

Shareholders' Activism and their Power to Instruct

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ABSTRACT

An important measure of shareholders' power is their ability to initiate and approve proposals. However, in many countries which have transplanted or inherited the Anglo-Saxon model of governance, shareholders intending to present their proposals to a general meeting often face a significant legal barrier due to the division of power doctrine. This article examines recent decisions within the Commonwealth where attempts have been made to reconfigure the division of power which confers to the board the power to decide on management matters. The article adopts a qualitative research method using case study of decisions in several Commonwealth countries where shareholders have attempted to present proposals on matters which ordinarily fall within the board's jurisdiction. Despite the strong opposition that shareholders face to reconfigure the division of power there is an increasing trend of shareholder-initiated proposals within the Commonwealth, reflecting changing community expectations.

Keywords: Board, Commonwealth, division of power, reconfigure, shareholders

INTRODUCTION

Shareholder activism is a means to address mismanagement and ensure director's accountability. A regime that does not empower shareholders will result in poor accountability as it creates mandatory

deference to management (Bebchuk, 2005; Fairfax, 2008; Smith, Wright, & Hintze, 2011). There are many forms of shareholder activism, one of which is shareholders filing their proposals (Sjöström, 2008; Levit & Malenko, 2011).¹ The shareholders' ability to propose and initiate proposals is considered crucial and significant to measure the level

¹Activism can be conducted via direct dialogue with corporate management or the board, during open sessions in corporate general meetings, writing open letters or by filing formal shareholder proposals (see Sjöström, 2008).

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of minority shareholder empowerment and protection in a particular jurisdiction (Anderson, Welsh, Ramsay, & Gahan, 2012a, 2012b; Armour, Deakin, Lele, & Siems, 2009; Holger, 2010; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; Lele & Siems, 2007). However, shareholders intending to present their proposals to a general meeting often face significant legal barrier due to the “division of power” doctrine prevalent in countries which have transplanted or inherited the Anglo-Saxon model of governance as practised in the UK. This is a major setback to shareholder activism (Choo, 1993; Harris & Raviv, 2010; Rachagan & Mohd-Sulaiman, 2013; Sealy, 1997). Based on this doctrine, most shareholder proposals will not be added to the agenda because it relates to a matter that the general meeting has no power to decide.

Shareholder proposals are therefore quite rare in the common law world because company law rules in general do not support the argument that shareholders should have the power to propose matters which are within the board’s authority.² The “division of power” doctrine in a majority of Commonwealth countries, including Malaysia, has primarily been in favour of conferring power over business decisions to directors. On a wide range of issues, shareholders have the power to approve business decisions but very limited authority to propose business decisions (Koh, 2005; Levit & Malenko, 2011) The prevailing

² For the difference between the US and the UK regulatory framework, see Hill (2005a, 2005b), and Anderson et al. (2012).

view within the Commonwealth countries is that shareholders cannot interfere or intervene in the directors’ exercise of their powers to make business decision; shareholders also do not have the power to instruct the board.³ The director primacy theory is backed by efficiency arguments, specifically that modern companies can only function efficiently if shareholders cede control to a select group for expeditious business decisions (Bainbridge, 2006a, 2006b). A corollary to the director primacy theory is that although shareholders may convene meetings themselves or request the company convene a meeting on behalf of the requisitionists, and put items on the agenda, the purpose of the meeting must not be an improper one and that the agenda cannot include resolutions that *the general meeting has no power to pass* (*NRMA Ltd v Parker* (1986) 6 NSWLR 517; 4 ACLC 609).⁴ This restriction applies even where the resolution is expressed to represent a non-binding opinion or request.

³ See *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113; *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunningham*, [1906] 2 Ch 34; *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206; dicta in *Quality Concrete Holdings Bhd v Classic Gypsum Manufacturing Sdn Bhd & Ors* [2012] 2 MLJ 521, citing these cases. See also *NRMA Ltd v Parker* (1986) 6 NSWLR 517; 4 ACLC 609 and contrast with *Credit Development Pte Ltd v IMO Pte Ltd* [1993] 2 SLR 370] criticised in Choo (1993).

⁴ In this case, the purpose of the meeting was to instruct the board of directors to conduct the election of directors in a particular way. Under the company’s constitution, the decision as to the manner in which the elections should be held was one that belonged to the directors.

Nonetheless, there are recent decisions within the Commonwealth where attempts have been made by shareholders to reconfigure the division of power. These cases indicate an increasing trend of shareholder activism within the Commonwealth, reflecting changing community expectations.

SHAREHOLDER PROPOSALS BY SOCIAL ACTIVISTS

Activist shareholders have been quite active in challenging the division of power doctrine (EY Centre for Board Matters, 2015; Buchanan, Netter, Poulsen, & Yang, 2012). They are often identified as shareholders who desire to influence companies to adopt socially responsible practices and policies particularly relating to environmental, social and governance issues (ESG). In 2015, the Federal Court of Australia handed down its judgement in *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* [2015] FCA 785 (ACCR v CBA) which reiterated the director primacy model of governance for Australian companies. The case arose out of attempts by the Australasian Centre for Corporate Responsibility (ACCR) to include several of its social and environmental proposals in the agenda of the annual general meeting (AGM) of the Commonwealth Bank of Australia (CBA).

In *ACCR v CBA* [2015] FCA 785, ACCR lodged its proposals to be considered at the company's AGM. The proposals were:

- (1) In the opinion of shareholders, it was in the best interest of the

company for directors to provide a report outlining the quantum of greenhouse emissions that CBA was responsible for financing, the risks to the company from unburnable carbon and the current approach adopted to mitigate those risks (the First Resolution);

- (2) That shareholders express their concerns as to the absence of a report identifying the level of greenhouse gas emissions CBA was responsible for financing and associated risks (the Second Resolution); and
- (3) That each year at about the time of the release of CBA's annual report, the director's report to shareholders on their assessment of the quantum of greenhouse gas emissions CBA was responsible for financing (the Third Resolution). The ACCR proposed for CBA's constitution to be amended to incorporate this resolution.

However, on 15 September 2014, CBA published its notice of meeting for the 2014 AGM which included only the third resolution, and ACCR was informed that the other two resolutions cannot be presented for voting as they encroached on the board's authority to make business decisions. The notice also included a statement by the CBA's board that it did not consider the resolution in the best interest of shareholders and *recommended shareholders to vote against the resolution*. The CBA's announcement to the ASX included the same statements.

The ACCR then brought an action for an injunction for CBA to include the two excluded resolutions arguing the company could not refuse to include the matter on the agenda to be voted as it was merely recommendation of a non-binding nature and would therefore not be in contravention of the rule that the board has the power to manage the company's business. The court had to consider whether the board was correct in refusing to include two out of the three resolutions presented in the notice of the AGM. The court decided that:

“...the CBA constitution vests all powers concerning the business of CBA in the board (or in management under the board's direction). The only powers that shareholders have are those which the Act “requires” be exercised by the company in general meeting and none of those powers include a power to pass non-binding advisory resolutions. The terms of the constitution, which make clear that management of the company is vested exclusively in the directors, preclude the implication of any power in the general meeting to pass resolutions proffering opinions on the way in which the board exercises its powers.”

The court also decided that under the Australian Corporations Act (ACA), there is no power given to shareholders to pass non-binding resolutions; this is only available for a listed company's remuneration report. In

addition, though the legal framework give the shareholders power to ask questions and comment on the management of the company in the general meeting, this is merely to enable them to express views on the company's management and not to pass non-binding resolutions or make recommendations to the board.

SHAREHOLDER PROPOSALS ON BUSINESS AND OPERATIONAL MATTERS

There have been several recent decisions involving shareholders' proposal on operational matters. In *Re Molopo Energy Limited v Keybridge Capital Limited* [2014] NSWSC 1864, a substantial shareholder of the company lodged a request for the company to convene a general meeting. The requisitioned meeting was for the purpose of proposing amendment to the constitution conferring the power to the general meeting to decide on a reduction of share capital and a further resolution to effect reduction of share capital. The company then applied to court for a declaration that the board was not required to convene the meeting as requested by the shareholder. This was on the basis that the general meeting has no power to propose a reduction of capital but only to approve it and “the shareholders, as a body in general meeting, are not an apt body to make a decision to effect a reduction in capital where the reduction is not proposed by the directors (para 77).”

In *Re Molopo Energy*, the shareholders proposal was in the form of an amendment to the constitution which confers management

powers to the board. Although the court conceded shareholders may present a proposal to amend the constitution, it did assert that the amendment was intended to affect a capital reduction. Therefore, it is not possible to do so as this would be in contravention of other provisions in the ACA.

Re Molopo Energy highlights a criticism often made against enabling shareholders to propose resolutions, that is, shareholders will encroach on operational matters with adverse impact on shareholder value (Bainbridge, 2006a, 2006b). For example, there are shareholders who have agitated for higher payment of dividend or for the company to return capital by way of a share buyback (Behrmann & Humber, 2013; Satariano, 2013). This type of shareholder proposals could hinder directors making decisions in the best interest of the company and could be detrimental to creditors' interests.

Nonetheless, *Re Molopo Energy* provides some evidence that this concern may not be as grim as it appears. The courts are unlikely to allow the exercise of power to override the board's management decision if it affects creditors' interests (Watson, 2015). Various corporate transactions require compliance with specific procedures or requirements with the corollary liability on directors and/or the company for non-compliance. The payment of dividends for example or reduction of capital cannot be made unless certain rules, particularly rules relating to solvency, are complied with. A solvency statement for example can only

be made by directors. Directors also have control over reporting of the firm's earnings which will be the basis for any decisions relating to return of capital to shareholders. Further, when these rules are breached, liability may be attached to directors *and* shareholders who approve the dividends with awareness or knowledge that the company may not be able to comply with dividend rules. The courts would also be guided by the directors' duty to act in the best interest of the company. It is unlikely that in the absence of bad faith or conflict of interest, the directors could be ordered to issue debentures instead of issuing shares or raising capital via private placement instead of a public offer.⁵

In *Petroceltic International PLC v Worldview Capital Management SA & Anor* [2015] IEHC 612, the Irish High Court was asked to grant an injunction preventing a shareholder of the company from convening an EGM to consider the passing of a shareholder sponsored resolution. The resolution was related to Petroceltic decision to issue bonds. The company had written to Worldview that the requisition would be against the articles of association and therefore could not be validly made. It requested Worldview to withdraw the notice of the EGM and to inform the shareholders that it will not take any action regarding the EGM. Worldview

⁵ See *CAS (Nominess) Ltd v Nottingham Forrest FC plc*. [2002] 1 BCLC 613; *McKillen v Misland (Cyprus) Investments Limited & Ors* [2012] EWHC 2343 (Ch) See *Passport Special Opportunities Master Fund LP v eSun Holdings Ltd* [2011] 4 HKC 62 (Wong, 2012).

refused to do so. The company then applied for an injunction. The court decided that since the power is power is given to the directors under the article of association, the members, in general meeting, cannot, by ordinary resolution, seek to override or fetter that exclusive power. The court followed the decision of the English Court of Appeal in *Automatic Self-Cleansing Filter Syndicate Co. v. Cunningham* [1906] 2 Ch. 34, stated clearly that the division of powers between the board of directors and the company in general meeting dependent, in the case of registered companies, entirely under construction of the articles of association, and that, where powers have been vested in the board, the general meeting could not interfere with their exercise. The articles were held to constitute a contract by which the members had agreed that the directors should manage certain aspects of the company's affairs.

One reason why the court granted an injunction in favour of the company was because of the possibility that successive resolutions seeking expressions of opinion could be abusive and could, therefore, be prevented by court if repeatedly made. In this case, Worldview had on four previous occasions requisitioned an EGM.⁶ The court stated that:

“To allow resolutions “for the expression of opinion” which in varying degrees would amount to a de facto restraint or impediment

⁶ Para 4 of the judgment: “In the calendar year of 2015 three E.G.Ms. have taken place due to the requisition of the defendant company, in addition to an A.G.M.”

in market terms would be adding an intolerable risk to the jungle of risks faced by those working in the commercial world, so that the creation of value added such as employment, product, interest, and profit would, be greatly hampered. It was submitted by the defendants that to deny the possibility of such resolutions expressing opinions would amount to “disenfranchisement and marginalisation” of the members on key issues and the suppression of their freedom of expression and the damage which would result to the members from that course of events is self-evidently inestimable; and further, that it was “counter intuitive” that shareholders cannot collectively express an opinion on the matter of concern in an era of increasing incorporate democracy and shareholder activism. However, the artificial construct of the company does, in fact, in an ordered way restrict the decision-making powers of the shareholders. The articles of association of any company may in particular cases increase such involvement with decision making and therefore aid democracy of shareholders but it is difficult to envisage any changes however liberal which would not at least in some way seek to put order on the expression of shareholders views so that such expression did

not have the direct or indirect effect of altering the way in which the company did business as it was intended by articles, statute and regulation, or (as in this case) to have to face de facto market impediments engendered by such “expressions of opinion”.”

Malaysian decision in *Expo Holdings Sdn Bhd v Toyo Ink Group Bhd* [2014] 10 MLJ 674, on the other hand, was an attempt by the shareholders of a Malaysian company to challenge the board's decision to make a bonus issue of shares. The minority shareholders challenged the bonus issue and the special resolution amending the memorandum and articles of association to enable the board to make a selective bonus issue of shares. They sought to declare these resolutions void. The court held that although sect 60 provides that the amount in the share premium account can only be used for certain purposes, the section does not require that if the share premium account is utilised to pay for the bonus shares, the bonus shares must be issued to all existing shareholders. Although the question in this case was whether there was a breach of duty by making a selective bonus issue, the court reiterated the view that the directors have the discretion to decide how to utilise the shareholders' funds and to capitalise sums in the reserves and share premium account as conferred on them *by the constitution*. Challenges through legal proceedings in this manner is quite rare in Malaysia although Malaysian shareholders have been vocal at general meetings (Lim, 2014).

DEVELOPING LEGAL ISSUES

The Future for Directors Primacy

Several common law jurisdictions have embarked on reform of corporate law and the issue on whether shareholders could initiate proposals on matters which were traditionally within the board's domain are being reviewed. A case in point is Malaysia. The Companies Act 2016 was passed by the House of Representative on 4th April 2016 and introduced wide ranging reform, amongst others, section 195 which will enable shareholders to give instructions to the board relating to board's management functions.

Section 195 of Companies Act 2016 provides

“(2) A meeting of members may pass a resolution which makes recommendations to the Board on matters affecting the management of the company.

(3) Any recommendation shall not be binding on the Board, unless the recommendation is in the best interest of the company, provided that—

(a) The right to make recommendations is provided for in the constitution; or

(b) Passed as a special resolution.”

Section 195(3) lays down several conditions before the board is *obliged* to act in accordance with the general meeting's instructions. The recommendation is binding if the right to make such recommendation

is conferred to the general meeting by the constitution. Although sub 195(3)(a) does not specify the voting threshold, the constitution may specify situations where the general meeting may make recommendations that will bind the board as well as whether *an ordinary resolution or any higher percentage* is needed. Alternatively, where the constitution is silent, the general meeting must pass *a special resolution* to instruct the board to do or refrain from doing something. The implication of these provisions is that even when the general meeting's power is expanded so that it has reserve power to instruct the board in managing the company, shareholders would still require at least majority support for any such proposal. Without at least majority support, the board retains decision making authority regarding management of the company.

From a comparative law perspective, the change places Malaysia in a unique position compared with other common law jurisdictions such as UK,⁷ Hong Kong,⁸ New Zealand, Singapore and Australia.

The present model Articles of Association for companies limited by shares in the UK Companies Act 2006 has made the UK the most shareholder-centric jurisdiction (Enriques, Hansmann, & Kraakman, 2009). The Malaysian Companies Act 2016 arguably will make Malaysia more shareholder-centric than the UK (Mohd-Sulaiman & Rachagan,

2017). Unlike the UK where the statement regarding the power to instruct is placed in the constitution and its binding effect is dependent on the constitution stating so, the new power to instruct the board given to the general meeting in Malaysia is embedded in statute and cannot be contracted out. The New Zealand Companies Act is one of the earliest legislation to confer on shareholders the power to make binding via section 130 of the New Zealand Companies Act 1993. However, this section states that the recommendation is only binding *if the constitution so provides* and if it does not intrude on the 'reserve list' i.e., schedule 2 which contains a list of transactions which are within the board's power. Reform is also underway within the European Union with its Shareholder Rights Directive 2007/36/EC adopted in July 2007, which introduced among others, minimum standards for admission to meetings, shareholders' access to meeting-related information, proxy allocation and distance voting, and participation rights in terms of shareholders asking questions and tabling their own proposals.

Australia did consider expanding the shareholders' power but the law reform committee decided not to recommend any changes to the existing practice. (Companies & Securities Advisory Committee, 2000) Singapore embarked on a review of its company law and in 2002 published the *Report of the Company Legislation and Regulatory Framework Committee*, Ministry of Finance with another review undertaken in 2007 by the Steering Committee for the

⁷ Model Articles for Private Companies and Model Articles for Public companies under The Companies (Model Articles) Regulations 2008.

⁸ Model articles under Hong Kong Companies 2014.

Review of the Companies Act which was completed in 2011. The respective reports stated that the review followed closely the development of the UK law reform development. However, to date, Singapore has not followed the UK Companies Act 2006 in giving shareholders power to make binding recommendations. Its model constitution for companies limited by shares does not have the equivalent of the UK model article. The Indian Companies Act 2013 identifies matters that are reserved for the board and provides that the constitution may provide for additional matters that are also reserved for the board. While there is no explicit provision giving the general meeting power to instruct the board, section 179 of the 2013 Act states that the Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do but this may be limited by the Companies Act, the constitution or regulations made by the company in general meeting. Malaysia, on the other hand, has introduced Section 195, Companies Act 2016 that arguably expands general meeting's power to make binding recommendations on the board, subject to certain conditions being met.

Legitimate Strategies to Influence the Board

It is worth noting that in *ACCR v CBA*, the court affirmed shareholders have the power to propose amendments to the constitution even if the amendment has the effect of making directors subject to shareholders'

instructions. In an earlier case, *Woolworths Limited v GetUp Limited* [2012] FCA 726, Getup requisitioned an EGM to consider a proposal to alter the Woolworths's constitution for the company not to be involved in electronic gaming machines. Woolworths's applied to the court for an extension of the time to convene the requisitioned meeting to coincide with the company's AGM. The Federal Court granted the application. However, the proposal obtained minimal support with 2.5% votes in support. In 2003, the Wilderness Society presented a proposal to amend the constitution of National Australia Bank to preclude any investment in logging of old-growth forests. Other banks which were targeted included ANZ, Westpac, and CBA. Although the proposal did not obtain the required votes for a special resolution, it was reported that in 2013, the resolution secured 125 million votes out of a total of 553 million votes at National Australia Bank's meeting. Earlier, during CBA's meeting, over 94 million voted in support of an identical resolution.⁹ Similarly in *Petroceltic*, the court stated that the legitimate avenues open to the shareholders are in the form of obtaining support to pass a resolution where 50% of shareholders are required to change directors or 75% to alter the articles of association. These two strategies are within shareholders' existing rights.

⁹ See more at: <https://www.wilderness.org.au/4-billion-capital-supports-forest-resolution#sthash.mpDA9Gwn.dpuf>. (accessed on 28 March 2016)

CONCLUSION

It is likely the debate regarding shareholders' right to initiate resolutions, to propose, approve or review corporate actions and attempts to reconfigure the division of power doctrine will continue. This is due to law reform and, in some cases, perseverance of activist shareholders. The environmental and social activist initiatives do not show signs of abating. The ACCR has not considered the *ACCR v CBA* judgment as a setback and has not slowed down its ESG proposals. With other activist shareholders such as Getup, the Asset Owners Disclosure Project and a number of ethical financial advisers, it has lodged shareholders proposals with Origin Energy, Origin Australia and AGL, three energy companies, seeking to require further information about ongoing power generation and supply chain emissions management and public policy positions relating to climate change in these companies' annual reports. Unfortunately, none of these have been successful. Nonetheless, the *ACCR v CBA* litigation is an example of a departure from the normal strategy adopted by activist shareholders who often do not litigate. By and large, activist shareholders often rely on persuasion. Even in the US, where shareholders proposals are not uncommon, shareholder proposals are relied on:

“... to trigger dialogue and help ensure a topic is raised at the board level. Investors that submit proposals generally view them as an invitation to a discussion, preferring to reach agreement with the targeted

company without the proposal going to a vote. If an agreement cannot be reached, they generally believe that votes on shareholder proposals provide management with valuable insights into investor views.” (EY, 2015)

The *ACCR v CBA* case was not the first where activist shareholders tried to change a company's strategy and practices to consider environmental, social and governance issues. There were attempts since 1999 where environmental and union activists in Australia utilised the right to convene AGM to highlight concerns about environmental degradation and protection of employees' interests in companies such as Rio Tinto and Westfarmers (Anderson & Ramsay, 2006; Biefeld, Higginson, Jackson, & Ricketts, 2004). The ACCR website also listed several other shareholders resolutions involving ESG related proposals which it and other activist shareholders had presented to various energy companies.¹⁰ There could also be more ESG proposals in the future given the focus on sustainability reporting.

In cases such as *Re Molopo* and *Petroceltic*, the traditional view that the general meeting has no authority to instruct the board on matters reserved for the board prevails. But this was due to the constitution of the respective companies. It could be argued that if general meeting's power is expanded by statute, the outcome of these cases could have been different as is likely to be the case in Malaysia.

However, even if the constitutions were

¹⁰ See <http://www.accr.org.au/australia>

changed to enable shareholders to instruct the board, shareholders are generally “aware of their own ignorance” and normally ‘insert’ themselves in management only when necessary (Fairfax, 2008; Listokin, 2010; McDonnell, 2011). Shareholders are more likely to respect management views and policies unless there are clearly visible signs of managerial failure - such as repeated unsatisfactory dividend distributions, continuous share price drops or blatant private rent extraction by directors (Dignam & Galanis, 2004). In addition, the shareholders’ power to instruct does not allow them to order the board to enter into a course of conduct which contravenes any other provisions of the Companies Act. In these situations, the power to instruct does not mean that shareholders recommendation even if passed as a special resolution has the effect of waiving compliance with statutory procedures and requirements (Mohd-Sulaiman & Rachagan, 2017; *Re Molopo Energy Limited v Keybridge Capital Limited* [2014] NSWSC 1864).

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