of the broader debate about the appropriate role of institutional investors in corporate governance,²⁹ which coincided with a great deal of academic interest in alternative governance structures of the public corporation, such as the German and Japanese two-tier board structures.³⁰

²⁵ USEEM, *supra* note 10, at 227.

²⁶ *Id.*

²⁷ See the account by Barnard, *supra* note 1, 1146.

²⁸ Bevis Longstreth, *The Fourth Abraham L. Pomerantz [sc. Lecture]: Tensions Between Institutional Owners and Corporate Managers: An International Perspective: Reflections on the State of Corporate Governance*, 57 BROOKLYN L. REV. 113, 114 (1991).

²⁹ See, e.g., Rock, *supra* note 1 (arguing that institutions would be unlikely to monitor their portfolio companies); Barnard, *supra* note 1 (examining shareholder advisory committees from the perspective of institutional investors); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991) (advocating the creation of a pool of professionals from which institutional investors could recruit outside directors for their portfolio companies); John C. Coffee, *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1276 (1991) (stressing the role of regulation in incentivizing institutions to monitor companies); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992) (making suggestions to facilitate monitoring by institutions); John H. Matheson & Brent A. Olson, *Corporate Law and the Longterm Shareholder Model of Corporate Governance*, 76 MINN. L. REV. 1313 (1992) (suggesting a model framework of corporate governance that includes a role for institutional investors).

³⁰ See, e.g., Gilson & Kraakman, *supra* note 29, at 876-879 (evaluating LBO associations and Japanese and German corporate groups); Barnard, *supra* note 1, at 1147-1149 (evaluating German

Commentators were not exactly enthusiastic about shareholder committees. Professors Gilson and Kraakman argued that shareholder advisory committees “would merely formalize existing management-shareholder exchanges in many companies,”³¹ and that there would be a danger of creating a “shadow board,” which “would suffer from all of the structural shortcomings that critics have identified in actual boards, while exercising none of an actual board’s power.”³²

Professor Rock classified shareholder committees according to their functions as “general purpose monitor,” “general purpose voice,” and “special purpose committees.”³³ Concerning the monitoring function, he agrees with Professors Gilson and Kraakman that it would be pointless to create a shadow board.³⁴ He is less pessimistic, though, with respect to the function of bundling shareholder voice: Although he does see some problems,³⁵ he concludes that “even a general purpose advisory committee has substantial potential to alter the balance of power between shareholders and managers.”³⁶ As to special purpose committees, which he envisions to decide on the most conflicted transactions,³⁷ he states that they would be a “welcome innovation” in light of the shortcomings of existing practices in solving the agency and coordination problems in these contexts.³⁸ In spite of these advantages, Professor Rock’s verdict is that “shareholders’ advisory committees, though potentially promising as an incremental step towards resolving some particularly sensitive corporate governance issues, seem unlikely to usher in any basic change in corporate governance.”³⁹

Professor Barnard evaluated three possible functions of shareholder committees, namely a “consultative function,” in which the committee reviews board

and Japanese board structures); Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91, 137-146 (1997) (evaluating German and Japanese board structures).

³¹ Gilson & Kraakman, *supra* note 29, at 872.

³² *Id.*

³³ Rock, *supra* note 1, at 498-504.

³⁴ *Id.* at 498. *Accord* ANDREAS BOHRER, CORPORATE GOVERNANCE AND CAPITAL MARKET TRANSACTIONS IN SWITZERLAND § 146 (2005).

³⁵ He particularly emphasizes the institutional investor’s dilemma concerning inside information. If the members of the shareholder committee receive inside information, institutions may not have incentives to serve because if they did, they would be considered as constructive insiders under sections 16(b) and 10(b) of the 1934 Securities and Exchange Act. Rock, *supra* note 1, at 499.

³⁶ Rock, *supra* note 1, at 501.

³⁷ He mentions the examples of a sale or of pursuing a derivative claim: *Id.* at 501.

³⁸ *Id.* at 502-503.

³⁹ *Id.* at 506.

proposals, a monitoring function, and a function as information conduit to and from the board.⁴⁰ Being particularly skeptical about the first two functions, she doubts whether “shareholders would be ‘better off’ with an advisory committee,”⁴¹ and concludes that “[r]ather than creating a ‘shadow cabinet,’ ... institutions can achieve the same result ... by putting institutional representatives on the board itself.”⁴² In a similar vein, Professor Black opined that “shareholder advisory committees [would be] a poor substitute for institutional directors.”⁴³

D. The Different Path of Corporate Governance Reform

Although shareholder proposals were still made occasionally after the initial boom around 1990,⁴⁴ the general development in corporate governance reform went down a different path. On the one hand, restrictions to the collective action of shareholders were relaxed. In 1992, the SEC amended the proxy solicitation rules⁴⁵ to make it easier for institutional investors to campaign for corporate governance changes.⁴⁶ This may have reduced the need for a separate body that engages with the board in these matters. On the other hand, reform focused on the board itself, just as many of the critics of shareholder committees had suggested.⁴⁷ The 1990s saw what Professor Gordon termed the “triumph of the independent board,”⁴⁸ and in 2002, after the corporate scandals at Enron, WorldCom, and oth-

⁴⁰ Barnard, *supra* note 1, at 1167. Accord Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009, 1029 footnote 62 (1994).

⁴¹ Barnard, *supra* note 1, at 1167

⁴² *Id.* at 1168.

⁴³ Black, *supra* note 29, at 844 footnote 90.

⁴⁴ An example is a proposal by a small shareholder of Texaco in 1997. For a detailed description of the proposal see James McConvill & Mirko Bagaric, *Towards Mandatory Shareholder Committees in Australian Companies*, 28 MELB. U. L. REV. 125, 150-151 (2004).

⁴⁵ Securities and Exchange Commission, Regulation of Communications Among Shareholders, Release No. 34-31326, 52 S.E.C. Docket 2028, Release No. IC-19031 (1992).

⁴⁶ In particular, shareholders are exempted from filing a form 14A when they solicit proxies from no more than ten shareholders (17 C.F.R. § 240.14a-2(2)(b) (2011)), when they merely announce how they intend to vote (§ 240.14a-1(1)(2)(iv) (2011)), and when they conduct “withhold the vote” campaigns (§ 240.14a-12 (2011)); *see also* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857 (1993)).

⁴⁷ *See* Gilson & Kraakman, *supra* note 29, at 883-892 (advocating the creation of a pool of professionals from which institutional investors could recruit outside directors for their portfolio companies); Barnard, *supra* note 1, at 1168 (recommending the placement of institutional representatives on boards); Black, *supra* note 29, at 842-844 (advocating, among other board reforms, the placement of institutional directors on boards).

⁴⁸ Gordon, *supra* note 10, at 1526.

ers,⁴⁹ the stock exchanges cemented important features of the independent monitoring board: Among other things, companies must have audit, compensation and nominating committees, which have to be composed entirely of independent directors, and independence is assessed by a tightened standard.⁵⁰ At the same time, empirical studies found that director independence was not correlated with the valuation of companies.⁵¹

Even during the time that corporate governance reform focused on boards, however, the idea of the shareholder committee was not completely forgotten. In 2003, Professor Dorff suggested the establishment of random shareholder committees consisting of a small group of retail shareholders.⁵² A random shareholder committee would have to engage with the chair of the board's compensation committee, so that the chair identifies with stockholders and develops a sense of responsibility towards them, and will (hopefully) refrain from granting executives excessive pay packages.⁵³ Independently thereof, two Australian scholars, McConvill and Professor Bagaric, advocated transplanting the idea of the shareholder committee to their country: They make the case for mandatory shareholder committees, which would consist of either randomly selected shareholders or shareholders who have held at least 1% for three years.⁵⁴ A committee would be advised by a panel of three experts and review shareholder grievances, ensure information flows between shareholders and management, and get involved in the director nomination process, should it deem it necessary.⁵⁵

⁴⁹ For a brief overview see Dylan McClain, *Corporate Scandals: A User's Guide*, N.Y. TIMES, May 11, 2003, §3, at 1.

⁵⁰ See, e.g., NYSE, Listed Company Manual §§ 303A.04-.06 (2011), available at <http://nysemanual.nyse.com/lcm/>. For an overview of the reforms see Robert Charles Clark, *Corporate Governance Change in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251, 267-272 (2005).

⁵¹ Sanjai Bhagat & Bernard Black, *The Uncertain Relationship between Board Composition and Firm Performance*, 54 BUS. LAW. 921 (1999) (finding no correlation between board independence and firm profitability or firm growth); Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231 (2002) (finding that firms with more independent boards do not perform better in the long run than other firms).

⁵² See Michael B. Dorff, *Softening Pharaoh's Heart: Harnessing Altruistic Theory and Behavioral Law and Economics to Rein in Executive Salaries*, 51 BUFFALO L. REV. 811, 878-886 (2003).

⁵³ See Dorff, *supra* note 52, at 878-886.

⁵⁴ McConvill & Bagaric, *supra* note 44, at 155-157; JEAN JACQUES DU PLESSIS, JAMES MCCONVILL & MIRKO BAGARIC, *PRINCIPLES OF CONTEMPORARY CORPORATE GOVERNANCE* 335-336 (2005).

⁵⁵ McConvill & Bagaric, *supra* note 44, at 158-162; DU PLESSIS, MCCONVILL & BAGARIC, *supra* note 54, at 336-338.

As of 2011, corporate governance scholars and activists in the United States seem to have lost interest in shareholder committees. For instance, Robert Monks (who made the Exxon proposal in 1992) and Nell Minow do not mention the idea in their influential treatise on corporate governance, but instead recommend that institutional shareholders intervene directly with the board in certain cases.⁵⁶

E. Conclusions

There is no uniform concept of a shareholder committee, even in its modern, corporate governance-oriented form. The idea has been around in the United States for roughly twenty-five years, and it had the most of its traction in the early 1990s when institutional shareholders were trying to find their role in corporate governance. Overall, the idea has not been particularly successful, and it lost its momentum as the general focus of corporate governance reform shifted towards reforming the board and empowering shareholders. Hence, shareholder committees appear to have been a blind alley in the evolution of U.S. corporate governance institutions.

III. Design Choices

The concept of a shareholder committee has been criticized for its obscurity as regards the designated role of such a committee.⁵⁷ The perceived obscurity may be less due to the vagueness of ideas than to the lack of a clear view of the range of options in the design of a shareholder committee. Table 1 provides an overview of the spectrum of choices.

⁵⁶ See ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 166-167 (4th ed. 2008).

⁵⁷ Cf. Rock, *supra* note 1, at 498 (remarking that “the role proposed for such committees by their proponents remains obscure”).

Table 1: Degrees of Freedom in Designing Shareholder Committees

Category	Dimensions or subcategories	Possible Specifications
Functions	General functions	Monitoring Information conduit Advice to board Make recommendations to shareholders Hear shareholder grievances
	Special functions	Involvement in nomination process Involvement in compensation setting Approve conflicted transactions etc.
Powers		Approve/veto board resolutions Enact binding policies Make proposals to shareholders Include messages in proxy statement Hold hearings of directors and officers Compel disclosure of confidential information Retain advisers
Members' Rights and Duties		Fiduciary duties or not Reimbursement Remuneration
Composition	Number of members	Any number (proposals range from 3 to 9)
	Selection of members	By board By shareholders Randomly
	Special members	Board representative Representative of the largest shareholders
Eligibility	Size of shareholdings	Any shareholder The largest shareholders Small shareholders
	Duration of shareholdings	No restriction Minimum holding period
Term of Office		Any duration (proposal range from 1 to 3 years) Renewable or non-renewable
Implementation		Mandatory for all listed companies Opt-in Opt-out Comply-or-explain

A. *Functions, Powers, Rights and Duties*

Following Professor Rock's framework,⁵⁸ shareholder committees could exercise either general or special functions. The monitoring function has been discussed frequently, but nobody seems to have ever advocated that function.⁵⁹ Compared to the monitoring function, the information conduit function has received quite favorable appraisals.⁶⁰ In addition or as an alternative to these functions, a shareholder committee could advise the board on important issues,⁶¹ make recommendations to shareholders,⁶² and hear shareholder grievances⁶³. In terms of special functions, a shareholder committee could be involved in the nomination process,⁶⁴ in setting executive compensation,⁶⁵ in making important strategic and organizational decisions, or it could be required to approve transactions that are prone to conflicts of interest⁶⁶.

Depending on its functions, a shareholder committee ought to have different powers. Examples are the power to approve or veto certain resolutions of the board or board committees, the power to enact binding policies for the board, to make proposals to shareholders, to include messages in the proxy statement⁶⁷, to hold hearings of directors and officers, and to compel the disclosure of confidential information,⁶⁸ as well as the power to hire advisers such as lawyers, investment bankers, accountants, or consultants.

The rights and duties of committee members will depend on the committee's powers. Members will need to have fiduciary duties if they have decisional

⁵⁸ *Supra* text accompanying note 33.

⁵⁹ This function has received the most criticism. *See supra* text accompanying notes 32, 34, and 41.

⁶⁰ *See supra* text accompanying notes 36 and 55. This was also the main thrust of the Calpers proposals. *See* Koppes & Gillan, *supra* note 18, at 30.

⁶¹ *See* Forstmoser, Hostettler & Vogt, *supra* note 3, at 31.

⁶² *Id.* This function is similar to the task of Carl Icahn's USX Shareholder Enhancement Committee. *See supra* text accompanying notes 16-17.

⁶³ *See* McConvill & Bagaric, *supra* note 44, at 158.

⁶⁴ *Id.* at 162.

⁶⁵ Dorff, *supra* note 52, at 878-891 (endorsing involvement); McConvill & Bagaric, *supra* note 44, at 162-163 (rejecting involvement); Forstmoser, Hostettler & Vogt, *supra* note 3, at 31 (endorsing involvement).

⁶⁶ *See* Rock, *supra* note 1, at 501 (referring to the sale of the company and lawsuits against directors and officers); Forstmoser, Hostettler & Vogt, *supra* note 3, at 31 (referring to lawsuits against directors and officers).

⁶⁷ *See* Forstmoser, Hostettler & Vogt, *supra* note 3, at 31.

⁶⁸ *Id.* (speaking of "access" to confidential information).

power or if they receive privileged information.⁶⁹ Moreover, they will need to be reimbursed for their expenses, if not be paid for their services.⁷⁰

B. Composition, Eligibility, Term of Office

The design choices concerning the composition of a shareholder committee relate to the number of members, eligibility for the office, the way in which members are selected, and the term of office. Proposals as to the number of members range from three⁷¹ to nine or more.⁷² Suggestions as to who should be eligible for committee membership range from small shareholders only⁷³ to anyone who holds shares above a certain modest threshold⁷⁴ to only the largest shareholders.⁷⁵ Some proponents suggest that a portion of seats be reserved for the largest stockholders.⁷⁶ Others recommend a minimal holding period.⁷⁷ It seems natural to have shareholders elect the committee—after all, it is called a shareholder committee. However, if a board wants to establish a shareholder committee to inform the board about shareholder sentiment, it might appoint committee members—or some of them⁷⁸—itself. A third possibility, which is favored by scholars who do not see shareholder committees primarily as a means to empower institutional shareholders, is to select members randomly.⁷⁹ The suggested terms of office range from one year to three years and could be renewable or not.⁸⁰

⁶⁹ *Id.* (stating that if committee members receive confidential information, they should have the same fiduciary duties as board members).

⁷⁰ See McConvill & Bagaric, *supra* note 44, at 142 (suggesting reimbursement and a small remuneration fee); Dorff, *supra* note 52, at 879 (suggesting that the randomly selected small shareholders be compensated “at a fairly generous daily rate”). The Calpers proposals of 1990 provided for reimbursement of expenses only. See Barnard, *supra* note 1, at 1139, with further references.

⁷¹ As in Robert Monks’ Exxon proposal. See *supra* text accompanying note 22.

⁷² See Koppes & Gillan, *supra* note 18, at 31.

⁷³ Dorff, *supra* note 52, at 879 and 883 (explaining why he wants to bar large institutions from serving).

⁷⁴ Koppes & Gillan, *supra* note 18, at 31.

⁷⁵ See Barnard, *supra* note 1, at 1139, with further references. McConvill & Bagaric consider this a second-best solution. See McConvill & Bagaric, *supra* note 44, at 157.

⁷⁶ Koppes & Gillan, *supra* note 18, at 31; Forstmoser, Hostettler & Vogt, *supra* note 3, at 31.

⁷⁷ Dorff, *supra* note 52, at 879; McConvill & Bagaric, *supra* note 44, at 157.

⁷⁸ McConvill and Bagaric suggest that one of the nine members be appointed by the board. McConvill & Bagaric, *supra* note 44, at 157.

⁷⁹ Dorff, *supra* note 52, at 879; McConvill & Bagaric, *supra* note 44, at 157. McConvill and Bagaric cite the example of an Alaska Native Corporation called CIRI, which has several Shareholder Participation Committees whose members are drawn randomly from a pool of its 7,300 native Alaskan shareholders who are interested in serving. *Id.* at 147-149; CIRI, *Shareholder*

C. *Implementation*

Thus far, only two possible ways of getting companies to adopt shareholder committees have been discussed: making a shareholder committee mandatory for all listed companies⁸¹ and allowing companies to opt into such a committee⁸². There are, however, two intermediate solutions. First, one might consider a statutory opt-out.⁸³ Second, an opt-in statute could be accompanied by a disclosure rule that obliges companies to explain themselves if they do not establish a shareholder committee (“comply or explain”).⁸⁴

D. *The Spectrum of Choices and Definitional Questions*

This brief overview of the design specifications of a shareholder committee shows how broad the spectrum of possibilities is. At the one end of the spectrum, one could imagine a committee set up by the board whose sole purpose is to give the board feedback about shareholder sentiments, without having any special powers. Its members would neither have access to confidential information nor fiduciary duties. This type of shareholder committee would essentially be a focus group of shareholders, just like market researchers use focus groups to receive feedback on a company’s products.⁸⁵ At the other end of the spectrum, a share-

Participation Committees, <http://www.ciri.com/content/shareholders/committees.aspx>, and CIRC Company Overview, <http://www.ciri.com/content/company/business.aspx>.

⁸⁰ Compare Koppes & Gillan, *supra* note 18, at 32 (advocating a one-year term), with McConvill & Bagaric, *supra* note 44, at 157 (advocating a three-year non-renewable term).

⁸¹ Advocates of a mandatory shareholder committee are McConvill & Bagaric, *supra* note 44, at 167. Dorff suggested that his idea be tested among a random sample of companies, from which I infer that he favors mandatory rules if the experiment is successful. Dorff, *supra* note 52, at 891.

⁸² Forstmoser, Hostettler & Vogt, *supra* note 3, at 31, propose such an opt-in solution.

⁸³ An opt-out might suggest itself under Bebchuk and Hamdani’s reversible defaults approach, according to which a statutory default should be restrictive to managers when it is uncertain whether a corporate governance arrangement is efficient and the collective action problem of shareholders is severe enough to prevent them from opting out of a manager-friendly default. They justify their approach by pointing out that the costs of overriding a default are lower when management has incentives to initiate the default override. See Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 500-506 (2002). Whether the collective action problem of shareholders is severe enough as to justify a statutory opt-out depends on whether the board has to approve the creation of a shareholder committee and on other circumstances.

⁸⁴ The approach was first proposed by the Cadbury Report. See Committee on the Financial Aspects of Corporate Governance, *The Financial Aspects of Corporate Governance* § 3.7, at 16 (1992), available at <http://www.ecgi.org/codes/documents/cadbury.pdf>.

⁸⁵ The focus group was invented by sociologist Robert K. Merton. See Michael T. Kaufman, *Robert K. Merton, Versatile Sociologist and Father of the Focus Group, Dies at 92*, N.Y. TIMES,

holder committee could be given the power to approve or veto certain board resolutions, including director nominations, to enact policies that are binding to the board, to make proposals to shareholders, and to access confidential information. Its members would necessarily have fiduciary duties. In effect, such a committee would be nothing short of a “shadow board.”⁸⁶ Existing proposals for shareholder committees occupy the middle ground between the two extremes, focusing on the committee’s role as an information conduit and on its involvement in some of the most conflicted board decisions.⁸⁷

The breadth of the concept of a shareholder committee raises the question of what distinguishes a structure in which a board is monitored by a powerful shareholder committee from such structures as the German and Japanese two-tier boards⁸⁸ or Professor Dallas’ idea of a dual board, a structure consisting of a conflicts board and a business review board, which have different functions, but equal status.⁸⁹ In fact, there is no bright line between these structures. It is a question of terminology whether a monitoring body is called a shareholder committee, a supervisory board, or something else.⁹⁰ Likewise, it is a matter of definition where the line is drawn between such a monitoring body (whatever its name) and a shareholder committee that has more limited functions. Thus, there seems to be less of a dichotomy between a board and a shareholder committee than some commentators may believe.⁹¹

Feb. 23, 2003, available at <http://www.nytimes.com/2003/02/24/nyregion/robert-k-merton-versatile-sociologist-and-father-of-the-focus-group-dies-at-92.html>.

⁸⁶ Gilson & Kraakan, *supra* note 29, at 872.

⁸⁷ See *supra* text accompanying notes 3, 19, 53, and 55.

⁸⁸ For references see *supra* note 30.

⁸⁹ See Dallas, *supra* note 30. The conflicts board would consist of independent directors. *Id.* at 114-116. The conflicts board would nominate director candidates, set executive compensation, hire and fire executive officers, select an auditor, approve conflicted transactions, decide on control changes, oversee auditing and financial reporting, monitor legal compliance, and set ethical standards. *Id.* at 117-122. The business review board would comprise inside and independent expert directors. *Id.* at 122. It would oversee business and management, and review, initiate or approve strategy, financial objectives, and major non-conflicted transactions. *Id.* at 122-123. Both boards would have a right to obtain reports from the other board and from employees. *Id.* at 124.

⁹⁰ As Professor Forstmoser has noted, the board itself was originally thought to be a shareholder committee. Peter Forstmoser, *Stärkung der Aktionärsdemokratie – aber wie? [Strengthening Shareholder Democracy—but how?]*, NEUE ZÜRCHER ZEITUNG [NZZ], July 29, 2010, at 26.

⁹¹ Cf. Black, *supra* note 29, at 844 footnote 90 (stating that shareholder advisory committees are a poor substitute for institutional directors); Barnard, *supra* note 1, at 1168 (recommending that reform focus on the board itself instead of shareholder committees).

IV. Potential Benefits

Shareholder committees offer several potential benefits. They could mitigate the collective action problem among shareholders, lower the agency costs of the board of directors and top management, improve board decisions, lower the communication costs between the board and shareholders, and have the benefits ascribed to a formalization of informal contacts between shareholders and managers. Each of these potential benefits varies depending on a shareholder committee's functions and powers.

A. *Mitigation of Collective Action Problem*

Shareholder committees may be viewed as mitigating the collective action problem among shareholders.⁹² Scholars are quite optimistic that shareholder committees have this potential. For instance, Professor Rock argues that shareholder committees “may significantly moderate the collective action problem facing shareholders.”⁹³ Advocates of shareholder committees do not explicitly mention collective action problems, but they apparently believe that shareholder committees are an appropriate means of empowering shareholders to monitor the board better or to make their voice heard by the board.⁹⁴ Skeptics mostly question the committees' capacity of performing these tasks,⁹⁵ but do not dispute the premise of their point: that a shareholder committee has incentives to perform whatever functions are assigned to it, while the shareholders themselves may not.⁹⁶

⁹² For a general formulation of collective action problems see MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (2d ed. 1971). For early applications to corporate law, see Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. R. 1161, 1170-1171 (1981); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 402-403 (1983).

⁹³ Rock, *supra* note 1, at 495. Accord McConvill & Bagaric, *supra* note 44, at 136-137.

⁹⁴ See *supra* text accompanying notes 3, 19, 53, and 55.

⁹⁵ See, e.g., Gilson & Kraakman, *supra* note 29, at 872; Black, *supra* note 29, at 844 footnote 90; BOHRER, *supra* note 34, at §§ 146 and 148.

⁹⁶ Dorff and Bohrer take a different stance with regard to the information conduit function of a shareholder committee. They dispute—in my opinion, quite rightly—that there is a collective action problem in the first place because boards and large investors already maintain informal contacts. See Dorff, *supra* note 52, at 883 (suggesting to bar large institutional shareholders from serving on a random shareholder committee because they already meet informally with management); BOHRER, *supra* note 34, at § 147 (suggesting that the largest investors would prefer to communicate their views to the board directly, not via a shareholder committee). Proponents of a “general voice” committee prefer to formalize the contacts between boards and large investors.

Because shareholder committees can only mitigate collective action problems to the extent that they do not face such a problem themselves, we need to determine first whether a shareholder committee itself faces a collective action problem. That depends on the collective action required from the shareholders in connection with the formation and the operation of a committee.

The collective action problems associated with the formation of a shareholder committee are quite different depending on the way a committee is formed. If shareholders have to take the initiative to put a committee in place, the collective action problem might be big enough to prevent a committee from being formed,⁹⁷ unless the gain in shareholder value of having a committee is large enough to make it rational for the largest stockholder or group of stockholders to shoulder the costs alone. At this point, it is important to note that the costs of shareholder action are to a large extent determined by legal requirements, such as the SEC rules concerning shareholder proposals in the United States,⁹⁸ and minimum shareholding requirements for shareholder proposals in Switzerland.⁹⁹ One way of mitigating the collective action problem without changing those legal requirements would be to mandate shareholder committees or to establish shareholder committees by default, with a possibility to opt out.¹⁰⁰ However, these measures would place a cost burden on companies that would not benefit from having a shareholder committee, and these costs may be greater than the benefits for those companies that would benefit from it.¹⁰¹

When it comes to serving on a shareholder committee, there should be no collective action problem in theory, since the shareholders who serve on the commit-

See Koppes & Gillan, *supra* note 18, at 30 (pointing out the limits of informal communications); Forstmoser, Hostettler & Vogt, *supra* note 3, at 31.

⁹⁷ See John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 Minn. L. Rev. 1443, 1478 (1994) (stating that the creation of shareholder advisory committees is unlikely “in all but the most extreme circumstances”).

⁹⁸ 17 C.F.R. § 240.14a-8.

⁹⁹ In Switzerland, the right to make proposals is limited to shareholders (or groups of shareholders) owning the lower of 10% or 1 million Swiss Franks in nominal capital. CODE OF OBLIGATIONS art. 699(3) (Switz.).

¹⁰⁰ Shareholder committees which are convened by the board as mere focus groups are not faced with a collective action problem, either.

¹⁰¹ This reasoning is based on the hypothetical bargains approach towards setting default rules, according to which the default should be the rule which would be most widely adopted. Assuming that the costs of overriding the default are the same for all firms, this strategy reduces total transaction costs. For an overview see Bebchuk & Hamdani, *supra* note 83, at 491 (with further references).

tee can be reimbursed or paid for their services. However, as Professor Rock points out, investors who trade in the stock of the company¹⁰² may not have incentives to serve if they thus come to be regarded as statutory insiders under § 16(a) and § 10(b) and rule 10b-5 of the Securities and Exchange Act of 1934.¹⁰³ This claim rests on the assumptions that investors cannot be fully compensated for the loss in liquidity stemming from the trading restrictions imposed by securities law, and that this is the case for all stockholders whose membership on the committee would be desirable. These assumptions are quite strong. If they are correct, shareholder committees whose members receive inside information would likely face a collective action problem. This problem would be smaller with respect to special committees that exist for a limited duration than with respect to permanent committees.¹⁰⁴

Even if enough stockholders have sufficient incentives to serve on a shareholder committee or to send a delegate, there is still no good reason to believe that a shareholder committee will mitigate the collective action problems that shareholders face today. I do not see a basis for the literature's optimism in this regard¹⁰⁵ because the collective action that shareholders need to take with respect to a shareholder committee is more, not less, demanding than their current involvement in the company's affairs. Hence, it would be illogical to assume that a shareholder committee could mitigate the collective action problem among shareholders, unless the legal constraints to collective action with respect to the shareholder committee are less severe than with respect to the board. If that is the case, however, it is more straightforward to relax the rules with respect to the board itself.

¹⁰² Although he writes about institutional investors, his point applies to any investor who trades because the trading restrictions that are the main drawback of being considered an insider in this context (*see supra* note 35) apply to any shareholder.

¹⁰³ *See* Rock, *supra* note 1, at 496 and 499. *Accord* Matheson & Olson, *supra* note 97, 1478. However, Rock's prediction (*id.* at 497) that institutional investors may prefer to trade on information gained from monitoring the company independently violates its own premise: If an investor does not have inside information, he does not have an informational advantage that he could trade upon over any other analyst in the market.

¹⁰⁴ *See* Rock, *supra* note 1, at 496 and 504 (predicting that institutional shareholders "will be less willing to serve on general purpose, continuing shareholders' committees than on special purpose, limited duration committees").

¹⁰⁵ *See supra* text accompanying notes 93-96.

B. Lower Agency Costs

To the extent that a shareholder committee has monitoring functions, its purpose is to reduce the agency costs that result from the conflict of interests between shareholders and managers.¹⁰⁶ As mentioned, a shareholder committee's monitoring function may be general or restricted to specific tasks or transactions.¹⁰⁷ While even the most ardent supporters of shareholder committees have not suggested that shareholder committees monitor managers generally, many proponents recommend that shareholder committees get involved in those matters which are presumably the most conflict-prone, such as the nomination of directors and top managers, the setting of executive compensation, the pursuit of derivative claims, and the sale of the company.¹⁰⁸ Today, these tasks are bestowed upon independent directors, either via board committees¹⁰⁹ or otherwise.¹¹⁰ Thus, the question arises whether a shareholder committee is in a better position to monitor managers and to decide on conflicted issues than outside directors or independent board committees. Commentators deny this unanimously. Their biggest objection is that a shareholder committee will not have more information than outside directors.¹¹¹ Additionally, critics expect shareholder committee members to have similar time constraints and a potential lack of expertise than outside directors.¹¹²

There can be little doubt that the tradeoff between independence and insider knowledge that limits the effectiveness of outside directors¹¹³ also applies to shareholder committees. Even if a shareholder committee has the power to compel the disclosure of confidential information, the costs of acquiring this informa-

¹⁰⁶ See generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 327-328 (1976).

¹⁰⁷ See *supra* text accompanying note 33.

¹⁰⁸ See *supra* text accompanying notes 64-66.

¹⁰⁹ The triad of the nominating, compensation, and audit committee is mandated by the Sarbanes-Oxley Act of 2002 and stock exchange rules. For references see *supra* note 50.

¹¹⁰ As to the role of independent directors in hostile takeovers according to Delaware case-law see Gordon, *supra* note 10, at 1524-1526. Delaware case-law also incentivizes boards to let independent directors decide on lawsuits against directors and officers. See *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); *Levine v. Smith*, 591 A.2d 194 (Del. 1991).

¹¹¹ Gilson & Kraakman, *supra* note 29, at 872; accord Rock, *supra* note 1, at 498, and BOHRER, *supra* note 34, at § 146. See also Barnard, *supra* note 1, at 1164 (stating that shareholder committee members would not have greater access to information than outside directors), and Black, *supra* note 29, at 844 footnote 90 (stating that it is unclear whether committee members will know enough about the company to ask hard questions at meetings with management).

¹¹² Gilson & Kraakman, *supra* note 29, at 872; accord Rock, *supra* note 1, at 498.

¹¹³ See, e.g., George S. Dallas & Hal S. Scott, *Mandating Corporate Behavior: Can One Set of Rules Fit All?* STANDARD & POOR'S, Spring 2006, available at <http://ssrn.com/abstract=907346>.

tion will often be prohibitive because the committee might not know what to ask for—there will be “unknown unknowns”¹¹⁴— and time constraints prevent committee members from collecting sufficient information.

On the other hand, a shareholder committee’s monitoring capacity might be increased due to its greater accountability to shareholders. It is widely acknowledged that boards, through their nominating committees, actually co-opt their members, and that the CEO has considerable power to block director nominations.¹¹⁵ Thus, outside directors may be more accountable to managers than to shareholders. Members of a shareholder committee who are nominated and paid¹¹⁶ by shareholders are less likely to be conflicted in that way. All other things being equal, they may therefore be better monitors than outside directors.

However, the increased accountability of shareholder committee members depends crucially on the capacity of shareholders to select and nominate candidates despite their collective action. If the obstacles to collective action in this regard can be removed, we would expect the accountability of outside directors to increase as well, because the collective action required from shareholders with respect to a board is no more demanding than with respect to a shareholder committee. Put bluntly, to the extent that a collective action problem prevents shareholders from installing accountable monitors, a shareholder committee will be useless, and to the extent that the collective action problem does not exist, a shareholder committee will be unnecessary.

There is one qualification to the prevailing pessimism regarding a shareholder committee’s capacity to monitor managers. Even a shareholder committee that acts in a purely advisory capacity may exert a subtle form of monitoring vis-à-vis directors and managers. As Professor Rock, who is otherwise a skeptic of shareholder committees, put it, it would be risky for the board to ignore a shareholder

¹¹⁴ Donald H. Rumsfeld, Department of Defense News Briefing, Feb. 12, 2002, 11:30 AM EST, available at <http://www.defense.gov/transcripts/transcript.aspx?transcriptid=2636>.

¹¹⁵ See LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 26 (2004) with further references. Exceptions are of course successful proxy contests and the election of insurgent directors nominated by shareholders who might obtain access to the corporate proxy if the court challenge to the 2010 proxy access rule is dismissed. For the challenged rule see Securities and Exchange Commission, Facilitating Shareholder Director Nominations, Release Nos. 33-9136, 34-62764, IC-29384 (Aug. 25, 2010), available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>. The rule was stayed on October 4, 2010. See Business Roundtable *et al.*, Release Nos. 33-9149, 34-63031, IC-29456 (Oct. 4, 2010), available at <http://sec.gov/rules/other/2010/33-9149.pdf>.

¹¹⁶ The nominating shareholder would need to be reimbursed by the company for the remuneration it pays to the committee member.

committee's recommendations, which is why "even a general purpose advisory committee has substantial potential to alter the balance of power between shareholders and managers."¹¹⁷ Even when a shareholder committee does not make specific recommendations, directors and officers are required to communicate with the committee, and these exchanges can hardly be as non-committal as statements to the public. Therefore, directors and officers may find it difficult to back down from the declarations and self-commitments they make to the committee.¹¹⁸ Moreover, the existence of a shareholder committee, if it is not mandated by law, is in itself a signal that shareholders have an eye on corporate governance and might thus deter certain actions by directors and officers that will likely destroy shareholder value.

Ultimately, it is an empirical question whether a shareholder committee is in a better position to monitor corporate insiders than outside directors or independent board committees. In the light of the foregoing analysis, however, I would not make a bet that a shareholder committee would reduce managerial agency costs to a sizeable extent.

C. Lower Information and Communication Costs

To the extent that a shareholder committee serves as an information conduit between shareholders and the board, it may decrease the information and communication costs between the two groups. This rationale comes in two flavors.

First, some proponents emphasize the potential of shareholder committees to decrease the information costs that shareholders incur when they evaluate board performance.¹¹⁹ However, many large shareholders already engage with boards informally, and there are reasons to believe that they would continue to do so

¹¹⁷ Rock, *supra* note 1, at 500.

¹¹⁸ I do not agree with Professor Black, who does not believe that "managers will pay more attention to shareholder complaints voiced at such a meeting than they now do to complaints through letters or telephone calls." Black, *supra* note 29, at 844 footnote 90. Everyday experience shows that direct communication with interlocutors who know each other is different from exchanges among strangers. It *does* make a difference whether the chairman of the board receives a letter from a shareholder and ask his assistant to write a noncommittal answer or whether the members of the shareholder committee, some of whom he has known for years, make a suggestion at a meeting and expect an immediate response.

¹¹⁹ See Koppes & Gillan, *supra* note 18, at 30 (arguing that institutional shareholders must have the information necessary to evaluate the performance of the directors, but lack the resources to engage with every underperforming company individually).

even if a shareholder committee is in place.¹²⁰ Direct exchanges offer shareholders greater flexibility in terms of timing and agenda setting. Depending on the magnitude of these advantages, large shareholders may not even have incentives to serve on a committee.¹²¹ Additionally, board performance is increasingly being evaluated by proxy advisers such as MSCI/RiskMetrics, Glass Lewis, and, in Switzerland, Ethos Services.¹²² These intermediaries may have economies of scale compared to a shareholder committee of a single company because they can use their evaluation tools to evaluate the governance of a large number of companies. Therefore, information cost savings on the part of shareholders that spring from a shareholder committee should not be overestimated.

As a second rationale, advocates of shareholder committees point to the potential cost savings when boards have the opportunity to engage with shareholders who are organized in a committee, instead of having to contact them individually.¹²³ Thus, the argument goes, the quality of board decisions could be improved.¹²⁴ This rationale is equally questionable. Nothing prevents boards from setting up shareholder focus groups should they believe that they do not have sufficient information about shareholder preferences. The reason why boards do not customarily do this might be that they do not need input from stockholders. The maximand—the value of the corporation—is sufficiently clear, and stockholders are not better informed than the board whether a particular decision is going to be value-increasing or not. Moreover, boards receive a great deal of feedback from investors through other channels, such as the stock price, informal meetings, or the media.

Overall, the potential for information and communication cost savings by use of a shareholder committee seems minimal since shareholders and boards already

¹²⁰ Cf. BOHRER, *supra* note 34, at § 147 (stating that large shareholders may prefer to engage with the board directly rather than via a shareholder committee).

¹²¹ For a discussion of other incentives to serve or not to serve on a committee see *supra* text accompanying notes 102 to 104.

¹²² For an empirical analysis of the significance of voting recommendations issued by U.S. proxy advisers see Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010).

¹²³ See Forstmoser, Hostettler & Vogt, *supra* note 3, at 31 (stating that a shareholder committee would facilitate the board's access to shareholders, who are otherwise anonymous).

¹²⁴ *Id.* (arguing that co-operation between shareholders and managers will optimize the quality of decision-making). *Contra* Barnard, *supra* note 1, at 1167 (arguing that a review of board decisions by a shareholder committee will improve the decisions).

have a broad range of information sources and communication channels at their disposal.

D. Formalization of Informal Shareholder Contacts

The last potential benefit of shareholder committees is not so much relevant to U.S. law than to Swiss law. Under Swiss corporate law, boards must treat shareholders equally.¹²⁵ This rule theoretically bars boards from giving some shareholders preferential access to information.¹²⁶ Hence, contrary to commentators in the United States,¹²⁷ the proponents of shareholder committees in Switzerland view the formalization of hitherto informal contacts between large shareholders and the board as a benefit.¹²⁸

As stated above,¹²⁹ it is doubtful whether shareholders have incentives not to communicate with directors and managers directly even if a shareholder committee is in place. A shareholder committee might channel some of the communication between shareholders and management, but it might not necessarily reduce the traditional, informal exchanges to a significant extent. If these informal exchanges are seen as a problem, one would have to ban them outright. I am not aware that this has ever been suggested.¹³⁰

V. Potential Costs

Shareholder committees generate transaction costs and, as an additional body in an organization, they may generate agency costs of their own.

¹²⁵ CODE OF OBLIGATIONS art. 717(2) (Switz.).

¹²⁶ See generally Emanuel Max Dettwiler, *Informationelle Gleichbehandlung der Aktionäre* [Equal Treatment of Shareholders as to Information] 91-106 (U. of St. Gallen Dissertation No. 2574, 2002).

¹²⁷ See Gilson & Kraakman, *supra* note 29, at 872 (arguing that “general voice” shareholder committees “would merely formalize existing management-shareholder exchanges”).

¹²⁸ See Forstmoser, Hostettler & Vogt, *supra* note 3, at 31 (arguing that a shareholder committee would put the prevalent practice of communicating with large shareholders onto a sound basis).

¹²⁹ See *supra* text accompanying note 120.

¹³⁰ For a discussion of many other mechanisms to enforce the principle of equal treatment of shareholders as to information see Dettwiler, *supra* note 126, at 157-189.

A. Transaction Costs

Shareholder committees cost money. Individual shareholders who serve on a committee need to be reimbursed for their expenses or paid for their services, and institutional shareholders that have delegated an agent to the committee must be reimbursed for their opportunity costs, including the time spent on evaluating candidates. If a shareholder committee exerts certain monitoring functions, it may be required to retain advisers, too, yet these costs may be merely shifted from a board committee to the shareholder committee. Furthermore, a shareholder committee will generate indirect opportunity costs, particularly the time spent by directors and officers on communicating with the committee.

It is an empirical question what amount of transaction costs a shareholder committee may generate. It may well be that the costs are small, especially if a committee mainly acts as an information conduit.¹³¹ Yet even in these cases, the transaction costs may not be negligible when they are compared to the benefits of a shareholder committee, which may be quite marginal.

B. Agency Costs

Being a body of an organization, a shareholder committee may generate agency costs of its own. There might be slack on the part of committee members, or they may pursue an agenda that conflicts with the goal of maximizing the value of the corporation. With respect to the United States it has been predicted that shareholder committees would be dominated by public pension funds,¹³² which have a reputation for pursuing their own political agenda.¹³³ (There is no comparable class of stockholder in Switzerland.) Furthermore, a problematic “advisory

¹³¹ See McConvill & Bagaric, *supra* note 44, at 141 (predicting that the costs of their version of a shareholder advisory committee would be negligible in comparison with the costs of board and ad-hoc committees).

¹³² Rock, *supra* note 1, at 497 and 504.

¹³³ For an overview of shareholder proposals made by public pension funds see Eric John Finseth, Shareholder Activism by Public Pension Funds and the Rights of Dissenting Employees Under the First Amendment, 34 HARV. J. L. & PUBL. POL’Y 289, 351-362 (2011). For an empirical study on shareholder activism by public pension funds see Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315 (2008).

interlock” could emerge, that is, a situation in which representatives of the same institutions serve on multiple shareholder committees.¹³⁴

Even though it can hardly be denied that shareholder committees might generate agency costs of their own, it is important not to count costs twice. To the extent, namely, that such agency costs merely cause the committee to be ineffective, they are already counted above as transaction costs: The money spent on the committee will simply be wasted. Beyond that, it seems unlikely that a shareholder committee’s agency costs will decrease firm value any further if adequate safeguards are in place. Election by shareholders should ensure that no candidate is elected who is incompetent or pursues a special agenda.¹³⁵ Additionally, agency costs can be mitigated through the compensation scheme of committee members. If those committee members who represent institutions are compensated by their principals, who will then be reimbursed by the corporation, they will be more accountable to their principals than to management than the average director.

VI. Conclusion: Let Shareholders Have the Final Word

My brief review of the potential benefits and costs of shareholder committees is sobering. We should not expect shareholder committees to mitigate the collective action problem of shareholders, and it is unlikely that they will reduce managerial agency costs to a notable extent. The potential for savings in information and communication costs is small, and shareholder committees are not necessarily going to provide shareholders with more equal access to information than they have now. In the light of these very limited benefits, the costs of establishing and maintaining a shareholder committee are not trivial.

For these reasons, I doubt whether it is in the best interest of public companies to adopt a shareholder committee, as Professors Forstmoser, Hostettler and Vogt seem to believe. However, I do not claim to know better than shareholders whether a shareholder committee would be in their interest. Given that shareholders will both reap the benefits and bear the costs of having a shareholder committee, it should be up to them to decide whether to adopt one. Yet currently,

¹³⁴ Barnard, *supra* note 1, at 1160-1162 (arguing that though the problem exists, it would not be a serious impediment to the adoption of shareholder committees).

¹³⁵ This would be different where there is a controlling shareholder. This scenario, however, is excluded from the analysis in this paper.

Swiss corporate law restricts the establishment of shareholder committees to the extent that their functions overlap the board's prerogative of overseeing the company and its management.¹³⁶ I see no policy rationale for this restriction. Rather, as Professors Forstmoser, Hostettler and Vogt suggest,¹³⁷ companies should be allowed to experiment with different types of shareholder committees. Because the benefits of shareholder committees are questionable, the law should not establish them by default.¹³⁸ Instead, shareholders should be allowed to adopt a shareholder committee,¹³⁹ and they should enjoy a great amount freedom in defining the committee's functions, powers, composition, and other parameters.

To conclude, I believe that corporate governance historians once will regard the concept of the shareholder committee as a blind alley in the evolution of corporate governance institutions. But the fate of that institution should be in the hands of shareholders, not of the law.

¹³⁶ CODE OF OBLIGATIONS art. 716a(1) (Switz.).

¹³⁷ Forstmoser, Hostettler & Vogt, *supra* note 3, at 31.

¹³⁸ Under the hypothetical bargains approach (*see supra* note 101), the prediction that the adoption of a shareholder committee will not be in the best interest of most companies is sufficient to justify an opt-in. Under the reversible defaults approach (*see supra* note 83), we further have to assume that the collective action problem of shareholders does not prevent them from establishing a shareholder committee under an opt-in regime. This assumption seems plausible with respect to Switzerland, where the board does not have to approve charter amendments.

¹³⁹ Such an opt-in default will not frustrate any effort to establish a shareholder committee: According to Swiss law, shareholders may amend the charter without the board's consent, and the thresholds for shareholder proposals are not prohibitive. *See* CODE OF OBLIGATIONS art. 699(3) (Switz.). The threshold is the lower of 10% or 1 million Swiss Franks in nominal capital.