Responsible Shareholdership: Call for a Derivative Company?

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The 4th Biennial Conference organized by the Centre for European Company Law (CECL), a cooperation between the Dutch law faculties of the universities of Leiden, Utrecht, and Maastricht, was held in Leiden on 16 September 2011. The conference was devoted to the topical theme of responsible – sometimes also referred to as 'engaged' – shareholdership. Distinguished academics from several universities tried to find different incentives to steer investors into a more long-term, company-oriented attitude, in particular as regards the behaviour of proxy advisers and institutional investors.

Koen Geens (Leuven, Belgium) kicked off the conference by, *inter alia*, advocating a liquidity test, in addition to a balance sheet test, for paying out dividends in a listed company. He also criticized hybrid financial instruments, such as convertible bonds, as they create no real tier one capital because of their lack of loss capacity when the crisis push comes to shove. *Holger Fleisher* (Max Planck Institute, Hamburg, Germany) pleaded for more transparency and accountability of proxy advisors, for example, by binding them to a code of conduct and obliging them to disclose their conflicts of interests and voting policies on a regular basis, just like credit rating agencies and auditors. *Iris Chiu* (University College London (UCL), London, UK) analysed the effect of the UK Stewardship Code on institutional investors. She noted that the Code was not clear at all on the meaning of the wider public good that institutional investors officially have to take into account and mentioned that the Code was 'peppered with rhetoric'. *Matthijs de Jongh* (Supreme Court, The Hague, The Netherlands) took a more ex post, judge-oriented approach and tried to strike a balance between the principles of shareholder autonomy and fairness when defining the standard for shareholder behaviour. He stressed that a growing factual influence of shareholders in the company should go hand in hand with a growing responsibility towards all other constituencies. In his opinion, good old Aristotle still has all the answers. *Jaap Winter* (Duisenberg School of Finance, Amsterdam, The Netherlands) once more stated his view that one of the fundamental problems lies in the widespread application of Modern Portfolio Theory (extreme diversification and index tracking) by fund managers.[1] Jaap announced that he is currently involved in a legal experiment, in an attempt to distract companies from the short-term discipline of financial markets, by creating a social cooperative that can be listed. For the content of my own speech at the conference about expropriation of shareholders in a distressed financial institution in The Netherlands, I refer to my contribution further on in this issue of ECL. Finally, *Pavlos Masouros* (PhD, Leiden, The Netherlands) took the audience to the economic sphere of statistics on capital accumulation over time in the western economies and its relation to equity short-termism. He advocated the introduction of loyalty shares in various forms. His speech ignited a lively and fierce debate, in which among others the president of the Dutch Shareholders Association (VEB), Jan Maarten Slagter, participated with great enthusiasm.

All in all, the conference highlighted many complicated aspects of an essential feature of our economic system, that is, shareholder autonomy, and the possible role of the law to commit investors to objectives beyond their short-term profit quests. The key question seems to me to be: How to realize the latter without adversely affecting the liquidity of the capital markets that have brought us so much prosperity in the past decades? Although I believe that there is no definitive answer to this question, I am inclined to seek the solution in the corporate structure itself rather than in restricting the market behaviour of investors. As to loyalty shares, whatever form one opts for, at the end of the day their introduction is inevitably at the other investors' expense. As such, they cannot but have a negative impact on capital liquidity.

In recent years, market liquidity of listed companies has improved as a result of using a myriad of derivative financial instruments, such as options, warrants, futures, and swaps. Securitisation, securities lending and empty voting are simply in line with the use of these instruments. Where, as a consequence thereof, the distance between an investor's risk and the financial results of a company has grown considerably, a shareholder's say in the company is still as close as

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1 Cf. Jaap Winter, 'Editorial: Governance and the Crisis', *European Company Law* 7, no. 4 (2010): 140–141.

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can be, albeit that, in most cases, it is indirectly exercised through fund managers and proxy advisors. Perhaps we should widen the gap here as well and create a kind of buffer between financial markets and a company's actual business and business policy. To mirror the derivative instruments investors use nowadays, they should likewise only have a say in a 'derivative company'. The derivative company should be a legal entity, a trust office, which holds all shares in the underlying company itself and, in turn, issues depository receipts for shares to investors. Only the depository receipts for shares will get listed at the stock exchange and profits are paid out to investors through the trust office.

Of course, adequate rules should be set to govern the relationship between investors and a trust office, *inter alia*, on information, distributions, director's remuneration, and voting policy in times of an imminent takeover and on matters affecting the company's identity. In addition, safeguards must be implemented for the independence of the board of a trust office vis-à-vis the company. One can think of many variants here. The bottom line is that this way the direct influence of shareholders in the company is mitigated while at the same time capital liquidity remains largely unaffected.

I must admit though that this is not an original idea at all. In The Netherlands, the creation and listing of depository receipts for shares by a trust company has been standard practice for decades after World War II. It is called *certificering van aandelen*, and over time it has developed to become a common defence against a threatening hostile takeover in The Netherlands. In recent years, however, under pressure from the corporate governance movement and international investment, this practice has gradually diminished at the Amsterdam stock exchange. Nevertheless, companies like Wolters Kluwer, Fugro, and ING are still hanging on to it. Perhaps this is the right time to revalue this anti-takeover practice in light of current and broader discussions on responsible shareholdership, in particular since the reality of the so-called 'Dutch discount' resulting from the use of depository receipts for shares has never been conclusively demonstrated. No need to say that the introduction of the derivative company requires an EU-wide approach, to say the least.