

Enforcing Shareholder Duties

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The discussion on shareholders' duties is constantly gaining momentum in the EU and has given rise to the adoption of duties in both company law and capital markets law. However, this discussion must be extended further if the duties that are increasingly imposed on shareholders are to have a genuine effect on the viability of the recent regulatory developments in this area. Enforcement mechanisms are crucial to this discussion as they are fundamental to preserving the credibility of markets, ensuring compliance with regulatory objectives and with sound corporate governance practices, as well as holding accountable persons who are supposed to fulfil the vast range of shareholders' duties.

1. TYPES OF ENFORCEMENT: LEGAL AND SOCIAL

Legal enforcement can be broken down into private and public enforcement. Private enforcement has not been harmonized in an increased fashion across the EU due to national idiosyncrasies and different legal traditions. Moreover, for private enforcement mechanisms to counter-balance any violation of shareholders' duties, private parties need to exercise their rights by having the necessary information, interest, resources and time to perform such a role. These conditions are not always met, especially taking into account the ever-increasing financial intermediation in the investment chain, the communication gap between market actors and the predominant governance role exercised by funds in their day-to-day management of beneficiaries' assets.

Public enforcement has received much more political and legislative attention, especially in the area of administrative sanctions and measures given the increased powers awarded to regulatory bodies that are progressively being seen as more fit to exercise such

powers and more adaptable to market developments and strategies. Criminal sanctions, nevertheless, remain largely dependent on national laws in the absence of harmonization efforts in the area of shareholders' duties and, more generally, of capital markets law violations. In the area of shareholders' duties, criminal sanctions are particularly modest or even inexistent.

Aside from the growing reliance on duties found in company law or capital markets law, social norms may form a parallel framework that specifies legitimate or desired behaviour among shareholders or other company stakeholders. Social norms may act as an important driver to ensure compliance with the underlying values found in various regulations. Thus, there is a symbiotic relationship between regulation and social norms as laws can encourage the development of social norms, but the social norms that place value on subscribing to those laws are important to ensure that the laws have an effect. The interplay between legislation and social norms is interesting in relation to corporate governance in general but also in relation to institutional shareholders in particular, where the emerging stewardship agenda can be seen as a tangible sign of social norms.

2. THE SUITABILITY AND EFFICIENCY OF ENFORCEMENT MECHANISMS

The emerging stewardship agenda includes shareholder duties that cannot readily be explained by the reduction of agency costs or the elimination of market failure, but seem to serve wider purposes, such as social or political objectives. This is particularly the case when it comes to the revision of the Shareholder Rights Directive, and the disclosure duties imposed on institutional investors. The arguments presented in the preamble of the Directive in support of the imposition of special duties on institutional investors are rather vague and seem to support a political agenda that has gained momentum in the wake of the financial crisis, whereby legislators not only aim to constrain the actions of institutional investors in specific ways, but also to change the behaviour of institutional investors without clearly specifying what the expectations are. Consequently, enforcement becomes essential to assist this transformation. While it is yet to be seen whether the chosen enforcement regime – which partly relies on private enforcement – will suffice, serious concerns could be expressed that the European

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regulatory developments on institutional investors may even have counterproductive consequences for shareholder engagement.

3. BARRIERS TO ENFORCEMENT

The enforcement of shareholders' duties arising from national law frequently involves a cross-border aspect as shareholders often invest in companies that are not governed by their own jurisdiction. Thus, the potential for private litigation may not be fully explored by private parties because of the litigation problems caused by jurisdictional barriers.

Barriers may also flow from primary EU law, and measures regulating and enforcing shareholders' duties will have to be assessed in the light of EU primary law. Primary law is important to the feasibility of the enforcement of shareholders' duties: Investors making cross-border investments may rely on the free movement of capital or on the freedom of establishment. But companies formed in accordance with the law of a Member State may also enjoy freedom of establishment in their own right, and the shareholders' position as members of the company is also protected in relation to corporate mobility. If shareholders' duties prevent or deter foreign investments, e.g. by imposing fines on larger shareholders for misconduct by the investee company, they may be incompatible with EU primary law.

Another series of difficulties in relation to enforcement arises out of barriers to shareholder identification. Characteristic examples include the increased intermediation between the final account holders and the settlement system, or the use of omnibus accounts that prevents upper-tier intermediaries and issuers from identifying shareholders at lower-tier levels. These difficulties further exacerbate identification problems in a cross-border context since holding systems usually operate on a national basis.

4. CONCLUSION

Well-known and emerging shareholder duties have been subject to considerable debate, with mixed views on their rationale, impact and feasibility. The enforcement of such duties is even more critical given the many rationales for the various enforcement mechanisms that come into play in this area. In the absence of market failure or agency problem considerations, the politicization of shareholder engagement and the role that institutional investors exercise seem to be at the origin of the multiplication of duties. The various enforcement mechanisms also reflect the difficulty in deciphering the respective rights of the parties harmed by violations of such duties and the legal instruments for their protection.