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THE REAL DIFFERENCE IN
CORPORATE LAW BETWEEN THE
UNITED STATES AND CONTINENTAL
EUROPE: DISTRIBUTION OF POWERS

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The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers

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Abstract

This paper challenges some common assumptions in comparative corporate law. It argues that differences in the degree of shareholder protection between common law and civil law countries are often overestimated, while some more fundamental corporate law differences remain overlooked. A milestone publication in this regard is the article of La Porta et al. entitled *Law and Finance*. The authors introduce an index to measure investor protection statistically and find that common law countries perform better on average than civil law countries. However, a broad array of legal sources reveals many mechanisms that interfere with, or substitute for, the mechanisms for shareholder protection used to construct the index. A recoding of the index to include these sources yields no significant differences between common law and civil law jurisdictions. This finding casts doubt on the received premise of recent research that common law jurisdictions offer better shareholder protection than civil law jurisdictions. It highlights instead the existence of a fundamentally different distribution of legal powers within U.S. and Continental European corporations. This paper shows that this difference shapes the functioning of the mechanisms of shareholder protection that comprise the index of La Porta et al. Furthermore, the difference in power distribution undermines the relationship they allege between shareholder protection and ownership structures and better explains in itself the differences in ownership structures, as well as many other aspects of corporate life.

¹ LL.M. Harvard Law School, Licentiaat rechten University Leuven. An earlier draft of this paper was awarded the Irving Oberman Memorial Award at Harvard Law School for the best paper related to corporate governance. I thank Professor Mark Roe, Professor Detlev Vagts, and especially Jane Fair Bestor for their helpful comments and the Belgian American Educational Foundation for its support. Comments and suggestions for improvement are very welcome at slcools@post.harvard.edu.

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INTRODUCTION

The Berle and Means corporation, with small and dispersed shareholders and control in the hands of management,² is not a worldwide phenomenon. Outside Anglo-Saxon jurisdictions, entirely different corporate ownership structures exist in which controlling shareholders have a large stake in the company's equity.³ Within Continental Europe, distinctions are made among the French tradition, where the dominant stockholder is usually a family or a company; the German tradition, characterized by a "universal bank" that holds a considerable share; and the Nordic countries, where families play an important role.

The differences in ownership structures are no longer news. The question over which the most brilliant minds have been pondering – and differing – during the last decade is what exactly causes them.⁴ A milestone was set by Rafael La Porta, Florencio Lopez-de-Silanes,

² Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (1932).

³ Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. Fin. 471 (1999).

⁴ Several explanations and correlations have been put forward. See Mark J. Roe, *Strong Managers, Weak Owners* (1994); Mark J. Roe, *Political Determinants of Corporate Governance* (2002) (situation on the political left-right continuum); Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. R. 127 (1999) (path dependence); Amir N. Licht, *The Mother of all Path Dependencies Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 Del. J. Corp. L. 147 (2001); Amir N. Licht, Chanan Goldschmidt & Shalom H. Schwartz, *Culture, Law, and Finance: Cultural Dimensions of Corporate Governance Laws* (2001), at <http://ssrn.com/abstract=267190> (last accessed December 2, 2003) (culture); Paul G. Mahoney, *The Common Law and Economic Growth: Hayek Might be Right*, 30 J. Legal Stud. 503 (2001); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control*, 111 Yale L.J. 1 (2001); John C. Coffee, Jr., *Do Norms Matter? A Cross-Country*

Andrei Shleifer and Robert Vishny (hereafter LLSV) in their seminal paper *Law and Finance* in 1996.⁵ In 1998, this was slightly modified in an article bearing the same title.⁶ In both publications, LLSV assert that ownership structures are determined by the degree of investor protection against expropriation by insiders. The authors demonstrate their thesis using what at that time was a particularly innovative technique: an index to measure the quality of investor protection. Common law countries, which typically have dispersed ownership, were found to score well on the index. Civil law countries, characterized by concentrated ownership, did not. The authors conclude that in part through a difference in the degree of investor protection, legal origin influences ownership structures.⁷

Even though in their further elaboration of the “law matters” thesis LLSV themselves seem to attach greater importance to private enforcement of securities law than to corporate law,⁸ the LLSV study has been and still is extremely influential. The index used in *Law and*

Evaluation, 149 U. Pa. L. Rev. 2151 (2001) (government’s intervention in property rights and its hospitality to private self-regulation); Lucian A. Bebchuk, *A rent Protection Theory of Corporate Ownership and Control*, NBER Working Paper 7203 (1999), at <http://www.nber.org/papers/w7203> (last accessed April 9, 2004); Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. Fin. 537 (2004) (the size of private benefits of control); Raghuram Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 J. Fin. Econ. 5, 43 (2003) (the relative powers of interest groups); Peter A. Gourevitch, *The Politics of Corporate Governance Regulation*, 113 Yale L.J. 1829, 1867-1869 (2003) (the likelihood of political swings); Sea Jin Chang, *Ownership Structure, Expropriation, and Performance of Group-Affiliated Companies in Korea*, 46 Acad Manage J. 238 (2003) (performance as a cause rather than a consequence); Ergun Dogan & Russell Smyth, *Board remuneration, company performance, and ownership concentration: evidence from publicly listed Malaysian companies*, 19 ASEAN Economic Bulletin 319 (2002) (the level of board remuneration).

⁵ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert W. Vishny, *Law and Finance*, NBER Working Paper No. 5661 (1996).

⁶ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert W. Vishny, *Law and Finance*, 106 J. Polit Econ 1113 (1998).

⁷ La Porta et al., *Law and Finance*, *supra* note 6, at 1151. The authors also note the importance of quality of law enforcement, which also (albeit somewhat differently) corresponds with legal origin. (La Porta et al., *Law and Finance*, *supra* note 6, at 1140-45).

⁸ La Porta, Lopez-de-Silanes and Shleifer recently showed that “private enforcement” variables in securities laws knock out anti-director rights as a significant predictor of market development: Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *What Works in Securities Laws?*, NBER Working Paper No. W9882, 17, available at <http://ssrn.com/abstract=430596> (last accessed March 28, 2004). Other authors also raised critiques against the claim that investor protection produces certain ownership structures. In addition to the above-mentioned theories on ownership structures (see *supra* note 4), one can mention Rajan & Zingales, *supra* note 4, at 7 (arguing that a historical analysis, as opposed to a cross-sectional analysis, refutes LLSV’s findings); Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals* in Curtis J. Milhaupt (ed.), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-*

Finance to measure investor protection is still being relied upon extensively as a quantitative measure of investor protection. It is used in regressions to establish the existence or non-existence of relationships between shareholder protection and several other variables. Scholars have found that investor protection correlates with broad and deep capital markets,⁹ higher dividend payouts,¹⁰ higher corporate valuation,¹¹ better access to external finance,¹² more efficient capital allocation,¹³ and the extent of exchange rate depreciation and stock market collapse during a crisis.¹⁴ They have uncovered correlations with a country's cultural profile,¹⁵ the value of control benefits,¹⁶ and many other factors, or use the index as a control variable.¹⁷ One can say that *Law and Finance* is a standard reference in comparative corporate and financial law.¹⁸

Border Deals (2004) (suggesting that ownership concentration may be a consequence of too much protection of minority shareholders). Mike Burkart & Fausto Panunzi, *Agency Conflicts, Ownership Concentration, and Legal Shareholder Protection*, CEPR Discussion Paper No. 2708 (2001), available at <http://ssrn.com/abstract=264361> (last accessed April 5, 2004) (noting that high quality investor protection may also have adverse effects); Coffee, *supra* note 4, at 80 (also pointing out that the order may have been reversed in that strong markets may have created a demand for a sound legal framework).

⁹ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, 52 J. Fin. 1131 (1997); Ross Levine, *Bank-based or market-based financial systems: which is better?*, 11 J. Fin. Intermed. 398 (2003).

¹⁰ La Porta et al., *Agency Problems and Dividend Policies Around the World*, 55 J. Fin. 1 (2000).

¹¹ La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. Fin. 1147 (2002).

¹² A good summary of the consequences that have been attributed to low investor protection can be found in: Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. Fin. Econ. 3, 13-17 (2000).

¹³ Jeffrey Wurgler, *Financial markets and the allocation of capital*, 58 J. Fin. Econ. 187 (2000).

¹⁴ Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. Fin. Econ. 141, 172-178 (2000).

¹⁵ Amir N. Licht et al., *Culture, Law, and Corporate Governance*, Int'l Rev. L. & Econ. (forthcoming 2004), working paper available at <http://ssrn.com/abstract=508402> (last accessed March 28, 2004).

¹⁶ Tatiana Nenova, *The Value of Corporate Votes and Control Benefits: A Cross-Country Analysis*, Harvard University Working Paper, 3-4 (2000), available at <http://ssrn.com/abstract=237809> (last accessed May 1, 2004); Luigi Zingales, *The Value of the Voting Right: a Study of the Milan Stock Exchange*, 7 Rev. Fin. St. 125-148 (1994).

¹⁷ Thorsten Beck & Ross Levine, *Industry growth and capital allocation: does having a market- or bankbased system matter*, 64 J. Fin. Econ. 147, 161-164 (2002); Randall Morck et al., *The information content of stock markets: why do emerging markets have synchronous stock price movements*, 58 J. Fin. Econ. 215, 255-258 (2000).

¹⁸ For an excellent survey of the law and finance literature, see Thorsten Beck & Ross Levine, *Legal institutions and financial development*, in Mary Shirley & Claude Ménard (eds.), *Handbook of New Institutional Economics* (2004), available at http://www.econ.worldbank.org/files/29888_wps3136.pdf (last accessed August 21, 2004).

Only a few authors, mostly from civil law countries,¹⁹ have questioned the index and in particular, the sub-index measuring shareholder protection. Of the three main issues investigated by LLSV – shareholder rights, creditor rights, and law enforcement – it was exactly the shareholder rights, as measured by the “anti-director index,” that had the strongest explanatory power. The anti-director index was the only sub-index to correlate completely with the division between common law and civil law, and the only one to correlate significantly with the degree of ownership dispersion.²⁰ Detlev Vagts raises short critiques against the scores given to Germany and against the relevance of some of the anti-director rights for the German system.²¹ Moreover, Markus Berndt presents an “Alternative Minority Protection Index,” where the “shares not blocked” and the “oppressed minorities mechanism” rights are replaced by “minority protection regarding authorized capital” and “minority protection regarding share repurchases.” On Berndt’s index, civil law countries, especially France, perform better than common law countries, in particular the U.K.²²

Is the reaction of civil lawyers one of self-defense arising from the weaker scores of countries in the civil law tradition, or are there factors at work that would render the index less appropriate for civil law jurisdictions? The latter would have severe consequences. If

¹⁹ For common law countries, reference can be made to John C. Coffee who, along with “many [unnamed] other commentators,” briefly notes that although not unimportant, the anti-director rights “seem to supply only partial and sometimes easily outflanked safeguards, which have little to do with the protection of control and the entitlement to a control premium”. (Coffee, *The Rise of Dispersed Ownership*, *supra* note 4, at 8 and fn 6). Frank Partnoy also briefly raises a similar critique on the value of the scores as statistical data. (Frank Partnoy, *Why Markets Crash and What Law Can Do About It*, 61 U. Pitt. L. Rev. 741, 765-67 (2000)). These critiques do not address the components of the index. An interesting but short critique from a civil law perspective is Alain François & Jeroen Delvoie, *De wet corporate governance in het licht van het ruimere corporate governance debat*, in Koen Byttebier et al. (eds.), *De wet corporate governance ont(k)leed*, 29-33 (2004) (suggesting briefly that the rules in the index are not the most crucial investor protection rights; that there may be substitute rules; and that investor protection may lead to ownership concentration rather than dispersion).

²⁰ La Porta et al., *Law and Finance*, *supra* note 6, at 1150. The scores correlate with the distinction between common law and civil law only with respect to the shareholder – anti-director – rights. For creditor rights, there is no correlation with legal origin and for law enforcement, common law countries fall in between the Scandinavian and German civil law family, on the one hand, and the French civil law tradition, on the other.

²¹ Detlev Vagts, *Comparative company law - the new wave*, in Rainer J. Schweizer, Herbert Burkert & Urs Gasser (eds.), *Festschrift für Jean Nicolas Druey* 600 (2002).

²² Markus Berndt, *Global Differences in Corporate Governance Systems*, in Peter Behrens et al. (eds.), *Ökonomische Analyse des Rechts* 17-18 (2002). He points out that both Germany and the U.K. have preemptive rights as a default rule and that in both countries those rights can be waived. The difference is that Germany has stricter requirements for a waiver, which would rather lead to a better score for Germany than for the U.K. than otherwise.

civil law countries perform poorly on the index because it has a common law bias, we no longer know whether investor protection is actually weaker there and whether it has any bearing on ownership structures. To put it more bluntly, if the index merely reflects whether a given corporate legal system belongs to the common law or civil law tradition, the only thing its correlation with ownership structures teaches us is that in common law countries ownership is dispersed, and in civil law countries it is concentrated.

This study investigates differences between common law and civil law countries that affect the relevance of the anti-director index. It starts from a U.S. law point of view and extends the research of Vagts and Berndt to other countries. Since these authors have revealed some problems with this index for the German law family, this paper focuses on the French civil law family, which according to the LLSV study is worst at protecting investors. Specifically, the jurisdictions examined most closely are France, the center of the French family of civil law countries, and Belgium, which received a score of zero, the worst performance recorded under the anti-director index.

The anti-director index is used in part I to illustrate the importance of seemingly unrelated or otherwise unnoticed technical elements of a legal system. Part I gives examples where, despite a score of zero, a country's law does provide for an anti-director right, but in case law or in practice rather than in an explicit statutory provision. Absence of a reference in the statute can mean not that a specific right is banned, but that it is permitted, depending on the legal framework. An example of this phenomenon that is valid for both France and Belgium is proportional representation on the board of directors. Sometimes the law of a country provides for an identical institution as listed in the anti-director index, only it bears a different name. Under Belgian corporate law, "preemptive rights," literally translated, is "preference rights." There is no doubt that different institutions can have similar effects. For

instance, sending a straight vote by mail – which is allowed in France but, admittedly, not frequently used – is very much the same as sending a proxy vote by mail. More important here is the finding that similar institutions can have a different effect as a consequence of other rules. For instance, in France sending the proxy by mail to the firm is indeed allowed, but only to *support* the incumbents.

On the basis of observations like these, one could wonder whether quantification is possible at all in the field of law, especially when the choice is between a score of zero and a score of one.²³ Leaving this question aside, one could re-code the anti-director index for France or Belgium on the basis of the above-summarized investigation. The results are astonishing: Belgium should be attributed a score of four instead of zero on a scale ranging from zero to six. France, which had a score of three in *Law and Finance*, should have received a four or five at that time. Now it should have a score of five or even six.

Similar institutions may also have different effects because of a different factual background or a difference in the fundamentals of corporate law. This difference in background is the subject of part II. Not only do the U.S. and Continental Europe differ in the extent of ownership concentration; something else has a pervasive influence on the functioning of technical rules and should always be considered in comparative law studies: *the fundamental choices of a legal system*. An extraordinarily important but continually overlooked concept underlying corporate law provisions concerns the respective roles of a corporation's constituents. Part II unveils a different distribution of legal powers in corporations in the U.S. and in Continental Europe and argues that this may well be a stronger distinguishing characteristic than the extent of investor protection. In a U.S. corporation, the center of powers lies within the board, or better, management. It can act autonomously in

²³ Another question that will not be examined here is whether the six anti-director rights are the most crucial elements of investor protection.

matters where a Continental European board or management would depend on the shareholders. This fundamental difference is supported by two other differences. First, it is easier for shareholders to set the agenda of the shareholders' meeting in Continental Europe than it is in the U.S. Second, the enabling approach of the Delaware legislator allows the board to assume several powers of the shareholders meeting. In contrast, in Continental Europe, the statutory allocation of powers is mandatory, and even with the permission of the shareholders' meeting the board cannot appropriate most of its powers.

In several innovative publications, Lucian Bebchuk calls attention to the relative powerlessness of shareholders in the U.S. and recommends that shareholder power be increased.²⁴ The comparison between the U.S. and Continental Europe supports and extends Bebchuk's arguments. It underscores just how few legal powers shareholders have in the U.S. and how fundamental the distribution of legal powers is in shaping the character of corporate life. Part III shows how recognition of the different distribution of legal powers requires a revision of several theories in corporate law scholarship. The distribution of legal powers affects the bearing of most of the anti-director rights, but its impact goes much beyond that. First of all, it is a crucial element in understanding why ownership structures are so different in the U.S. and Continental Europe, the question that led to the development of the anti-director index. In the U.S., the board can act relatively independently from the shareholders. Conversely, in Continental Europe, the board needs the permission of the shareholders for a range of decisions, and it can be replaced by a new team at any moment a simple majority of shareholders wishes to do so. Thus, in Continental Europe, the stable situation is one in which the board and the majority shareholder cooperate extensively, whereas in the U.S., a majority

²⁴ Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, forthcoming Harv. L. Rev. (2004), available at <http://www.law.harvard.edu/faculty/bebchuk/pdfs/04.Bebchuk.case-empowering-shareholders.pdf> (last accessed August 31, 2004); Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 Bus. Law. 43 (2003); Lucian A. Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. Chi. L. Rev. 937 (2002).

stake does not impart significant control over the company and therefore does not outweigh the costs such a stake would entail.

The difference in the typical distribution of legal powers in a corporation arguably has many of the consequences that have so far been attributed to differences in investor protection. Firm growth, firm size, private benefits of control, stock options incentives, and many other aspects of corporate life become more intelligible when seen against this background. Finally, a consideration of the difference in allocation of legal powers may have important consequences for initiatives in international corporate governance. This paper invites new research on these and other fascinating aspects of corporate life.

I. SMALL DIFFERENCES IN SHAREHOLDER PROTECTION

A. Introduction

1. Methodology

LLSV do not give many details on the anti-director index or on the reasoning behind a particular score. They define the index as a tool for “measur[ing] how strongly the legal system favors minority shareholders against managers or dominant shareholders in the corporate decision-making process, including the voting process.”²⁵ In the 1996 paper, the index consists of five shareholder rights. Countries are assigned one point for every one of those rights their laws provide for. LLSV explicitly exclude any information from security exchanges regulations from their research.²⁶ By 1998, LLSV had revised their index, which since then includes six rights. As a result, the scale ranges from zero to six. The U.S., for which LLSV sensibly chose to investigate Delaware law, no longer has a perfect score, since it kept its five. In addition, some countries’ scores were modified, so that only Belgium was

²⁵ La Porta et al., *Law and Finance*, *supra* note 6, at 1127.

²⁶ La Porta et al., *Law and Finance*, *supra* note 6, at 1120.

left with a score of zero.²⁷ Common law countries generally obtain high scores, with an average of 4.00. Civil law countries apparently do not offer much protection for minority shareholders. The average for both French-origin and German-origin countries is 2.33. France is a bit above the average with a score of three, which is also the average of Scandinavian countries.

This part critically investigates each of the anti-director rights in light of Delaware law and French and Belgian law, with a few references to other jurisdictions as well.²⁸ The focus is on the interrelation among different rules and its importance in comparative law. Unlike the LLSV article, this paper also examines case law and regulations other than statutory law where they prove relevant. References to fundamental differences in legal and economic background are left for part II as much as possible.

2. Introduction to the French and Belgian Legal Systems

France, the center of the French origin family, received a score of three in the LLSV publication, which is better than the average in the French family, at 2.33. The most common corporate form for public corporations in France is the *Société Anonyme* (S.A.),²⁹ which is mainly governed by the Commercial Code of 2000. This code codified the provisions of a 1966 Act³⁰ without major changes in content.³¹ The Commercial code was amended significantly by the New Economic Regulations Act of 2001 (hereafter: the NER Act).³² This act, among other things, reinforced the rights of non-associated minority shareholders.

²⁷ At least in the 1998 version of the LLSV paper. Originally, also Indonesia and Mexico scored zero. La Porta et al., *Law and Finance*, *supra* note 6 (table 2 in appendix). In La Porta et al., *Legal Determinants*, *supra* note 23, at 1138, these original scores were used. In the 1998 version of *Law and Finance*, the scores were slightly modified.

²⁸ Like the LLSV study, this description confines itself to the law applicable to listed companies.

²⁹ A less complicated form, the *société par actions simplifiée* (SAS) is having increasing success.

³⁰ Loi No. 66-537, executed by Decree No. 67-236.

³¹ Ordonnance No. 2000-912, which entered into force immediately. The provisions of the 1966 Act can be found in Book II.

³² Loi No. 2001-420.

Hereafter the regulations of the former Financial Markets Board (*Conseil des Marchés Financiers*) will be referred to as FMA regulations. Recently, the Financial Markets Board merged with two other institutions³³ into the FMA (Financial Markets Authority - *L'Autorité des marchés financiers*)³⁴ and its regulations are now part of the general regulations of the FMA. In addition, the corporation's own foundational provisions and bylaws are laid down in its constitution (*statuts*), which encompasses both charter and bylaw provisions.

The constitution can provide that the board of directors (*conseil d'administration*) includes directors elected by the personnel of the firm or affiliated firms.³⁵ Mostly the board functions according to a monistic system.³⁶ Nevertheless, the board can decide to delegate the general direction to a *directeur général*, who can be the president of the board.³⁷ This personnage has become a pivotal figure since the NER Act.³⁸ It is also possible to establish a two-tier system in the *constitution* in which the firm's management board (*directoire*) is controlled by a supervisory board (*conseil de surveillance*).³⁹ Membership in these bodies is mutually exclusive.⁴⁰

As mentioned in the introduction, Belgium is the only country that received a score of zero in the 1998 version of *Law and Finance*. The corporate form in which a Belgian company's shares can be listed is the *Naamloze Vennootschap* (N.V.) or *Société Anonyme* (S.A.). In 1999, the Companies Code was promulgated. This is a codification of the old Companies Act, the relevant articles of the Civil Code and some other statutes. Since then, the

³³ These are the *Commission des Opérations de Bourse* (COB) and the *Conseil de discipline de la gestion financière* (CDGF).

³⁴ Loi No. 2003-706 (especially Article 46 V 1° and 2°).

³⁵ Commercial Code Article L. 225-27.

³⁶ Commercial Code Articles L. 225-17 to L. 225-56.

³⁷ Commercial Code Article L. 225-51-1.

³⁸ Philippe Merle, *Droit commercial. Sociétés commerciales* 466 (8th ed. 2001).

³⁹ Commercial Code Articles L. 225-57 to L. 225-93.

⁴⁰ Commercial Code Article L. 225-74.

Companies Code has been significantly amended by the Corporate Governance Act 2002.⁴¹ As in France, Belgian companies are further governed by a single constitution (the *statuten* or *statuts*).

Traditionally, the board of directors (*raad van bestuur, conseil d'administration*) in a Belgian company worked in a single-tier system. Since the Corporate Governance Act 2002, a company's constitution can allow the board to delegate management to the Managing Committee (*directiecomité, comité de direction*).⁴² However, the previously existing facultative administrative board (*orgaan van dagelijks bestuur, les délégués à la gestion journalière*) was not abolished.⁴³

B. The First Right: Proxy by Mail Allowed

The first right in the anti-director index is that of shareholders to send their proxy by mail rather than to show up in person or send an authorized representative to the shareholders' meeting.⁴⁴ It "equals one if the company law or commercial code allows shareholders to mail their proxy vote to the firm, and zero otherwise."⁴⁵ LLSV granted the U.S. and France a score of one, and Belgium a score of zero. When considered from the standpoint of the "indexer," Belgium, I argue, should have received a point. But I also show some problems with the indexer approach. These are: the importance of surrounding legal provisions, the existence of alternatives, and the very desirability of sending a proxy vote by mail.

Obviously, Delaware law deserves a score of one with regard to the right to send a proxy by mail to the firm. It does not need much explanation that proxy solicitation by the

⁴¹ Act of August 2, 2002.

⁴² Companies Code Article 524bis.

⁴³ Companies Code Article 525.

⁴⁴ La Porta et al., *Law and Finance*, *supra* note 6, at 1127.

⁴⁵ La Porta et al., *Law and Finance*, *supra* note 6, at 1122.

incumbents is an allowed and even widespread practice, particularly for the election of directors. Delaware law does not impose requirements as to the form of proxy,⁴⁶ save that "to be effective as a proxy, a document must identify the shares that are to be voted by the agent and include some indication of authenticity, such as the stockholder's signature or a facsimile of the signature."⁴⁷

In contrast, it is surprising that Belgium was given a zero on the first anti-director right. Already at the time of the LLSV article, the Companies Code unequivocally stated that a shareholder can vote in person or by proxy.⁴⁸ The Companies Code does not explicitly state that shareholders can mail their proxy to the firm, but there is no doubt that they can. Why otherwise would the Code include provisions with regard to proxy solicitations by the firm? Admittedly, the proxy system is different from that in the U.S. in that it is based on the concept of power of attorney. Nevertheless, this Belgian version of the proxy system is used frequently⁴⁹ – although less than in the U.S. – and proxies are often given to the chairman unless otherwise stated.⁵⁰ Accordingly, the score for Belgium should be amended to a score of one.

In France, it is a lawful and frequent practice for large firms to solicit so-called *mandats en blanc*. For this purpose, the corporation mostly asks the banks to send proxy solicitations to their clients, or to keep them at their disposal in case of bearer shares.⁵¹ The shareholder then signs the proxy form and sends it to the company.⁵²

⁴⁶ *Lobato v. Health Concepts IV, Inc.*, 606 A.2d 1343 (Del. Ch. 1991).

⁴⁷ *Eliason v. Englehart*, 733 A.2d 944, 946 (Del. 1999).

⁴⁸ Companies Code Article 547. This provision also existed at the time the LLSV paper was published. Then it was to be found in Companies Act Article 74, §2.

⁴⁹ Eddy Wymeersch. & Christoph Van der Elst, *De werking van de algemene vergadering in de Belgische beursgenoteerde vennootschappen: Een empirisch onderzoek*, 1997 TBH 72, 75.

⁵⁰ Eddy Wymeersch in Theodor Baums & Eddy Wymeersch (eds.), *Shareholder Voting Rights and Practices* 43 (1999).

⁵¹ Under the discussion of the second anti-director right, the practice of bearer shares is described in more detail.

⁵² The fact that this proxy form does not mention the name of the person who will exercise the proxy does not render the practice illegal, since there is no prohibition on signature to a blank document. 2 Georges Ripert & René Roblot, *Traité de droit commercial* 342 (18th ed. 2001).

A close reader will have detected a first qualification to the value of the first anti-director provision in the French regulation: shareholders can send only *blank* proxies to the firm. In other words, the incumbent directors have full discretion in the exercise of their proxy mandate. It goes without saying that such a mechanism does not provide much protection to minority shareholders against the incumbent directors. In fact, it even reinforces the position of the latter – or rather, of the controlling shareholder who appoints the directors. This becomes even clearer if one reads what the Commercial Code itself provides for when no particular person is appointed in the proxy form; the president of the shareholders’ meeting will vote in favor of the resolutions proposed by the board (the *conseil d’administration* or the *directoire*) and against all other resolutions.⁵³

The protective value of the first anti-director right thus largely depends on the shareholders’ equal opportunity to mandate their proxy to vote for *or against* any resolution. In the US, a similar debate is going on for corporations that are not governed by SEC rules. It is a common critique that when the board sends out notices of a shareholders’ meeting, it usually includes a proxy form soliciting shareholders’ signatures and provides postage, all at the expense of the company. These are ordinarily blank proxies, which are exercised by a proxy committee selected by the board or by management and expected to vote in favor of the incumbents. In this manner, “proxy voting has operated to enable the management in office to perpetuate itself and control the corporation.”⁵⁴ This argument does not hold true – or, better, not to the same extent⁵⁵ – for companies subject to SEC rules. These rules require that the form of proxy affords the stockholder an opportunity not only to approve, but also to disapprove or abstain with respect to each separate matter.⁵⁶ Similarly, shareholders in Belgian public companies cannot give blank proxies; they must instruct the proxy how to

⁵³ Commercial Code Article L. 225-106 al 7. In its proxy solicitation, the corporation has to inform the shareholder of this rule: Decree No. 67-236 Article 133.

⁵⁴ James D. Cox & Thomas Lee Hazen, *Cox & Hazen on Corporations* 781 (2d ed. 2003).

⁵⁵ See section II.C.5 for the rules with regard to reimbursement of the expenses by the corporation.

⁵⁶ Rule 14a-4(b) (17 CFR 240.14a-4(b)).

vote. Proxy solicitations, which include the actual proxy form,⁵⁷ must state the agenda, the proposed resolutions and the way the proxy holder will vote in the absence of instructions.⁵⁸

These considerations lead us one step further. Even if shareholders can withhold their vote or vote against a proposal or a nominee, this possibility is valuable only if they can propose an alternative. This is the weak point under U.S. law. Although the “town meeting rule” in principle entitles shareholders to have their proposal included in the company’s proxy materials, corporations can invoke a wide range of grounds to exclude the matter from the proxy materials.⁵⁹ Civil law countries generally do better in this respect. This, however, is a matter closely related to the fundamental difference between U.S. and civil law, and will therefore be elaborated in part II.

Many other surrounding provisions have an impact on the protective effect of the right to mail a proxy to the firm. For example, directors or management should not be able to “bundle” proposals. Otherwise, they could obtain a positive vote for unpopular proposals by tying them to more attractive proposals, nicely named “sweeteners.”⁶⁰ Also, it should not be possible to deprive shareholders of the rights summed up in the company’s bylaws or constitution or to restrict them; the authority conferred by a proxy should be limited in time; proxy solicitation should include adequate information about the proposed resolutions; outright vote buying should be prohibited, etc.

The weakness of the proxy system if some of those rules are not – or not sufficiently – applied in a particular jurisdiction could still be counterbalanced by the existence of alternatives to the described proxy mechanisms. In France, a shareholder can grant a non-

⁵⁷ 1 Bouckaert, *supra* note 231, at 406; Frank Helleman, *De algemene vergadering. Een onderzoek naar haar grondslagen, haar bestaansredenen en de geldigheid van haar besluiten* 491 (2001).

⁵⁸ Companies Code Article 548.

⁵⁹ Rule 14a-8 (17 CFR 240.14a-8).

⁶⁰ In the US, bundling has not been allowed since 1992: Rule 14a-4(b)(1) (17 CFR 240.14a-4(b)(1)).

discretionary proxy to another shareholder or to her spouse.⁶¹ Obviously, the limitation of the persons to whom such a proxy can be given prevents it from being a fully fledged alternative, but at least it mitigates to some extent the shortcoming of the *mandat en blanc*.⁶² More important are some other and better substitutes. In Germany, for instance, large numbers of shareholders have deposited their shares with German banking institutions. These shareholders usually have their votes cast at the meeting according to the instructions they give. Thus, deposition of shares functions as a sensible substitute to the proxy system.⁶³ Another option is a more direct solution than mailing *proxy forms*, namely sending a *vote* by mail or by means of telecommunication. Very often, however, jurisdictions that allow this mechanism do not facilitate its exercise, because they impose too many administrative burdens.⁶⁴ In light of the development of new technologies, several jurisdictions have introduced or are considering the introduction of new possibilities, such as webcast shareholder meetings, or voting over the phone, by e-mail or other means of communication.⁶⁵ These methods are convenient for the shareholders, cheaper for the

⁶¹ The rationale for this restriction is the legislature's distrust of agitators, blackmailers and enterprises specializing in representing shareholders (Merle, *supra* note 38, at 509; 2 Ripert & Roblot, *supra* note 52, at 341). Since this is too rigid by international standards, the NER Act has introduced an additional possibility for the representation of non-resident shareholders. Under this regime, shareholders hold their shares in accounts in the name of a financial intermediary that can represent the shareholders. The intermediary has to disclose the fact that it is acting as intermediary and, upon request of the issuer, the identity of the owner of the shares (Commercial Code Article L. 225-107-1 et seq.; see also Commercial Code Article 228-1 al 3).

⁶² A shareholder who intends to vote against the incumbents' proposals or in favor of insurgents' proposals but who is not able to attend the shareholders' meeting has to find another proxy who is willing to vote in this way (Commercial Code Article L. 225-106 al 7).

⁶³ This "voting right of nominee shareholder," or *Depotstimmrecht* is exercised in accordance with the conditions laid down in AktG §128 & 135. See Vagts, *supra* note 21, at 600.

⁶⁴ In France, vote by mail (*par correspondance*) is a mechanism which cannot be excluded by the constitution (Commercial Code Article 225-107 al 1). From the calling of the shareholders' meeting and until six days before the meeting is held, a shareholder can ask the firm to send him a form for vote by mail (Decree No. 67-236 Article 131-1). With this form, the shareholder must be able to vote on all of the resolutions in the order of their presentation at the meeting (Decree No. 67-236 Article 131-2). Since voting by mail does not enable the shareholder to express an opinion in case the resolution is amended during the meeting, this method is not used frequently (Patrick Ledoux, *Le droit de vote des actionnaires* 266 (2002)). In Belgium, a shareholder can vote directly by mail if the company's constitution so permits. Upon a shareholder's request, the board will then deliver the requisite form. The content of this form is prescribed by the constitution. Blank votes are not allowed (Companies Code Article 550; Hellemans, *supra* note 57, at 500). Again, this method is not frequently used (Eddy Wymeersch in Baums & Wymeersch, *supra* note 50, at 39).

⁶⁵ This is allowed in Delaware (DGCL § 212(c)(2)), where it seems to have become a success (Theodor Baums & Johann Wolfgang, *General Meetings in Listed Companies – New Challenges and Opportunities*, OECD study, 6 (2000), at <http://www.oecd.org/dataoecd/61/15/1931816.pdf> (last accessed April 5, 2004)). In France, the

corporation than paper-based voting and can be processed easily and quickly. The *OECD Principles of Corporate Governance* (both 2004 and 1999) encourage the enlarged use of information technology in voting.⁶⁶

The question remains whether, even if all supporting provisions do exist, the possibility of mailing a proxy to the firm is that desirable as a protective mechanism. In several countries, this question has received a negative answer. They have introduced or are considering introducing the possibility for an “independent proxy” or an independent person to receive and collate proxy votes.⁶⁷ In the same line of reasoning, the solicitation of proxies at the company’s expense is sometimes *prohibited*.⁶⁸ Indeed, as will be shown in parts II and III, proxy solicitation works to the advantage of incumbent managers. In addition to concerns about the independence of the proxy, in many jurisdictions, especially civil law jurisdictions, concerns have been raised about the possibility of holding a real debate at the shareholders’ meeting.⁶⁹

The above considerations make clear how difficult it is to determine which of the three countries, France, Belgium and the U.S., has the best rule when only one technical feature is

legislature recently provided for voting through telecommunication, primarily video conferences. However, this is only possible if permitted by the constitution (Commercial Code Article L. 225-107 II, as implemented by the NER decree No. 2002-803).

⁶⁶ *OECD Principles of Corporate Governance* (2004), Annotation C.4; *OECD Principles of Corporate Governance* (1999), Annotation C.3.

⁶⁷ In France, proxies to fellow shareholders have sometimes been misused by these shareholders, since they are not bound by the instructions of the owner unless she gives an “imperative proxy.” This produced a critique in legal doctrine (Ledoux, *supra* note 64, at 108-09); 2 Ripert & Roblot, *supra* note 52, at 343). For these reasons, the Marini report, which was drafted in 1996 with the goal of reforming the former 1966 Loi but which was not implemented, proposed to introduce the possibility of appointing an independent proxy (Marini Report, § 87). Arguably, in the U.S., the role of an independent proxy is taken up by institutional investors.

⁶⁸ E.g., Italy (except with shareholder approval). A similar prohibition is being considered by Sweden.

⁶⁹ Ledoux, *supra* note 64, at 264-68; 2 Ripert & Roblot, *supra* note 52, at 343. Merle is skeptical, however, and notes that most of the time there is not a true deliberation anyway. Merle, *supra* note 38, at 511. The possibility of holding a real discussion is a concern in common law countries as well. See the Australian case *Re South British Insurance Co Ltd* [1981] 1 NZCLC 95-004 at 98,064, where the Court observed that “an annual meeting of the shareholders is an important event. (...) It is the one occasion in the year when the shareholders have a right to meet the directors or their representatives and to question them on the company’s accounts, the directors’ report and the company’s position and prospects.”

considered. When the assessment is limited to a score of zero or one, the result is even more problematic. As part II shows, fundamental choices of a system can have an even more important impact on the significance of a specific rule in that system than the working of other such features. But for the reader who wants to see concrete numbers, leaving aside the more fundamental considerations that follow, the scores in the first anti-director right should be amended as follows:

Table 1: Scores on the First Anti-director Right

| | LLSV score | Revised score |
|---------|------------|---------------|
| U.S. | 1 | 1 |
| France | 1 | 1 |
| Belgium | 0 | 1 |

C. The Second Right: Shares Not Blocked Before Meeting

The second variable in the anti-director index concerns whether or not shares are blocked before a shareholders' meeting. The score "equals one if the company law or commercial code does not allow firms to require that shareholders deposit their shares prior to a general shareholders' meeting, thus preventing them from selling those shares for a number of days, and zero otherwise."⁷⁰ Although it remains true that Delaware law was the only legal system to deserve a point at the time *Law and Finance* appeared, the following discussions show how much this provision is intertwined with other legal provisions and the general framework.

A Delaware corporation cannot block the shares before the shareholders' meeting. The most the board can do is to establish a record date. If it does not do so, the record date is

⁷⁰ La Porta et al., *Law and Finance*, *supra* note 6, at 1122.

determined by the statute.⁷¹ As a rule, only registered stockholders – those who own stock on the record date – have the right to vote. In a post-record date sale of stock, however, the buyer can compel the seller to grant him proxies to vote the transferred stock.⁷² Conversely, in Belgian public companies, owners of *bearer* shares who wish to exercise their voting right are required to deposit their shares several days before the meeting.⁷³ Combined with a criminal sanction on exercising the voting rights attached to shares that are no longer one's property at the date of the shareholders' meeting, those shareholders see their shares blocked in the time period between the deposition and the meeting. Ironically, the legislature's intention was to promote participation in the shareholders' meeting by facilitating public proxy solicitation.⁷⁴ In a new attempt to promote institutional shareholder participation, the Corporate Governance Act 2002 introduced an optional record-date system for listed companies.⁷⁵ Under this system, shareholders who are registered at midnight on the registration day can participate in the shareholders' meeting and cast their vote, regardless of whether they are still shareholder at the moment the meeting is held. This implies that the shares will still be blocked during an "overnight deposit."⁷⁶ Indeed, shareholders will ordinarily be required to deposit their shares

⁷¹ The board can only set this date at some point not more than sixty days nor less than ten days before the shareholders' meeting. If the board does not fix a date, then the record date is automatically at the close of business on the day next preceding the day on which notice is given, or, in case of waiver of notice, at the day next preceding the day on which the meeting is held. DGCL § 213(a).

⁷² *Commonwealth Assocs. v. Providence Health Care, Inc.*, 641 A.2d 155, 158. This case confirms what has been held in several cases handed down under the old Delaware Corporation Law, e.g. *In re Canal Constr. Co.*, 21 Del. Ch. 155, 182 A. 545 (1936).

⁷³ The term in which this must be done is to be determined by the constitution and can range from three to six working days before the meeting. Companies Code Article 536.

⁷⁴ Hellemans, *supra* note 57, at 474.

⁷⁵ Companies Code Article 536, alinea 3. The system can be applied only if it is authorized in the constitution. It is contested whether in the latter circumstance the board retains the power to decide whether or not to apply the system (some authors argue that art. 536 should be read as an authorization for the board: Christel Haverans & Hendrik Van Driessche, *De Wet Corporate Governance en de algemene vergadering van aandeelhouders*, 2003 T.R.V. 207, 221-22). The opposite position is taken in Frank Hellemans, *De algemene vergadering and e Wet Corporate Governance*, in Jan Ronse Instituut (ed.), *Nieuw Vennootschapsrecht 2002: Wet Corporate Governance* 234-35 (2003)). It is not clear whether or not the application of the new record date system renders inoperative for public companies the traditional deposit requirement. Most probably it does (Hellemans, *supra* note 75, at 241). So far, the companies that have adopted the record-date system are few. However, companies may soon adopt it if it is preferred or even required by institutional investors (Hellemans, *supra* note 75, at 242).

⁷⁶ In practice, ownership is proven by means of a certificate delivered by the bank that evidences the number of shares deposited in the name of the shareholder. Eddy Wymeersch, in Baums & Wymeersch, *supra* note 50, at 24.

at the seat of the corporation or at the bank before closing time, and they will be released the next morning.⁷⁷

In the past, Delaware law did allow for blockage of the stock before the meeting, through the closing of the stock transfer books.⁷⁸ Why has Belgium not yet taken the same step towards no blockage as Delaware? The answer may very well lie in the difference between registered or nominative shares, the ownership of which is proven by registration in the company's register, and bearer shares, which are the property of the person who presents the paper in which they are materialized. As a result of stock exchange requirements in the U.S., listed stock is always registered stock.⁷⁹ In such a system, deposition is not needed for identification purposes.⁸⁰ In Belgium, bearer shares have traditionally played an important role.⁸¹ Since owners of bearer shares remain anonymous, deposition is inevitable for their proper identification.⁸² In addition, because of this anonymity, corporations cannot ascertain whether registered stockholders are still owner of the declared stock at the date of the meeting, unless they either block the stock until the meeting or require stockholders to present their shares a second time at the opening of the meeting. As long as no exception is made to the rule that shareholders must own the stock at the moment they use the attached voting rights,⁸³ blockage is almost unavoidable.⁸⁴

⁷⁷ Hellemans, *supra* note 75, at 239.

⁷⁸ Old Section 17 of the Delaware Corporation Law, Rev. Code of Del. 1935, § 2049.

⁷⁹ The New York Stock Exchange Listed Company Manual requires that each stock certificate on its face indicates ownership (§501.01) and that the company maintains registrar facilities for all NYSE listed stock (§601.01(A)). Bearer securities are not popular in common law countries in general. In Australia, *all* shares are registered to an owner since Australian companies are by statute forbidden to issue bearer shares (Corporations Act Section 254F).

⁸⁰ Like the DGCL, none of the Australian Corporations Act provisions allow the company to require its members to deposit their shares before the annual general meeting if they want to exercise their voting power.

⁸¹ Although many companies have both bearer and registered shares. Wymeersch & Van der Elst, *supra* note 49, at 75.

⁸² An exception must be made for dematerialized bearer shares, see below under the explanation for France.

⁸³ For the newly introduced optional record date system, the Belgian legislature made an exception to this prohibition. Companies Code Article 651.

⁸⁴ As in France (*infra* note 86), there is no reason why the shares could not be sold off-exchange. But delivery and opposability would not be possible until after the meeting.

In Belgium shareholders have an inalienable right to have their bearer stock converted into registered stock at any time,⁸⁵ for which blockage does not occur.⁸⁶ Why don't they use this right? Or, more drastically, why not eliminate bearer shares? The Belgian government has announced that from 2007 or 2008 it will no longer be possible to issue bearer securities. For a long time, this move would not have been politically feasible. The very reason why bearer shares exist – and are not converted into nominative shares – is their absolute anonymity. *Registration* would be a nightmare for many of its owners. Belgium is well-known for its heavy tax burden and its citizens for their creativity in developing techniques to avoid taxes. In this context, the “Belgian dentist” is interested only in bearer shares, the dividend coupons of which she can secretly cash in neighbor Luxembourg or in another tax haven. However, the European Union and international organizations like the OECD are working to abolish this practice. This story shows that although the second anti-director right in itself is good for shareholders, its introduction into Belgium, all else being equal, would not have been welcomed by most shareholders.

In France, the situation has changed since the publication of *Law and Finance*. Before, shares were blocked if the company required identification to take place before the meeting.⁸⁷ Now a stockholder is still able to sell her shares after identification. In that case she will not

⁸⁵ Companies Code Article 462.

⁸⁶ For France, see Decree No. 67-236 Article 136 al 1 (For nominative shares the firm can only subject the voting right to the registration of the shareholder – or of the intermediary of a non-resident shareholder – in the register of nominative shares held by the corporation.). For Belgium, see Companies Code Article 536, al 2 (The registration of nominative shares in the company's register of nominative shares suffices.). However, the company's constitution can require shareholders to declare in advance if and how many shares they intend to vote at the meeting (Wymeersch, in Baums & Wymeersch, *supra* note 50, at 24). This does not prevent the owner from selling her stock and not exercising her voting rights.

⁸⁷ The rule was and still is that the holder of nominative shares must demonstrate her identity in order to be admitted to the shareholders' meeting, whereas a holder of bearer shares can prove her capacity as shareholder by means of a certificate issued by the intermediary certifying the unavailability of the shares until the meeting (2 Ripert & Roblot, *supra* note 52, at 340-41). This identification can take place at the entrance to the meeting, but a corporation can also require that the certificates be filed earlier in order for the shareholder to exercise her voting right. Blockage is not full, however, since the shares can be sold off the exchange. Only delivery and opposability are deferred until the day after the meeting (Yves Guyon, in Baums & Wymeersch, *supra* note 50, at 98).

have a right to vote at the meeting.⁸⁸ This evolution was facilitated by the fact that bearer stock was strictly limited after 1981,⁸⁹ but especially by the fact that nominative and bearer shares were dematerialized about two decades ago.⁹⁰ The only materialization now consists of registration in an account with the issuer (for nominative shares) or with a financial intermediary (for bearer shares).⁹¹ This system has ended the anonymity of bearer shares, which in Belgium renders it so difficult to eliminate blockage efficiently.

Table 2: Scores on the Second Anti-director Right

| | LLSV score | Revised score* |
|---------|------------|----------------|
| U.S. | 1 | 1 |
| France | 0 | Now 1 |
| Belgium | 0 | 0 |

* This score is from the strict “indexer” point of view and cannot reflect all of the complexities noted above.

D. The Third Right: Cumulative Voting or Proportional Representation

The possibility of cumulative voting or proportional representation constitutes the third anti-director right. A country’s score here “equals one if the company law or commercial code allows shareholders to cast all their votes for one candidate standing for election to the board of directors (cumulative voting) or if the company law or commercial code allows a mechanism of proportional representation in the board by which minority interests may name a proportional number of directors to the board, and zero otherwise.”⁹² An investigation of this right in the three jurisdictions examined highlights the importance of including case law

⁸⁸ Upon the sale, she must notify the intermediary where the account is held. She must also provide the intermediary with all information necessary to cancel or adopt the number of votes if she has already requested an “admission card” or if she has already sent her vote by mail. Decree No. 67-236 Article 136 (as modified by the Loi 2003-706).

⁸⁹ Merle, *supra* note 38, at 309.

⁹⁰ Decree No. 83-359. In Belgium, dematerialized shares are a third and distinct category, *in addition to* bearer shares and registered shares.

⁹¹ Merle, *supra* note 38, at 278. See also ANSA, *Identification of Shareholders*, at http://www.ansa.asso.fr/site/acv_uk_2.asp# (last accessed September 7, 2004).

⁹² La Porta et al., *Law and Finance*, *supra* note 6, at 1122.

in comparative law research. A consideration of case law requires that the scores for France and Belgium be amended from zero to one. This section ends with some remarks on the impact of other rules.

Delaware law explicitly allows the charter to provide for cumulative voting.⁹³ Thus, a point is accorded as soon as the law enables the charter and/or bylaws to provide for this right. The French Commercial Code and the Belgian Companies Code do not explicitly allow the constitution to provide for cumulative voting. Hence, *Law and Finance* awards a point to the U.S. and no point to France and Belgium. Nevertheless, both rights can be validly provided for under Belgian law, and the same is true at least for proportional representation under French law. Since the description by LLSV of the criterion and its application to Delaware law makes clear that a score of one is given as soon as a company's constitutional documents allow for cumulative voting or proportional representation or both, France and Belgium should both receive a point.

It is true that the Belgian Companies Code does not explicitly permit cumulative voting and proportional representation. Nevertheless, case law and doctrine agree that the constitution can validly provide for cumulative voting and proportional representation.⁹⁴ Such a provision may not, of course, go against any provision of the Companies Code. Therefore, two conditions are generally set.⁹⁵ First, the shareholders' meeting must retain some freedom

⁹³ DGCL § 214. Proportional representation as a distinct mechanism does not seem an issue in jurisprudence and case law. The DGCL also remains silent on this point. One can assume it is allowed, but that does not change much for the analysis here.

⁹⁴ The Companies Code explicitly provides that the constitution can establish the rules governing the shareholders' meetings except where the Companies Code provides otherwise (Companies Code Article 63). This provision has been interpreted as follows. Cumulative voting rights and proportional representation concern the *manner* in which directors are elected and not the number of votes each shareholder has. In particular, cumulative voting affects the number of rounds in which the directors are elected, while proportional representation boils down to a distribution of the right to nominate (not to elect) directors. Bouckaert bases the validity of cumulative voting on other grounds. He argues that cumulative voting is a deviation from the majority decision, but that it is a lawful deviation: 1 Bouckaert, *supra* note 231, at 431.

⁹⁵ With regard to cumulative voting: Eric De Bie, *Het cumulatief stemrecht en de evenredige vertegenwoordiging van aandeelhouders in de raad van bestuur van een N.V.*, 1995 TRV 70-71; With regard to proportional

of choice in appointing directors. That is, there must be a choice between at least two directors per vacancy. Otherwise the method would violate the statutory power of the shareholders' meeting to appoint the directors.⁹⁶ Second, the mechanism may not impair "the spirit of cooperation between shareholders," which is deemed an essential characteristic of corporations. As for cumulative voting rights, they do not violate the one share one vote principle as laid down in the Companies Code,⁹⁷ since cumulative voting rights are obviously different from multiple voting rights. Hence, the zero score for Belgium is not warranted.

Similarly, the French statute mentions neither cumulative voting nor proportional representation.⁹⁸ Nevertheless, the validity of clauses of proportional representation⁹⁹ is generally admitted in French case law.¹⁰⁰ Case law commonly sets out two conditions that are similar to those under Belgian law.¹⁰¹ First, the clause must be in conformity with the social interest – the interest of the corporation. This does not usually pose a problem, since it is recognized that proportional representation can also indirectly benefit the corporation.¹⁰² The second requirement is that shareholders preserve their freedom of choice.¹⁰³ There should be at least two candidates for each position.¹⁰⁴ Given the rule that every director must also be a shareholder,¹⁰⁵ corporations with only a few shareholders are barred from proportional representation. A clause putting into effect proportional representation would render it

representation: Dirk Van Gerven, *De evenredige en onevenredige vertegenwoordiging van aandeelhouders in de raad van bestuur van een N.V.*, 1991 TBH 855-59.

⁹⁶ As laid down in Companies Code Article 518.

⁹⁷ Companies Code Article 541.

⁹⁸ It merely states that the directors are appointed by the shareholders' meeting: Commercial Code Article L. 225-18.

⁹⁹ These clauses are sometimes called "privilèges d'administration." Ledoux, *supra* note 64, at 340.

¹⁰⁰ It should be noted that case law from before the 1966 Loi can still be referred to, since the 1966 Loi and the codification of the Commercial Code did not change the developed theory.

¹⁰¹ Marie-Christine Monsallier, *L'aménagement contractuel du fonctionnement de la société anonyme* 60-71 & 73-75 (1998).

¹⁰² Conversely, an *over*representation of the minority may be problematic.

¹⁰³ This condition was explicitly stated in a 1937 Decree-Act, but the legislature inadvertently forgot to restate it during one of the corporate law reforms: 2 Ripert & Roblot, *supra* note 52, at 383.

¹⁰⁴ This is because the constitution and shareholders' agreements cannot deviate from mandatory statutory provisions and non-written principles of corporate law. One of those principles is that of the free vote. Monsallier, *supra* note 101, at 47-48.

¹⁰⁵ Commercial Code Article L. 225-25. This is not so in Delaware (DGCL § 141(b)).

impossible for shareholders to revoke the directors' mandate at will (*ad nutum*) and would therefore be void.¹⁰⁶ For firms with a limited number of shareholders, the LLSV score should indeed have been zero. Not so for listed firms that have enough shareholders to apply proportional representation.

Cumulative voting is not well-known in France. It is virtually not dealt with in case law or legal doctrine. Nonetheless, it appears that there is nothing that would make cumulative voting unlawful.¹⁰⁷ Even if it were unlawful, however, France would be entitled to a point on the third anti-director right, for it allows proportional representation.

Interestingly, this anti-director right presents an example of a case where a specific rule is provided by the statute in a common law country and is judge-and-scholar made in the civil law countries examined. It also shows that comparative research should include all relevant legal sources. Doing so yields the following amended scores:

Table 3: Scores on the Third Anti-director Right

| | LLSV score | Revised score |
|---------|------------|---------------|
| U.S. | 1 | 1 |
| France | 0 | 1 |
| Belgium | 0 | 1 |

The account above is written from the point of view of an indexer. However, several objections can be raised against the relevance of this anti-director right. First, in all three jurisdictions, cumulative voting and proportional representation only exist if they are authorized by the corporation's constitutional documents. In Delaware, this must even be done in the charter,¹⁰⁸ over which shareholders have less to say than over the bylaws. It is being debated whether cumulative voting should be mandatory for public companies, on the ground that a protective mechanism for the minority should not merely be permissible at the

¹⁰⁶ Commercial Code Article L. 225-18, al 2; Ledoux, *supra* note 64, at 342.

¹⁰⁷ Implicitly in 2 Ripert & Roblot, *supra* note 52, at 403-04.

¹⁰⁸ DGCL §214.

option of the controller(s).¹⁰⁹ Indeed, since cumulative voting is merely an option, it does not play a significant role in U.S. public corporations.¹¹⁰ It has also been argued that cumulative voting is an ambiguous right, as it ensures that directors who are either shareholders themselves or who hold proxy rights of other shareholders will be able to influence the outcome of board elections.¹¹¹

A second objection is related to a previous comment. Cumulative voting does not have much value where shareholders cannot easily nominate candidates, as in the US. It has been shown above that even under the provision of the pending SEC proposal, shareholder access to the company's ballot is severely restricted. Therefore, a company's charter should not just make provision for cumulative voting, but should also contain the necessary guarantees concerning the nomination of candidates. This point again touches upon those matters discussed under the heading of corporate law fundamentals in part II.

E. The Fourth Right: Oppressed Minorities Mechanism

Fourthly, the anti-director index contains a variable for the existence of an oppressed minorities mechanism. A point is given "if the company law or commercial code grants minority shareholders either a judicial venue to challenge the decisions of management or of the assembly or the right to step out of the company by requiring the company to purchase their shares when they object to certain fundamental changes, such as mergers, asset dispositions, and changes in the articles of incorporation. The variable equals zero otherwise. Minority shareholders are defined as those shareholders who own 10 percent of share capital

¹⁰⁹ Cox & Hazen, *supra* note 54, at 767.

¹¹⁰ Vagts, *supra* note 21.

¹¹¹ Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 Colum. L. Rev. 124, 142-60 (1994).

or less.”¹¹² Thus, there are two prongs to this anti-director right, the right of action and the right of appraisal, the presence of either of which is sufficient to confer a point. The U.S. was the only country of the three investigated to receive a point on this fourth anti-director right. Nevertheless, the following investigation makes clear that all three have similar features, together with mechanisms tailored to the environment in which they operate.

The first prong of the fourth anti-director right is thus the right of action. Procedurally, each of the three legal systems distinguishes between individual actions and actions by or on behalf of the corporation. Roughly speaking, in each jurisdiction the first category of suits is available to one or more stockholders who sustained a special injury that was not inflicted upon all stockholders or not in proportion to their stakes.¹¹³ All three jurisdictions allow shareholders to institute this action individually or to be represented as a group. Nonetheless, in France and Belgium this representation is limited to the classical mandate mechanism of contract law. Thus, shareholders need to *appoint* a representative. This mechanism is not as efficient as the class action in Delaware, where the chronological sequence is reversed. The initiative is taken by a (candidate) “class representative,” who asks the court to “certify the class” or, in other words, to state that she is representative of a class of harmed stockholders. If the court agrees, it orders notice to be given to the members of the class, who then decide whether or not to join the proceeding.¹¹⁴ The crucial difference with the French and the

¹¹² La Porta et al., *Law and Finance*, *supra* note 6, at 1122.

¹¹³ In the U.S., “special injury” has been defined in several ways. See *Lipton v. News International PLC*, 514 A.2d 1075, 1078 (Del. 1986); *Moran v. Household International, Inc.*, 490 A.2d 1059, 1070 (Del. Ch.); *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988). In France, it is required in addition that the injury was caused by a director and not by the corporation itself. See Merle, *supra* note 38, at 440.

¹¹⁴ Chancery Court Rule 23. The class representative must prove numerosity, commonality, typicality, and adequacy of representation. In addition, she must demonstrate that separate actions would entail a risk of inconsistency, or that the party opposing the class has acted or refused to act on grounds generally applicable to the class, or that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

Belgian system is that shareholders who did not take the initiative are *invited to join*.¹¹⁵ The most powerful incentive for the frequent use of this mechanism in the U.S. is probably the rewarding of meritorious claims combined with the possibility for lawyers to share in the proceeds through contingent fees. Although the occurrence of strike suits gives rise to much criticism, the frequent use of this mechanism may have a beneficial deterrence effect.¹¹⁶

The second category of actions, those by or on behalf of the corporation, can be instituted where a wrong has been inflicted upon the corporation or upon all shareholders in proportion to their stakes. At first sight, the basis for these claims seems very different in the U.S., on the one hand, and France and Belgium on the other. In the US, this is generally breach of a fiduciary duty towards the corporation, primarily the duty of loyalty. In France and Belgium, the basis is civil liability,¹¹⁷ which is considered in light of the directors' duty to act in the "interest of the corporation." Despite this structural difference, the outcome under both is essentially the same. The basic mechanism is procedurally similar in all three jurisdictions, but the practical implementation is different. In each country, either the corporation or its shareholders can institute this action. But each differs in what is understood by "the corporation" in this context. Under Delaware law, the directors act for the corporation in bringing the action.¹¹⁸ Under Belgian law, the shareholders' meeting brings the action.¹¹⁹ As shown in part II, this difference is significant. It is archetypal of the difference in

¹¹⁵ It should be noted that this invitation could not be organized as efficiently where bearer shares exist. See above in the explanation of the second anti-director right.

¹¹⁶ The lack of success of the derivative action in Belgium is often attributed to the fact that in the case of a successful claim, damages are awarded to the corporation, whereas in the case of dismissal, the plaintiff *can* be ordered to pay the costs of the proceedings and even damages to the directors. (Companies Code Article 567) This rule, however, is similar to the American sanction for frivolous action. The main reason seems to be that lawyers are prohibited from making the amount of their fees dependent on the proceeds of the client's claim.

¹¹⁷ The general provision for civil liability in both countries is Article 1382 of their respective Civil Codes. This is rendered applicable and supplemented by the Belgian Companies Code Article 527 to 530. In France, directors are subject to civil liability for facts that constitute criminal offenses, for violations of statutory or regulatory provisions or provisions in the company's constitution, and for bad management of the enterprise due to imprudence or negligence. (Commercial Code Article L. 225-251; 2 Ripert & Roblot, *supra* note 52, at 510).

¹¹⁸ DGCL §141(a) (pursuant to its general powers to manage the corporation).

¹¹⁹ Companies Code Article 561. Pursuant to the general rule of Companies Code Article 63, the meeting decides this with a simple majority.

fundamental choices between the corporate laws of Delaware, on the one hand, and of France and Belgium, on the other.

In each of the three jurisdictions investigated, the action can also be instituted by shareholders on behalf of the corporation. In the U.S., stockholders have to pass several procedural hurdles before the court will consider the substance of this derivative claim. These hurdles are essentially standing requirements, demand requirements, and after the proceedings have begun, the possibility of dismissal after a special litigation committee of disinterested directors has been set up. Whereas standing requirements refer to the quality of shareholder and the absence of conflicts of interests and do not usually pose any serious problem, the demand requirements can be a real impediment. Unless demand is excused, a stockholder must demand that the board initiate the claim. If the board refuses and its refusal survives a relaxed business judgment review, shareholders cannot sue derivatively.¹²⁰ The demand requirement does not exist and the stockholder can bring the action himself without demand where that would be “futile.” The test for demand futility is whether reasonable doubt exists that (1) the directors are disinterested and independent, or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.¹²¹ Once the proceeding is initiated, after the court has determined that demand is excused or that the board illegitimately refused to bring suit after demand was made, the board still has a tool to stop the proceeding called the “special litigation committee.” If this committee is independent and recommends in good faith that the litigation be dismissed, the court can apply its own business judgment and accept this decision.¹²²

¹²⁰ *Levine v. Smith*, 591 A.2d 194 (Del. 1991).

¹²¹ The court used the word “and” in *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984). Later cases made it clear, however, that the test is disjunctive. See *Levine v. Smith*, 591 A.2d 194 (Del. 1991) and *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988). In case of a “double derivative suit” only the first prong should be applied. See *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). In Delaware, making a demand entails a risk. It has been held that the making of a demand implies a concession that the board is independent and disinterested (*Speigel v. Buntrock*, 571 A.2d 767 (Del. 1990)). The rule has thus become one of “universal nondemand” (William T. Allen & Reinier Kraakman, *Commentaries and Cases on the Law of Business Organizations* 367 (2003)).

¹²² *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).

Demand and special litigation committees do not exist in France and Belgium, where a quantitative rather than a qualitative test is applied.¹²³ In France, there are three ways to bring a derivative suit.¹²⁴ As a general rule, shareholders bring the suit individually.¹²⁵ However, they can mandate one or some among them to represent them if they represent a percentage of the social capital ranging from 5 percent to .5 percent, depending on whether the corporation's capital exceeds certain thresholds.¹²⁶ Finally, the derivative action can be commenced by any association of shareholders that fulfills certain conditions.¹²⁷ In Belgium, only a minority of shareholders or an individual shareholder is entitled to introduce a derivative claim if they or she possess(es) shares that represent more than €1,250,000 of the company's capital¹²⁸ or more than 1 percent of the votes.¹²⁹ Contrary to what is the case in France,¹³⁰ under Belgian law shareholders who voted for a (valid) discharge are precluded from bringing this suit.¹³¹

To end the discussion of the first prong of the oppressed minorities mechanism here would be too hasty a comparative analysis. A derivative action challenges decisions and actions that cause harm for *all shareholders in proportion to their holdings*. This mechanism is important in a system such as the U.S., where the controller of the company is the board and does not own a large stake in the company. In France and Belgium, corporations are

¹²³ This is, of course, subject to the general rule of civil procedure that a plaintiff must have a legitimate interest in bringing the suit. Code of Civil Procedure Article 17 & 18.

¹²⁴ Commercial Code Article L. 225-253.

¹²⁵ Commercial Code Article L. 225-252.

¹²⁶ Commercial Code Article L. 225-252; Decree No. 67-236 Article 200 (as amended by art. 6 Decree No. 2002-803).

¹²⁷ Only shareholders whose shares have been registered for at least two years and who hold at least 5 percent of the voting rights are able to form associations in order to represent their interests within the company. Where the company's capital exceeds certain thresholds, the share of voting rights to be represented is reduced gradually until 1 percent. In order to exercise the rights to which shareholders' associations are entitled, they must have notified the company and the FMA of their legal status. A second condition is that the company's shares are admitted to trading on a regulated stock market.

¹²⁸ This may be voting or nonvoting stock. In the latter case, however, the claim can only concern matters in which nonvoting stock has a voting right on the basis of Companies Code Article 481.

¹²⁹ Companies Code Article 562, alinéas 1 & 2.

¹³⁰ 2 Ripert & Roblot, *supra* note 52, at 519.

¹³¹ Companies Code Article 562, alinea 3.

controlled by large shareholders.¹³² In this setting, harm obviously is not inflicted upon every shareholder in proportion to her stake. A majority shareholder who does not want to shoot himself in the feet will employ other mechanisms to obtain private benefits. Thus, the “oppressed minorities mechanism” needs to be different to address situations adequately where the majority shareholder abuses her influence. This could arguably be done by facilitating individual claims and class actions, but it may also be achieved through another mechanism.

Such a mechanism exists both in France and in Belgium in addition to the above-described individual and derivative claims. Only there is no single reference to it in the French Commercial Code and it is only partially codified in the Belgian Companies Code.¹³³ It is the courts that have developed a similar, indeed almost identical, theory of “abuse of majority power” in both countries – to be understood as abuse by stockholders of their power ensuing from a majority stake. The claim can be instituted by any person who has a personal and legitimate interest.¹³⁴ If she is successful, the court will nullify the abusive decision and/or award damages to be paid by the majority.¹³⁵

The definitions of abuse of majority power in both countries refer to decisions of the board or shareholders’ meeting where the major shareholder has used her influence in

¹³² Part II will expound on this crucial difference between the U.S. on the one hand and France and Belgium on the other hand.

¹³³ The French Commercial code stipulates that the nullity of a decision to modify the constitution can only result from an explicit statutory provision of Book II of the Commercial Code or from the statutes governing nullity of contracts (Commercial Code Article L. 235-1 al 1). Other acts or meetings can only be null and void if they violate a mandatory provision of Book II of the Commercial Code or of the statutes governing nullity of contracts (Commercial Code Article L. 235-1 al 2). There is no legal provision in Book II providing for nullity as a remedy specifically for minority shareholders in their relation with the majority or with management. The Belgian Companies Code provides for nullity of the decisions of the shareholders’ meeting not only in case of non-compliance with procedural requirements or lack of authority, but also for reason of “abuse of power” (Companies Code Article 64). This latter ground especially covers abuse of majority power (Bernard Tilleman, *De nietigheid van besluiten van de algemene vergadering: het nieuwe artikel 190bis Venn.W.*, 1994 T.B.H. 987, 997-98).

¹³⁴ Companies Code Article 178; Code of Civil Procedure Article 17 & 18.

¹³⁵ Merle, *supra* note 38, at 635. In Belgium, the remedy is in principle nullification of the decision of the board or assembly. If that is necessary to protect vested interests of good faith third parties, the court can decide that the assembly’s decision is not null and void towards them. In that case the court can grant damages to the claimant (Companies Code Article 180).

furtherance of other interests than those of the corporation.¹³⁶ In this assessment, courts apply a sort of business judgment rule. For there to be an abuse of majority power, there must be an unjustifiable breach of equality among shareholders or diversion of power in an illegitimate interest, and not merely poor management or pursuit of a policy that displeases the minority.¹³⁷ Frequent examples of abuse of majority power are tunneling and excessive director remuneration. Certainly, the notion of interest of the corporation leaves the courts substantial room for interpretation,¹³⁸ and their use of this liberty will determine whether or not the claim of abuse of majority power is a real protection for minority shareholders. The same holds true for the concept of fiduciary duties for which American corporate law is so well-known, and in fact for all legal provisions that do not prescribe clear-cut rules for every imaginable situation.

Based on the first prong of the oppressed minorities mechanism alone, all three countries should have received a point. As mentioned above, there is a second prong to the oppressed minorities mechanism, namely the right of a dissenting shareholder to receive “fair value” for her shares, called appraisal in the U.S. If one of the three investigated countries was not entitled to a point on the basis of the first prong, it could not really claim a point on the basis of the second prong, either.

¹³⁶ In France, the standard definition is that the decision can be shown to have been made “against the general interest of the corporation and with the unique intention of favoring the majority to the detriment of the minority” (*Société des Anciens Etablissements Piquard*, Com. April 18, 1961, Bull. III, No. 175, D. 1961, p 661). In Belgium, abuse of majority power is mostly defined as the situation where the board uses its competences or a majority employs its power in the shareholders’ meeting for private purposes outside the corporation rather than for the interests of the corporation (Jan Ronse, *Nietigheid van besluiten van organen van de naamloze vennootschap. Preadvies voor de Vereniging voor de vergelijkende studie van het recht van België en Nederland* 25 (1966)).

¹³⁷ For France: Merle, *supra* note 38, at 634; 2 Ripert & Roblot, *supra* note 52, at 337 & 369. The standard of scrutiny will be more stringent vis-à-vis board decisions, since the board’s power only serves the interests of the company. Conversely, shareholders’ voting rights have a mixed functionality: shareholders are allowed to take into account their private interest as well (Lucien Simont, *L’égalité des actionnaires de la société anonyme*, 1997 R.P.S. 235, 246-47). In both cases, the court’s intervention is limited to cases where the “range of reasonableness” has been exceeded.

¹³⁸ See Ledoux, *supra* note 64, at 171.

For the U.S., the appraisal remedy is well-known. However, because of its limitations, appraisal would not in itself warrant a score of one. As for charter amendments or sale of all assets, appraisal is merely permissive and thus exists only if provided for in the charter.¹³⁹ It is mandatory only for mergers, but the “market-out rule” in principle denies the remedy if the company is listed.¹⁴⁰ Therefore, appraisal is only relevant here in the exception to the market-out rule, namely when the consideration for target shareholders is anything other than stock in the surviving corporation, other stock in a listed company and/or cash in lieu of fractional shares.¹⁴¹ Nonetheless, even in these rather exceptional circumstances, “merging” corporations can avoid appraisal by structuring the transaction as a sale of assets in exchange for stock of the buying company.¹⁴² Although economically the consequences are identical to those of a formal merger, merger protections such as appraisal do not apply in this case.¹⁴³ Similarly, in Belgium the right to step out with appraisal exists upon proof of well-founded reasons,¹⁴⁴ but not for listed companies.¹⁴⁵ In France as well, the statute does not provide for an appraisal right.

Many other legal rules mitigate the absence of appraisal. In the U.S., for instance, appraisal has been held not to exclude claims that controlling shareholders owe a fiduciary duty to the public shareholders.¹⁴⁶ The court will then apply a “non-bifurcated test” of “fair dealing” and “fair price.”¹⁴⁷ Thus, in controlled mergers, such as freeze-out mergers, fiduciary duty claims can set off the shortcomings of the appraisal remedy. For France and Belgium, the

¹³⁹ DGCL § 262(c).

¹⁴⁰ DGCL § 262(b)(2).

¹⁴¹ DGCL § 262(b)(2).

¹⁴² Subsequently, the seller dissolves and distributes the buyer’s stock to its shareholders. Allen & Kraakman, *supra* note 121, at 459-60.

¹⁴³ Delaware courts do not accept the de facto merger doctrine put forward by dissenting shareholders. *Hariton v. Arco Electronics, Inc.*, 182 A.2d 22 (Del. Ch. 1962), *aff’d*, 188 A.2d 123 (Del. 1963).

¹⁴⁴ Stockholders do not have this right merely because they disagree with certain fundamental decisions.

¹⁴⁵ Companies Code Article 635.

¹⁴⁶ *Rabkin v. Phillip A. Hunt Chemical Corp.*, 498 A.2d 701 (Del. 1985); *Cede v. Technicolor, Inc.*, 684 A.2d 289 (Del. 1996).

¹⁴⁷ *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

theory of abuse of majority power and some other rules come into play. In the case of a merger, for instance, one of the parties often acquires a large stake before the actual merger takes place. In such cases, rules from the non-merger context may provide some relief.¹⁴⁸ If this block of stock (together with the stock already owned) confers control upon the acquirer, she must commit herself to buying shares offered by the remaining shareholders at the same price.¹⁴⁹ In this respect, shareholders have a limited exit right at an earlier stage than the merger. Another rule in France that is said to alleviate the absence of appraisal is the ability for shareholders to request the Financial Markets Authority (FMA) to order a 95+ percent shareholder to buy their minority stake. The FMA will assess the fairness of the price.¹⁵⁰ Likewise, in the cases of a sale of all or substantially all of the corporation's assets and changes in the articles of incorporation,¹⁵¹ appraisal will often be available on the basis of the FMA regulations.¹⁵²

All these considerations underscore the need for a consideration of all relevant legal provisions when engaging in comparative law. They also show once more how difficult it is to award scores. Although such scoring cannot perfectly reflect all of the above considerations, the most representative scoring would be the revised score in the table below.

¹⁴⁸ James A. Fanto in Arthur R. Pinto & Gustavo Visentini, *The Legal Basis of Corporate Governance in Publicly Held Corporations. A Comparative Approach* 32-34 (1998).

¹⁴⁹ For France: CMF regulation Article 5-4-1 & 5-4-2. For Belgium: Royal Decree of November 8, 1989, Article 41.

¹⁵⁰ Decree No. 88-603 Articles 5-5-1 to 5-5-6.

¹⁵¹ The latter category can be translated in the French system as some major changes in the *statuts*, since these also encompass bylaws.

¹⁵² Article 5-6-6 CMF Règlement Général, available at http://www.amf-france.org/styles/default/documents/general/5241_1.pdf (last accessed April 9, 2004). This will soon be available as an AMF regulation. These regulations provide that a controller must inform the FMA when she will propose some significant modifications of the constitution to an extraordinary shareholders' meeting or when they decide upon some major transactions, including disposition of the entirety or the main part of the assets. The FMA will evaluate the consequences for the shareholders and decide whether or not the controlling shareholder must repurchase the minority's shares.

Table 4: Scores on the Fourth Anti-director Right

| | LLSV score | Revised score |
|---------|------------|---------------|
| U.S. | 1 | 1 |
| France | 0 | 1 |
| Belgium | 0 | 1 |

F. The Fifth Right: Preemptive Rights

The fifth anti-director right is termed “preemptive rights.” In the original paper of 1996, this right was not yet included in the index. It “equals one when the company law or commercial code grants shareholders first opportunity to buy new issues of stock, and this right can be waived only by a shareholders’ vote; equals zero otherwise.”¹⁵³ In *Law and Finance*, France was the only one of the three jurisdictions investigated here to receive a point for this anti-director right. Again, the question arises whether the scores for these countries were correct.¹⁵⁴

Contrary to what was the case for cumulative voting or proportional representation, the law of a country must provide for, and not merely allow, preemptive rights in order to be accorded a point. That is why Delaware law scores a zero here. Preemptive rights only exist for those shareholders who have been expressly granted it in the company’s charter.¹⁵⁵

In contrast to Delaware, France does provide for preemptive rights. The Commercial Code explicitly grants shareholders the right to buy a proportional amount of the stock issued in a capital increase. Any clause contrary to the system of preemptive rights as described in the preceding paragraph will not be effective.¹⁵⁶ However, in accordance with the exception

¹⁵³ La Porta et al., *Law and Finance*, *supra* note 6, at 1123.

¹⁵⁴ In addition to the problem set out below with regard to the score of Belgium, a problem arises with regard to the score for Germany. See Berndt, *supra* note 22.

¹⁵⁵ DGCL § 102 (b)(3). Preemptive rights used to exist in US, but they disappeared over time (Allen & Kraakman, *supra* note 121, at 87, fn 20).

¹⁵⁶ Commercial Code Article L. 225-132 al 2.

provided for in the LLSV index, the shareholders' meeting can totally or in part waive the preemptive rights.¹⁵⁷ This can be done in favor of one or more specifically designated persons or without indicating such person(s). It should also be noted that the shareholders' meeting can delegate to the board the right to increase the capital up to a maximum sum and to exclude preemptive rights.¹⁵⁸ Needless to say, a right is not an obligation. This implies a second type of waiver: a shareholder can renounce her preemptive right individually.¹⁵⁹ Although this exception is not explicitly provided for in the LLSV method, it is no limitation of the protection resulting from preemptive rights and must, therefore, be assumed implicitly.

A translation issue arises with regard to the score for Belgium. Preemptive rights do exist, but only under another name: the literal translation is "preference right" (*voorkeurrecht, droit de préférence*). "Preemptive right" (*voorkooprecht, droit de préemption*) in the Belgian sense is an expression outside the context of the issue of new stock. It refers to the right of first refusal someone may have when a shareholder decides to sell her stock. This right, of course, only exists on the basis of an agreement with the selling shareholder or of a provision in the company's constitution. As regards "preference rights," the Companies Code provides that in a capital increase, the new shares that represent cash contributions must first be offered to the existing shareholders in proportion to their existing stake.¹⁶⁰ This is obviously what is covered by the fifth anti-director right.¹⁶¹

¹⁵⁷ Commercial Code Article L. 225-135.

¹⁵⁸ The latter requires a separate resolution and a special report of the "commissaire des comptes." This special resolution ensures that shareholders have consciously given their approval to the exclusion of preemptive rights. Commercial Code Article L. 225-129, III & L. 225-135.

¹⁵⁹ Commercial Code Article L. 225-132 al 4.

¹⁶⁰ Companies Code Article 592. The restriction to shares issued for cash consideration does not seem to be a reason for denying a score of one, since the same restriction exists in France, where a point was granted (Commercial Code Article L. 225-132 al 1-2). Non-cash contributions render preference rights burdensome to realize, if possible at all. The holders of shares without voting rights do have preference rights. If the capital is proportionally increased through shares with and shares without voting rights, then shareholders have a preference within their class of shares (Companies Code Article 592).

¹⁶¹ See section I.C. for the definition in *Law and Finance*, which makes it clear that the term is used as a synonym for "subscription privilege," defined in Black's Law as "a shareholder's privilege to purchase newly issued stock – before the shares are offered to the public – in an amount proportionate to the shareholder's holdings in order to prevent dilution of the shareholder's ownership interest." (Black's Law Dictionary 1197 (7th ed. 1999)).

The LLSV condition that a waiver be possible only with a shareholders' vote is also met. The Companies Code stipulates that the preference right cannot be restricted or waived in the constitution.¹⁶² This can only be done by the shareholders' meeting, acting with the same quorum and majority requirements as for amendments of the constitution¹⁶³ and only in the interest of the company.¹⁶⁴ In fact, this "waiver" could be translated better by "abolition." "Waiver" technically refers to an additional mechanism, available to every shareholder individually for her own preference right, as in France. Using this mechanism, the shareholders' meeting can decide unanimously immediately after the capital increase that it will not use its preference rights.¹⁶⁵

Table 5: Scores on the Fifth Anti-director Right

| | LLSV score | Revised score |
|---------|------------|---------------|
| U.S. | 0 | 0 |
| France | 1 | 1 |
| Belgium | 0 | 1 |

One could conclude from the above overview that civil law countries perform better on the preemptive rights criterion. Both Belgium and France provide for it, as do many other civil law countries.¹⁶⁶ The picture becomes less beautiful when the different economic background and corporate law fundamentals are considered. That is material for part II.

¹⁶² Companies Code Article 595.

¹⁶³ The company's constitution can authorize the board to increase capital up to a specified amount ("authorized capital"; *toegestaan kapitaal*; *capital autorisé*; Companies Code Article 603. The translation "authorized capital" may be misleading, since its use is subject to noticeably more restrictions than under Delaware law). In principle, the shareholders' meeting retains power over the decision whether or not to waive preferential rights. The board does not have this power unless its authorization to increase capital explicitly includes an authorization to waive preference rights (Companies Code Article 605). In the latter hypothesis, the above described provisions concerning board report and control report apply (Companies Code Article 603 al 3; 2 Bouckaert, *supra* note 231, at 591). A waiver in favor of one or more specific persons is only possible if the board is explicitly authorized by the constitution to do so (Companies Code Article 605).

¹⁶⁴ Companies Code Article 596. It also requires an elaborate report from the board and a control report by the statutory auditor, the auditor or an external accountant. Additional protective provisions apply if the preference rights are waived in favor of one or more specific persons. (Companies Code Article 598).

¹⁶⁵ 2 Bouckaert, *supra* note 231, at 606-07.

¹⁶⁶ e.g. Germany: AktG § 186.

*G. The Sixth Right: Percentage of Share Capital to Call an Extraordinary
Shareholders' Meeting*

Finally, the index looks at the “minimum percentage of ownership of share capital that entitles a shareholder to call for an extraordinary shareholders’ meeting.” A point is granted if that percentage is less than or equal to 10 percent.¹⁶⁷ In *Law and Finance* both the U.S. and France received a point. This section deals with the problems, even from the indexer point of view, that affect these scores. Criticism of the relevance of this last anti-director right is based on more fundamental considerations and will therefore be considered in part II.

It is surprising that the U.S. got a score of one on this anti-director right. The DGCL grants only the board of directors statutory power to convene an extraordinary meeting, though the charter or bylaws can authorize other persons to do this.¹⁶⁸ This finding led LLSV to the conclusion that Delaware law leaves the percentage up to the corporation and that one, therefore, must look at practice in other states.¹⁶⁹ The majority of other states and the RMBCA indeed provide for a threshold of 10 percent.¹⁷⁰ Hence the score of one.

In Delaware, however, companies’ charters or bylaws rarely entitle shareholders representing 10 percent or less of the stock to call an extraordinary meeting.¹⁷¹ In addition, there is a more essential problem with the reasoning behind the U.S. score: It would allow every country to receive a score of one on almost every right in the anti-director index. There are not many jurisdictions in which it is forbidden to lower a statutorily provided threshold. In Belgium for instance, there is no doubt that despite the statutorily stipulated threshold of 20

¹⁶⁷ La Porta et al., *Law and Finance*, *supra* note 6, at 1123.

¹⁶⁸ DGCL § 211 (d). The DGCL consistently uses the word “special meeting.”

¹⁶⁹ La Porta et al., *Law and Finance*, *supra* note 6, at 1128, fn. 6.

¹⁷⁰ RMBCA §7.02.

¹⁷¹ Mark J. Roe, *Corporate Law’s Limits*, 31 J. Leg. St. 233, 252, fn 28 (2002).

percent, the company's constitution can grant shareholders representing 10 percent of the stock to convene an extraordinary meeting. What is important is that Delaware law, just as Belgian law, allows corporations to *deny* shareholders representing 10 percent of the stock the ability to convene such a meeting, because it is not provided for in a mandatory statutory provision.¹⁷²

Again, another possibility comes into play that can radically reduce the need for shareholders' authority to convene a meeting: shareholder action by consent. Unless the charter provides otherwise, shareholders can take any action that normally should be taken at a meeting without a meeting if consents are signed by the holders of no fewer than the minimum number of votes that would be required for such action at a meeting.¹⁷³ Insurgents thus do not even need to call a meeting and can just solicit consents if the annual meeting is too far away.

The situation is ambiguous for France too, but in a different way. Although with reason LLSV awarded a point for the sixth anti-director right, one could make an equally strong argument the other way around. Indeed, shareholders in France do not have authority to convene a meeting themselves. They need to request the court to appoint a judicial representative who will then convene a meeting.¹⁷⁴ The court has discretionary power in deciding whether the nomination of a representative is in the social interest.¹⁷⁵ Therefore, shareholders can never be said to be able to "call" a meeting, no matter what percentage of the shares they represent. Clearly, much depends on how the court and the judicial representative exercise their powers. One could argue that the index is directed only to a fair use of the possible power to convene a meeting. If in those cases the courts systematically appoint a

¹⁷² See Michael Klausner & Jason Elfenbein in Baums & Wymeersch (eds.), *supra* note 50, at 355-56.

¹⁷³ DGCL § 228(a). This threshold may be higher than the 10 percent put forward by LLSV for the calling of a meeting, but after the calling of a meeting this threshold would be required for the decision itself and because of the general absence at shareholders meetings the explanation at the meeting itself would not change much anyway.

¹⁷⁴ Commercial Code Article L. 225-103, II, 2.

¹⁷⁵ 2 Ripert & Roblot, *supra* note 52, at 358.

representative, one should merely investigate what percentage of stock shareholders must represent in order to be able to introduce a request with the court. For France, the principles are as follows. In the event of an emergency, any interested party can apply. Otherwise, such an application can be made by one or more shareholders who together hold more than 5 percent¹⁷⁶ of the share capital, or by an association of shareholders¹⁷⁷ that fulfills certain conditions.¹⁷⁸ For special meetings,¹⁷⁹ shareholders applying for the appointment of a judicial representative must hold at least one tenth of the shares of the relevant class.¹⁸⁰ For none of these situations is the minimal amount of stock that must be represented above 10 percent. Therefore, an equally strong case can be made for a score of one.

Belgium was accorded zero, which in itself cannot be disputed, given the threshold of 20 percent and the fact that even then shareholders do not call the meeting themselves. The Companies Code only requires the board or the statutory auditor, if there is one, to convene a shareholders' meeting if one fifth of the shareholders makes a request for it.¹⁸¹ However, the board or the statutory auditor has no discretionary power. If they do not convene the shareholders' meeting within three weeks after the request, they are subject to criminal sanctions.¹⁸² In case of refusal, the court can appoint an ad hoc administrator, who will act for the board in convening the meeting. If this strict approach is also applied in countries like France,¹⁸³ there is no reason for denying them a point. Most likely however, some of those countries are "somewhere in between" a systematic admission of the shareholders' claim and a court review of the reasons for the claim and perhaps its compliance with certain formal or

¹⁷⁶ At the time the LLSV article was published (i.e. before the NER Act) it was 10 percent (art 158 al 2, 2° of the 1966 Act). Therefore, already at that time both arguments were valid.

¹⁷⁷ Commercial Code Article L. 225-103, II, 2.

¹⁷⁸ Commercial Code Article L. 225-120. See *supra* note 126.

¹⁷⁹ French corporate law makes a distinction between three types of shareholders' meetings. The "general ordinary meeting" and the "general extraordinary meeting" are covered by the 5 percent requirement. The 10 percent requirement applies to the third type, i.e. the "special meeting."

¹⁸⁰ Commercial Code Article L. 225-103, IV.

¹⁸¹ Companies Code Article 532.

¹⁸² Companies Code Article 647, 1°.

¹⁸³ For instance, the Netherlands also received a score of one despite the fact that court approval is required for calling the meeting.

substantive requirements. The difficulty of drawing a line renders a choice between zero and one necessarily inaccurate and somewhat discretionary. Once more, the interrelation and interdependence of even technical provisions is manifested. As will be shown in part II, fundamental provisions and economic background play an even weightier role.

Table 6: Scores on the Sixth Anti-director Right

| | LLSV score | Revised score |
|---------|------------|---------------|
| U.S. | 1 | 0 |
| France | 1 | ? |
| Belgium | 0 | 0 |

H. Conclusion

The above investigation shows that the difference between common law and civil law with regard to shareholder protection is not as straightforward as the numbers in *Law and Finance* suggest. The scores should be amended such that the U.S. and Belgium receive four points and France probably even five.¹⁸⁴ This conclusion confirms that the findings of Vagts and Berndt are not limited to Germany. For France and Belgium as well, the quality of investor protection has been seriously underestimated. That is a pity, given the large number of studies that draw upon the findings of *Law and Finance*. It is sometimes debated whether the complexity of law can be reduced to numbers. If one does so, there is one sacred tenet of comparative law that should not be violated. This is that a functional approach must be used, since the same goal may be obtained through another legal rule or through an extra-legal

¹⁸⁴ A closer investigation of the application to common law countries shows that the scores for this legal tradition are generally more representative.

phenomenon.¹⁸⁵ In itself, the anti-director index does leave some room for such an approach, and by using this approach this paper amends the scores as follows.

Table 7: Overview of the Scores on the Anti-director Index

| | France | | Belgium | |
|----------------------------|----------|--|----------|-----------------------------|
| | LLSV | Revised | LLSV | Revised |
| Proxy by Mail to Firm | 1 | 1 (but not protective) | 0 | 1 |
| Shares Not Blocked | 0 | Now Rather 1 | 0 | 0 |
| Cumul Voting / Prop Repres | 0 | 1 | 0 | 1 |
| Oppressed Min Mechanism | 0 | 1 | 0 | 1 |
| Preemptive Rights | 1 | 1 | 0 | 1 |
| % Extraordinary Meeting | 1 | 1 | 0 | 0 (but not less protective) |
| TOTAL | 3 | 4 or 5 at time of LLSV paper; 5 or 6 now | 0 | 4 |

Yet, even with the scores revised, the index does not reflect all the protective mechanisms that a legal system offers. The existence of a slight differentiation in a seemingly identical or similar mechanism, or even a different context gives an identical or similar rule a totally or slightly different meaning. “Cross-reference,” as it is called, is not always possible.¹⁸⁶ To quote Bradley: “We are tempted to think that we understand what the rules are in another legal culture because we think they are like our own, or we think we understand how they are different. But the reality is usually more complex than we could ever imagine [...] It is not enough to read the foreign rules, because even when the rules appear to be written in our own language they are not.”¹⁸⁷ A look at law in practice often produces a different

¹⁸⁵ Mathias M. Siems, *Numerical Comparative Law. Do we need statistical evidence in law in order to reduce complexity?*, Working paper European University Institute Florence (2004), available at <http://ssrn.com/abstract=514142> (last accessed September 1, 2004).

¹⁸⁶ William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case against Global Cross Reference*, 38 Colum. J. Transnat'l L. 213 (1999).

¹⁸⁷ Caroline Bradley, *Transatlantic Misunderstandings: Corporate Law and Societies*, 53 U. Miami L. Rev. 269, 314 (1999).

outcome than an analysis of the law on the books. Some of these complicating mechanisms have been described above. The more fundamental factors are dealt with below.

II. FUNDAMENTAL DIFFERENCES IN THE DISTRIBUTION OF POWERS

A. Introduction

In addition to the technical rules described in the previous part, there is one more factor that shapes the effect of the six anti-director rights in a particular country. This factor is the typical distribution of powers within a corporation. The difference in distribution of powers is a distinguishing characteristic between corporate law in the U.S. and in Continental Europe, one that is far more fundamental than investor protection.¹⁸⁸ Because it is of such great importance, parts II and III are dedicated to it. The distribution of power not only affects the bearing of anti-director rights in different jurisdictions, it also affects other legal provisions and economic realities. To use the different distribution of powers as a starting point in comparative corporate law is to open new perspectives. It leads to a better understanding of legal, economic and methodological factors, including factors that have so far been related to investor protection.

The difference in the distribution of powers among corporations has two facets. The first one has received ample attention in previous scholarship and will therefore be dealt with only briefly under section B. It is the difference between dispersed and concentrated ownership. More often than not unobserved is the second facet, namely the distribution of powers as it ensues from corporate law provisions.¹⁸⁹ This is the subject of section C.

¹⁸⁸ See *Investor Protection and Corporate Governance* (2000), P 24: “Using investor protection as the starting point appears to be a more fruitful way to describe differences in corporate governance regimes across countries than some of the more customary classifications such as bank- or market-centeredness.”

¹⁸⁹ The only publication where the distribution of legal powers has received full attention, although without coverage of all relevant aspects and only with respect to common law countries, is Bebchuk, *supra* note 23, at 8. The author formulates the independence of the distribution of legal powers from the economic allocation of

B. Economic Distribution of Power

It is well-known that in common law countries, ownership is commonly dispersed among many shareholders, whereas in civil law countries, it is mainly concentrated in the hands of a few shareholders. In the U.S. shareholders do not have large stakes. Also, voting blocks, consisting of several stockholders voting in concert, are small. The largest voting block typically represents between 5 and 9 percent of the stock, with the following blocks being insignificantly small.¹⁹⁰ Numerically, share ownership of the French S.A. is in fact less concentrated than is often assumed.¹⁹¹ This is due to the use of techniques to maintain control without owning majority stakes.¹⁹² When looking at voting blocks instead of direct shareholdings, one finds that the three largest voting blocks are about 20 percent, 6 percent and 3 percent respectively. The following blocks are negligible.¹⁹³ Similarly, in Belgium the possibility of pyramidal structures and other techniques to separate cash flow and voting rights makes it more interesting to look at voting blocks than at shareholdings. The largest voting block represents typically 56 percent. Remarkably, many of the following voting blocks are also considerable: about 5 percent for the second to the tenth largest voting block.¹⁹⁴ In terms of the amount of stock the largest shareholder owns, percentages are, of

powers as follows: “even with [dispersed ownership], introducing shareholder power to intervene would considerably change the balance of powers between management and shareholders.”

¹⁹⁰ Fabrizio Barca & Marco Becht (eds.), *The Control of Corporate Europe* 289 (2001). Other strong empirical research can be found in Mara Faccio & Larry H.P. Lang, *The ultimate ownership of Western European Corporations*, at <http://ssrn.com/abstract=286053> (last accessed April 9, 2004); Christoph Van der Elst, *Aandeelhouderschap van beursgenoteerde vennootschappen, Economisch-juridische analyse in België en Europa* (2001).

¹⁹¹ See Florencio Lopez-de-Silanes, Securities Laws and Enforcement for 49 countries (dataset for paper “What works in Securities Laws”), at http://iicg.som.yale.edu/data/datasets/securities_data.xls (last accessed February 12, 2004).

¹⁹² Fanto *supra* note 148, at 8-9.

¹⁹³ Barca & Becht, *supra* note 190, at 318.

¹⁹⁴ Barca & Becht, *supra* note 190, at 318.

course, lower. Where they do not exceed 50 percent, the term “majority” shareholder is not accurate, and therefore, the term “reference” shareholder is often used as a generic term.

These different ownership structures have often been identified as the cause of shareholders’ weak power in the U.S. and their stronger power in Continental Europe. The following section shows that ownership structure is definitely not the only cause, and probably not even the deepest cause, of differences in the degree of shareholder power. However, it remains an important fact, as it both affects the anti-director rights and is one aspect of the distribution of power, the other of which is dealt with in the next section.

C. Legal Distribution of Power

1. Introduction

The fundamental *legal* difference between the U.S. and the Continental European corporate law system is the way they distribute powers within a corporation. A first aspect is who gets to decide upon what, or the allocation of decision-making powers (subsection 2). A second aspect is who can initiate the proceeding that leads to decision-making (subsection 3). In both respects, the lion’s share of powers in the U.S. is in the hands of the board and management, whereas in Continental Europe, the shareholders hold the greater part. This discrepancy is buttressed by the enabling character of the DGCL and the mandatory character of most Continental European corporate legislation. Because of the DGCL’s enabling character, the board has a greater say over the relative distribution of powers in the U.S. than in Europe, where the allocation of powers is by and large statutorily fixed (subsection 4). This section will end with a salient example, namely the election and removal of directors (subsection 5).

It should be noted that not all of these differences can be generalized to a distinction between common law and civil law. For instance, with regard to the allocation of decision-making powers, including the dismissal of directors, the U.K. and Australia are closer to the civil law tradition. Regarding other points, such as the mandatory or enabling character of the distribution of powers, they rather fit with the U.S. configuration. Although the following discussion will sometimes refer to these jurisdictions, a systematic examination falls outside the scope of this paper.¹⁹⁵

2. The Allocation of Decision-making Power

The common law principle that the board is the holder of primary management power¹⁹⁶ is well embodied in the DGCL.¹⁹⁷ DGCL § 141(a) stipulates that “[t]he business and affairs of every [corporation] shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.” Although in some Continental European countries the default powers also reside with the board,¹⁹⁸ in general the opposite is the case: the shareholders’ meeting has all powers that are not by statute given to the board.¹⁹⁹ In both cases, the shareholders’ meeting generally has considerably broader powers than in the U.S. In the latter, shareholders’ substantive powers “are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and

¹⁹⁵ I discuss the separate situation of the U.K. and Australia in an unpublished paper entitled *Corporate Law Fundamentals: The Distribution of Legal Powers and its Consequences*. See also part III of this paper.

¹⁹⁶ *Automatic self-cleansing filter syndicate co., Ltd. v. Cunninghame*, 2 Ch. 34 (Eng. C.A. 1906).

¹⁹⁷ In practice, the board delegates much of its power to managers. That does not change anything to the validity of the hereafter presented theory. It is sufficient that the power appertains to directors and management (de facto with the managers dominating), but certainly not to the shareholders.

¹⁹⁸ These are Austria, Belgium, Italy, Ireland and Luxembourg.

¹⁹⁹ For instance France (Commercial Code Article L.225-98). APCIMS-EASD study, at <http://www.apcims.co.uk/public/publications/discussions/pdf/Shareholders%20Rights%20-%20Preface.pdf> (last accessed April 9, 2004).

voluntary dissolution.”²⁰⁰ Apart from the election of directors and amendment of the bylaws, all these decisions need approval by the board. Therefore, these two exceptions can be and are considered the most important powers of shareholders in a Delaware corporation. Startlingly, it is exactly with regard to these two powers that the discrepancy between the U.S. and Continental Europe is greatest. De facto, even the outcome of the board election is predetermined by the incumbent board.²⁰¹

For this part of the argument, the critical difference lies in the power to amend the company’s constitutional documents. Under Delaware law, charter provisions can be amended only upon the board’s proposition and with approval of the shareholders’ meeting.²⁰² As a result, the board has an effective veto over any provision in the charter. This power is far-reaching, given the wide range of issues that can be addressed in the charter, such as the rights and powers of stockholders, directors and officers,²⁰³ and the veto power it holds over the bylaws. Indeed, bylaw provisions may not be inconsistent with the provisions of the charter.²⁰⁴ In addition, the board has the authority to amend the bylaws if the charter so stipulates,²⁰⁵ which it mostly does.²⁰⁶ Shareholders have an inalienable right to amend the bylaws too,²⁰⁷ but the board is in a better position to do so because of the collective action problem shareholders face. Conversely, in Europe, charter and bylaws usually are one single document, and a shareholders’ vote is required for *any* change in any of its provisions.²⁰⁸ The board does not even need to *agree* with an amendment, let alone initiate the procedure leading

²⁰⁰ Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 *Transnat’l Law* 45, 48 (2002).

²⁰¹ See subsection C.5.

²⁰² DGCL § 242 (b)(1).

²⁰³ DGCL § 102.

²⁰⁴ DGCL § 109 (b).

²⁰⁵ DGCL § 109 (a) (after the corporation has received any payment for any of its stock).

²⁰⁶ 1-9 *Delaware Corporation Law and Practice* § 9.02.

²⁰⁷ DGCL § 109 (a) (after the corporation has received any payment for any of its stock).

²⁰⁸ For Belgium: Companies Code Article 558. For France: Commercial Code Article L. 225-96. The required percentage of favorable votes depends on the nature of the amendment, but is never below 50 percent (except in some extreme circumstances; see for instance for Belgium: Companies Code Article 535, al 3).

to the amendment, even when the amendment modifies a provision that would be a typical charter provision in the U.S.

Of course, a shareholders' meeting makes numerous decisions that do not concern charter or bylaw amendments or elections. The number of such decisions is larger in Continental Europe than in Delaware. As mentioned above, in Delaware, the remaining powers of the shareholders' meeting are votes on major structural changes, such as mergers and consolidations²⁰⁹ or sales, leases or exchanges of all or substantially all of the corporation's property and assets.²¹⁰ Stockholders in Europe not only vote on business combinations²¹¹ and sales of all or substantially all of the corporation's assets,²¹² they also vote on various other decisions, such as spin-offs and divisions,²¹³ the increase or decrease of the company's capital,²¹⁴ and the waiver of preemptive rights thereby.²¹⁵ A typical power of the shareholders' meeting in Europe is the approval of the dividend,²¹⁶ which in Delaware is the exclusive authority of the board.²¹⁷ As a consequence of their limited powers, stockholders in Delaware often use bylaw amendments as a means to have input in corporate decisions, a situation that has been labeled "a malfunction in the corporate mechanism."²¹⁸

²⁰⁹ DGCL § 251(c).

²¹⁰ DGCL § 271(a).

²¹¹ For Belgium: Companies Code Articles 699, 712 & 722. For France: Commercial Code Article L.236-9. For Germany: § 319 & § 320 AktG; § 65 & § 73 Reorganization Act.

²¹² For Belgium: Companies Code Article 761. For Germany: § 179a AktG.

²¹³ For Belgium: Companies Code Article 733. For France: Commercial Code Article L.236-9, rendered applicable by Article L.236-16. For Germany: § 65 & § 125 Reorganization Act.

²¹⁴ For Belgium: Companies Code Articles 581 & 612 respectively. For France: Commercial Code Articles L.225-129 & 225-204 respectively. For Germany: §§ 182, 192, 202, 207, 222, 229 & 237 AktG.

²¹⁵ For Belgium: Companies Code Article 596. For France: Commercial Code Article L.225-135. For Germany: § 186 AktG.

²¹⁶ For France: Commercial Code Article L. 232-11. For Germany: AktG § 174. For Belgium, the power is implicitly but incontrovertibly laid down in Companies Code Article 554.

²¹⁷ DGCL § 170.

²¹⁸ David C. Donald, *The Nomination of Directors under U.S. and German Law*, ILF Working Paper Series No. 21, at 11, at http://www.ilf-frankfurt.de/publications/ILF_WP_021.pdf (last accessed August 31, 2004).

3. The Allocation of Agenda-Setting Power

If a shareholder cannot raise an issue, her right to vote on that issue has less value. Therefore, one should consider not only the distribution of substantive powers, but also how much initiative shareholders can take to exercise these powers. Put differently, how easy or difficult is it for shareholders to have their proposals included in the company's proxy or to solicit proxies themselves? Or, in civil law countries, how smoothly can they put their proposals on the meeting's "agenda"?²¹⁹ This is an important question, since the proxy forms and the agenda are the only means in the respective legal traditions for informing other shareholders over which issues will be decided. Because of the success of proxy voting in the U.S., it is *de facto* the last moment on which a new issue can be put forward with a reasonable chance of obtaining enough votes. In civil law countries, it is even a rule *de iure* that except in some limited circumstances such as urgency, the shareholders' meeting cannot decide upon issues other than those included in the agenda of the meeting.²²⁰

Here again, a fundamental difference is visible between the U.S. and Continental Europe. In the U.S., running a proxy contest is so costly that it is used only in egregious cases where the contestant aims at taking control. Holders of at least \$2,000 in market value or of 1 percent of the company's securities for at least one year by the date the proposal is submitted are entitled to include certain proposals in the company's proxy materials under the town meeting rule.²²¹ However, the board has a broad variety of permissible grounds for excluding the proposals from the company's proxy materials. This includes cases where the proposal relates to the company's ordinary business operation or to an election of directors or where

²¹⁹ This part does not deal with the decisions for which the statute designs a specific procedure, such as for the above-mentioned structural changes.

²²⁰ For France: Commercial Code Article L. 225-105, alinea 3. In Belgium it is a generally accepted principle that is not explicitly in the statute (Bernard Tilleman, *De geldigheid van de algemene vergadering* 226-227 (1994)).

²²¹ SEC Rule 14a-8; 17 CFR 240.14a-8. Contrary to what is the case in Continental Europe, not only the proposal is then included, but also a brief supporting statement.

the proposal is improper under state law. In order to avoid the latter objection, the SEC recommends that shareholders frame their resolutions in a precatory form.²²² In that case, however, the board can, and routinely does, ignore the shareholder proposal, regardless of the percentage of shareholders who support it.

The situation is different in Continental Europe. When shareholders there convene a meeting or have a meeting convened, they generally set the agenda too. In Belgium, the board²²³ in such a case is obliged to set the proposed issues on the agenda.²²⁴ It is only in exceptional circumstances, such as a proposal that could harm the corporation, that the board can modify the shareholder proposal.²²⁵ In France, the situation is somewhat different. The agenda of an extraordinary meeting is set by the president of the commercial tribunal when designating the representative who will convene the meeting.²²⁶ However, stockholders in France can easily include a proposal in the agenda of a meeting convened by the board. Thus, for submitting a proposal to the shareholders' meeting, they do not even *have* to convene a meeting themselves. One or more shareholders representing a percentage of the share capital ranging from .5 percent to 5 percent, depending on the size of the company's capital,²²⁷ or an association of shareholders can demand the inclusion of draft resolutions in the agenda.²²⁸ The statutory schedule for the calling of a shareholders' meeting is actually designed to allow shareholders to have their draft resolutions entered in the meeting's agenda. After the board of directors or the managing board has published a "notice of meeting," the shareholders can submit additional draft resolutions and/or amendments to the management's resolutions.²²⁹

²²² Note to SEC Rule 14a-8(i)(1).

²²³ Sometimes, other bodies are competent, e.g. the statutory auditor or a liquidator.

²²⁴ This is important, since as a rule the shareholders' meeting can generally decide only over issues on the agenda (and unforeseen urgent matters). For Germany: §124 Abs 4 Akt.G.; for France: Commercial Code Article L. 225-105, al. 3 & Article L. 225-121. The Belgian Companies Code does not explicitly state the principle, but it is generally accepted; see Hellemans, *supra* note 57, at 399.

²²⁵ Hellemans, *supra* note 57, at 398-99.

²²⁶ Decree No. 67-236 Article 122, al 2.

²²⁷ Decree No. 67-236 Article 128.

²²⁸ Commercial Code Article L. 225-105. See *supra* note 126.

²²⁹ See also fn. 156.

These will be included in the final agenda as contained in the second notice, the “notice of call.” Thus, shareholder proposals are presented to shareholders to the same extent as the proposals from the board.²³⁰

In Belgium, it is assumed that shareholders who meet the ownership threshold for convening a meeting can also have items included in the agenda for a meeting called by the board.²³¹ The threshold is 20 percent of the company’s capital. Given the typical stock ownership structure of a Belgian corporation, this is not as high as it seems to be at first sight.²³²

4. Enabling versus Mandatory Approach as a Supporting Factor

The difference in the internal distribution of decision-making and agenda-setting powers is strongly supported by the difference between an enabling and a mandatory approach in the investigated countries’ corporations acts.²³³ Contrary to what is the case for the allocation of powers itself, this distinction correlates well with the division between common law and civil law. What is said about the U.S. in this section essentially also holds true for other common law countries. Roman Tomasic’s observation that in Australia “the distribution of decision-making power within the corporation is a contractual matter” aptly characterizes the enabling approach in common law jurisdictions in general. The Australian Corporations Act only requires a few decisions to be made by the general meeting of members and leaves the distribution of powers up to the corporation. Most companies follow the replaceable rule that confers on the board of directors all powers that have not been

²³⁰ ANSA, *Calling the Shareholders*, at http://www.ansa.asso.fr/site/acv_uk_3.asp (last accessed April 9, 2004). In practice, however, dissenting proposals are rare.

²³¹ E.g. – but carefully formulated – Eddy Wymeersch in Baums & Wymeersch, *supra* note 50, at 27.

²³² In Germany, shareholders must represent 5 percent of the share capital or a nominal amount of EUR 500,000: AktG § 124(1).

²³³ François & Delvoie, *supra* note 19, at 31-32 (noting the difference between enabling and mandatory law, but stressing its importance only with regard to investor protection rules).

attributed to the general meeting by the company's constitution.²³⁴ Tomasic concludes that “[w]hilst the law does not prescribe any general division of power within a corporation it does, however, have more to say about relations between the board and the general meeting once their respective powers have been specified by the corporate constitution.”²³⁵

A reading of the DGCL leaves no room for doubt about the proposition that the above also holds true for Delaware law. The DGCL explicitly mentions that the charter may contain “any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the shareholders.”²³⁶ Legislators in common law jurisdictions adopt a more flexible approach than those in civil law countries, and leave room for the reallocation of rights.²³⁷ This is the case not only for decisions that strictly concern the corporation itself, but also the removal of directors. The charter can provide that removal of directors from a classified board not be limited to cases where there is a cause.²³⁸

De facto, this means that in Delaware the legislator has left it up to the board to reduce its own authority, since it has an absolute veto power over charter amendments. The statute assigns most powers to the board and, in the terms of Richard Buxbaum, “any alternative provision is hostage to the consent of the board of directors to that alternative.”²³⁹ Not surprisingly, the result is that the board has in effect all powers that are not mandatorily attributed to the stockholders.

In contrast, Continental European countries' statutes mandatorily define the division of power between shareholders and directors. The company's constitution or even a

²³⁴ Corporations Act Section 198A.

²³⁵ Roman Tomasic et al, *Corporations Law in Australia* 263-64 (2nd ed. 2002); with reference to Corporations Act Section 140.

²³⁶ DGCL §102(b)(1).

²³⁷ Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. Pa. J. Int'l Econ. L. 791, 828 (2002). In Delaware, this situation was reached by the late 1920s. In the U.K., this liberalization occurred even earlier. It should be noted that federal securities law in the U.S. is mandatory.

²³⁸ DGCL §141(k).

²³⁹ Richard M. Buxbaum, *Facilitative and Mandatory Rules in the Corporations Law(s) of the United States*, 50 Am. J. Comp. L. 259, 257 (2002).

shareholders' resolution cannot assign to the board powers that are statutorily attributed to the shareholders' meeting, except in the few cases where the statute authorizes such a delegation.²⁴⁰ Thus, in civil law countries, the legislature deems it necessary to determine itself how powers should be allocated in a corporation. It has given most powers to the shareholders' meeting, with no possibility for the board to appropriate them.

5. Election and Removal of Directors as a Special Example

The weak power of shareholders in the U.S. is often justified by reference to a different type of decision-making power, namely the shareholders' authority to elect and remove directors.²⁴¹ Stockholders who do not agree with board and management, the argument traditionally goes, can replace the board with a new team. Nonetheless, it has become obvious not only that replacement is a very crude device for resolving disagreement on a particular action,²⁴² but also that shareholders really do not have much power to replace directors. Nevertheless, a comparison with Continental Europe shows that this weakness is still underestimated. Election and removal of directors is one of the best examples of shareholders' weakness in the U.S. compared to Continental Europe. This is so for the annual board election and even more so, though less often noticed, for removal during a director's term.

In the annual election of directors in the U.S., shareholders' powers of initiative are weaker than they already are under the general regime regarding shareholder proposals described above. As mentioned above, proposals relating to the election of directors appear in

²⁴⁰ Pistor et al., *supra* note 237, at 818-19; Berndt, *supra* note 22, at 11. For Belgium: Hellemans, *supra* note 57, at 555-611 (arguing that this is a "public order" rule, which is even stricter than a "mandatory" rule). For Germany § 23(5) AktG (the charter may deviate from the provisions of the AktG only if expressly allowed.).

²⁴¹ DGCL § 211(b).

²⁴² Bebchuk, *supra* note 189, at 18-23 (2004) (problem of bundling).

the list of proposals that the board is allowed to exclude from the company's proxy.²⁴³ Insurgent stockholders are thus obliged to solicit proxies themselves. This, however, is prohibitively costly for them. Under the "Froessel rule," incumbents are almost systematically reimbursed for their expenses, win or lose, whereas insurgents have to win in order to be reimbursed.²⁴⁴ The problem is made even worse by the collective-action problem shareholders face.²⁴⁵

Yet, proposing an alternative candidate at the yearly elections is extremely important, since mere abstention or a vote against a proposed candidate will not be sufficient to prevent her election. Indeed, in the absence of a different provision in the charter or the bylaws, directors are elected not by majority but by plurality.²⁴⁶ In the words of Joseph Grundfest, this means that if "a million shares count as a quorum, and if 999,999 ballots strike your name out and say no, you, as the director, owning only one share, and you vote for yourself, congratulations, you win. You have the plurality."²⁴⁷ Insurgent stockholders must therefore be prepared to bear the costs of the proxy contest. Theoretically, they could also nominate candidates at the meeting. This would be too late, however, since the vast majority of shareholder votes is normally already cast by proxy, on the basis of the proxy materials that are distributed before the meeting.²⁴⁸

As a result of these difficulties for insurgents, incumbents usually are re-elected, or to state the case more strongly, they re-elect themselves by the mere fact of proposing themselves.²⁴⁹ The recent SEC proposal to require companies to include shareholder

²⁴³ SEC Rule 14a-8 (17 CFR 240.14a-8).

²⁴⁴ *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E.2d 291 (N.Y. 1955).

²⁴⁵ Allen & Kraakman, *supra* note 121, at 182-85.

²⁴⁶ DGCL § 216 (3).

²⁴⁷ Lucian A. Bebchuk (ed.), *Symposium on Corporate Elections*, Harvard Law and Economics Discussion Paper No. 448, at 95, at <http://ssrn.com/abstract=471640> (last accessed August 31, 2004).

²⁴⁸ Donald, *supra* note 218, at 9-10.

²⁴⁹ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 311 (1999).

nominees in their proxy materials²⁵⁰ will certainly make shareholder participation in the proxy process more meaningful. Yet its impact will be seriously limited because of some important requirements. Most importantly, in order to gain access to the company's ballot, shareholders or groups of shareholders must satisfy a 5 percent ownership requirement for the previous two years. In the preceding year, a triggering event must have occurred, i.e., a majority vote in favor of a proposal to have shareholder access or a 35 percent vote to withhold support from one of the directors. If these requirements are met, one shareholder or a group with the largest two-year beneficial ownership at the time of delivery of the notice of nomination would have a limited access to the ballot. Limited, because the shareholder or shareholders would be allowed to nominate only very few directors²⁵¹ and would still have to bear their own campaign costs.

Although in Continental Europe, directors are generally not up for re-election every year, as in Delaware, shareholders can more easily elect their own candidates. They do so by application of the rules described above concerning the meeting's agenda.²⁵²

The story does not end with the annual election of the board. An effective weapon for stockholders is their ability to remove incumbents before they have served their entire term. Intuitively, one thinks here of takeover defenses. However, the main difference is probably the degree to which it is possible to remove directors without cause outside the takeover context. The biggest stick for a board that does not act according to the stockholders' wishes is the latter's power to remove the board without cause. Therefore, it is important to know how broad this power is.

²⁵⁰ Security Holder Director Nominations, Proposed Rule, October 23, 2003, at <http://www.sec.gov/rules/proposed/34-48626.pdf> (last accessed September 4, 2004).

²⁵¹ Only one nominee in a board of up to eight members, two nominees in a board of between nine and nineteen members, and three nominees in a board of twenty or more members.

²⁵² The agenda is typically very concise and does not include supporting statements, but that is the case for the board as well. Election before the end of the term is always paired with removal. Mention of this in the agenda indicates that insurgents have launched a proposal.

At common law, it was an absolute rule that directors could be removed only for cause.²⁵³ Today, Delaware law provides that outside the election at the end of directors' terms, shareholders can remove members of a classified board only for cause.²⁵⁴ As James Cox and Thomas Hazen note, "a director who is serving the corporation faithfully is privileged to continue in office until the end of the term despite the opposition of a majority of the shareholders."²⁵⁵ Even at the time of the election, shareholders' possibilities of replacing directors are seriously limited by the common practice of putting up only one third of the directors for re-election. Indeed, boards are staggered in the majority of corporations.²⁵⁶ Consequently, the only alternative is often a hostile bid, a proxy contest or a hybrid combination of both.²⁵⁷ It is well-known that Delaware law is fairly liberal in allowing takeover defenses. *Unocal* set out the general rule that such defenses must pass a two-prong test. First, the board must have had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed." Second, the measure "must be reasonable in relation to the threat posed."²⁵⁸ In *Paramount v. Time* it was held that such a threat can even consist of the possibility that shareholders elect to tender their stock to the bidder "in ignorance or mistaken belief,"²⁵⁹ which led several commentators to conclude that the board could "just say no."²⁶⁰ It is only when the company is put up for sale or breakup – in *Revlon* mode – that courts apply more stringent standards.²⁶¹ Also, the board may not deploy its power for inequitable purposes, even when legally possible,²⁶² or interfere with the

²⁵³ *Campbell v. Loew's Inc.*, 134 A.2d 852 (Del.Ch. 1957).

²⁵⁴ DGCL § 141(k).

²⁵⁵ Cox & Hazen, *supra* note 54, at 446-47.

²⁵⁶ Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, NBER Working Paper (2003), at <http://ssrn.com/abstract=476561> (last accessed May 1, 2004).

²⁵⁷ Allen & Kraakman, *supra* note 121, at 497-98.

²⁵⁸ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

²⁵⁹ *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1989).

²⁶⁰ Allen & Kraakman, *supra* note 121, at 530.

²⁶¹ *Revlon, Inc. v. Macandrews and Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1989).

²⁶² *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971).

effectiveness of the shareholders' franchise.²⁶³ Outside the context of an existing bid, the Delaware Supreme Court in *Moran v. Household* validated the poison pill and considered its adoption²⁶⁴ by the board to pass the *Unocal/Unitrin* test.²⁶⁵ Boards can adopt this pill without a shareholder vote and at any time, even after a hostile bid has been launched (the "shadow pill" or "morning after pill") if they do not already have one at that time.²⁶⁶ Thus, the company does not have to put a pill into place beforehand and can thus avoid the costs that a pill implies. Since at the time of *Moran v. Household* most companies had staggered their boards,²⁶⁷ this meant that boards could easily and safely protect themselves against hostile bids. The combination of an effective staggered board and a poison pill ensures that a hostile bidder has to wait a long time, namely two elections, before she can gain a majority of the board seats. In addition, she has to win those two elections. The most difficult problem here is that she has to keep her bid open during this entire period. As a consequence, the takeover threat is only nominal in these circumstances.²⁶⁸ In addition to these strong anti-takeover devices, there are some other impediments to running a proxy contest. Most importantly, as explained above, insurgents face the risk of bearing all costs of the procedure if they lose. Bebchuk recently concluded that "[a]lthough shareholder power to replace directors is supposed to be an important element of our corporate governance system, it is largely a myth."²⁶⁹

In conclusion, boards can safely rely on a variety of techniques and case law and do not have to retain a large participation in the company's equity in order to secure their

²⁶³ *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

²⁶⁴ According to the court, its use in response to an actual takeover bid must be judged separately.

²⁶⁵ *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985).

²⁶⁶ John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 Tex. L. Rev. 271 (2000).

²⁶⁷ Lucian Bebchuk, et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 Stan. L. Rev. 887, 887 (2002); recent shareholder attempts to de-stagger the board have not been very successful.

²⁶⁸ Bebchuk et al, *supra* note 267, at 887.

²⁶⁹ Lucian A. Bebchuk, *Designing a Shareholder Access Rule*, Discussion Paper No. 461 John M. Olin Center for Law, Economics, and Business 1, available at <http://ssrn.com/abstract=511882> (last accessed April 9, 2004).

position. Ironically, it is often said that because tender offers must be negotiated with the board, “devices that enable boards to protect small shareholders from large shareholders become devices that are used to protect boards (and management) from takeover bids.”²⁷⁰

In Continental European countries the law rarely provides as strong entrenchment opportunities against hostile takeovers as in the US.²⁷¹ More importantly however, shareholders’ right to remove directors has considerably more significance. Directors can generally be removed from office at will (*ad nutum*), which means at any time, at the mere discretion of the majority of the shareholders. Combined with the shareholders’ strong agenda-setting rights, this means that in Continental Europe, *a shareholder or group of shareholders can convene a meeting and then dismiss all directors by a mere majority vote.* Not surprisingly, staggered boards are almost unknown – because of directors’ revocability at will, staggering the board would not entrench it. The only hurdle is to get director removal on the agenda of the shareholders’ meeting. As explained above, the thresholds for doing this are not prohibitively high. In France, the shareholders’ assembly can revoke and replace directors or members of the *conseil de surveillance* even if that issue was not on the agenda.²⁷² This situation implies that a board that wants to lock up its seats must be able to rely continuously on the trust of a majority stockholder. To formulate it the other way around, only a majority shareholder can be sure that the directors she appointed will not be removed the next day. As a consequence, of all possible board compositions, only that which has the approval of the majority shareholder will produce a stable board.

With regard to anti-takeover techniques, Belgian corporations are very open to hostile takeovers by comparison with its neighboring countries. Because of statutory restrictions, poison pills are not a potent defense against a hostile bid. In principle, capital can only be

²⁷⁰ Barca & Becht, *supra* note 190 at 13.

²⁷¹ Entrenchment is *de facto* obtained by the large block of stock of the reference shareholder, not as a consequence of legal provisions. On the relationship between both, see part III.

²⁷² Commercial Code Article L. 225-105, alinea 3. This is one of the few departures from the general rule mentioned in section II.3.

increased by the shareholders' meeting.²⁷³ The board's maneuvering space to increase capital, if authorized to do so in the constitution, becomes much smaller than it already is once the company is notified by the Banking Finance and Insurance Commission that a public takeover bid has been made. In that case, the board can increase capital with 10 percent at most, and cannot exclude preemptive ("preference") rights.²⁷⁴ Obviously, these conditions cancel out much of the potential power of a poison pill. France is in about the same place as Belgium on the continuum from no to absolute entrenchment.²⁷⁵

III. A NEW PERSPECTIVE FOR COMPARATIVE CORPORATE LAW

A. Introduction

The amended scores in the anti-director index show that investor protection – at least as measured by the anti-director index – is not an effective way to distinguish between the U.S. and Continental European corporate legal systems. Part II has revealed a critical difference in the way powers are typically distributed within corporations. The impact of a country's typical distribution of corporate powers is sweeping and therefore needs to be given more attention. This is the task of part III. First, it shows how most of the anti-director rights take on a different dimension depending on the allocation of legal powers and the ownership structure (section B). Next, this part demonstrates that the distribution of powers explains to a large extent the observations that have been explained to date as a consequence of differences in investor protection as measured by the index.²⁷⁶ The argument of this paper is that the allocation of legal powers is fundamental to understanding many key economic differences

²⁷³ Companies Code Article 581.

²⁷⁴ Companies Code Article 604 & 607.

²⁷⁵ Two-tier regimes, such as the Netherlands and Germany, tend to provide for more entrenchment.

²⁷⁶ See the introduction for a list of studies that attributed some findings to differences in investor protection. I discuss the most important consequences systematically in an unpublished paper entitled "*Corporate Law Fundamentals: The Distribution of Legal Powers and its Consequences.*"

between the U.S. and Continental Europe, such as ownership structures, firm growth and firm size, the value of control, the success of stock options as an incentive mechanism, and the division between common law and civil law as far as corporate law is concerned (section C). Part III ends by situating the distribution of powers theory in the context of the underlying principles of a corporate law system (section D).

B. Consequences for the Anti-Director Rights

The difference in allocation of legal powers outlined above shed a new light on most of the anti-director rights.²⁷⁷ This is particularly so for the proxy mechanism, cumulative voting, the right of appraisal, the existence of preemptive rights, and the percentage that must be represented by the shareholders for them to be able to call a special meeting.

The stockholders' substantive powers and their agenda-setting rights deeply affect the relevance of the proxy mechanism. This mechanism may be an important device for management to gather the necessary quorum in a dispersed ownership structure, but shareholder meetings are not only about quorums but also about the actual vote. In that respect, the proxy mechanism may facilitate the *exercise* of a shareholder's voting right, but if the shareholder does not *have* a voting right in many matters, it loses much of its value. Accordingly, from the stockholder point of view the proxy mechanism has least value in the jurisdiction where it is best developed, namely the US, and would have most value in the countries where, although existent, it is used less frequently.

²⁷⁷ Although LLSV consider the divergence between diffuse and concentrated ownership to be a consequence of the presence or absence of anti-director rights – through legal origin, this divergence also influences the effect the anti-director rights have. The argument here is not that more shareholder power rules out the need for protection of small shareholders. In a concentrated ownership structure, shareholder(s) with a large stake can relatively independently exercise the powers that are assigned to the shareholders by statute. In extreme cases, the minority will depend on shareholder protection in the same way as dispersed stockholders in the U.S.

From the point of view of board and management, however, the proxy mechanism has most value in the U.S. legal framework. This becomes clear if one considers the extent of the stockholders' agenda-setting rights, which has an even more severe effect on the value of the proxy mechanism than the level of substantive rights. Where stockholders do not have much power of initiative, the proxy mechanism in fact works to their disadvantage. As explained above, stockholders in the U.S. are in a much weaker position than management to propose alternative candidates in a board election or to make other proposals. The proxy mechanism as it exists today, with management being reimbursed automatically and insurgents only when successful, renders it intolerably costly for insurgents to use the proxy machinery. Management thus has a huge and even decisive "competitive advantage."

That these characteristics are linked to the distribution of powers in Delaware corporations has been well described by William T. Allen, Jack B. Jacobs and Leo Strine: "The notion that stockholders should have the power to disrupt the functioning of the republic whenever they see fit is viewed as fundamentally inconsistent with the Delaware model of the corporation. (...) [T]he election of directors is the one area in which stockholders may act affirmatively." However, with reference to the Froessel Rule, the authors note that "[o]ne fundamental reality is that the annual election process is tilted heavily towards management and does not operate in a way that encourages genuine choice or debate."²⁷⁸

The lack of shareholders' agenda-setting power also affects the utility of cumulative voting. Cumulative voting makes sense only where stockholders have a real choice between candidates. If the only candidates are those proposed by the incumbents, shareholders will only be able to cumulate their votes in favor of one or more incumbents. This is not the only problem arising out of the legal rules with regard to board election. The staggered board is a

²⁷⁸ William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. Chi. L. Rev. 1067, 1094 (2002).

serious threat to the existence of any effect of cumulative voting. When the board is classified, fewer directors are put up for election every year. A minority will therefore need a larger stake in order to be able to appoint a director. Staggering the board has indeed been used as a way to hamper minority representation.²⁷⁹ On the other hand, the inefficiency of the cumulative voting mechanism is not a primary concern in a typical U.S. corporation. Where stockholdings are scattered, the votes are not dominated by one stockholder or group or stockholders anyway, and there is no other stockholder or group that would have enough votes to effectively appoint a director by voting cumulatively. The practical utility of cumulative voting exists where a few individuals or groups hold stakes that represent a substantial portion of the shares outstanding.²⁸⁰

The different distribution of legal powers can also be associated with the existence – or non-existence – of appraisal rights. Katharina Pistor et al. present this relationship as a choice between “voice” and “exit.” “Voice” here should be understood as the shareholders’ input in corporate decision-making. “Exit,” in contrast, refers to the right of dissenting shareholders to exit the company by selling their stake to the company at an “appraised” value.²⁸¹ The U.S. clearly opts for exit, while Continental Europe chooses to give shareholders voice. Indeed, appraisal was introduced in the U.S. when unanimity in the shareholders’ meeting was no longer required to approve a merger.²⁸²

A similar conclusion to that on cumulative voting holds concerning preemptive rights. Delaware fails on this part of the index because of the permissive approach of its Corporation

²⁷⁹ At least, this was the claim of the plaintiff in the following cases. The court concluded that the practice was not illegal under Michigan law and not in conflict with the Pennsylvania constitution, respectively. *McDonough v. Copeland Refrigeration Corp*, 277 F.Supp. 6 (E.D. Mich 1967); *Janney v. Philadelphia Transp. Co.*, 128 A.2d 76 (Pa. 1956).

²⁸⁰ Cox & Hazen, *supra* note 54 at 766.

²⁸¹ Pistor et al., *supra* note 237 at 830-831.

²⁸² Cox & Hazen, *supra* note 54 at 1367.

Law. However, against the background of diffuse stock ownership structures and an allocation of most substantive powers to the board, this right would not be as valuable as it is in Continental Europe. In a concentrated ownership structure as it typically exists in Continental Europe, preemptive rights prevent the reference shareholder from reinforcing her position by diluting the fairly large stakes of other shareholders. In a dispersed ownership structure, the size of the controllers' stake is small already. Why bother diluting shareholders who do not even have 1 percent of the company's stock? Yet, it is in a concentrated ownership structure that the majority required for the waiver of preemptive rights can be reached most easily. The "consent of the shareholders" often means nothing more than the consent of the reference shareholders and some others. Indeed, this right is often set aside.²⁸³

The divergent power allocation works in the same direction. In the US, preemptive rights do not have the same crucial role in capital increases as in Continental Europe, simply because the size of the board's equity stake is not as important. The board can undertake most actions without needing shareholder consent and therefore does not worry as much about the size of stockholders' stakes. Put differently, the board is not as heavily inclined to keep their stakes small by diluting them if they grow large. From the viewpoint of the shareholder whose stake is diluted, this is not unimportant, but it is still less of a disaster than in Continental Europe, since every single share does not carry as much voting power as in Continental Europe. Apart from the takeover scenario, the importance of preemptive rights would surface solely if a corporation could sell stock at a discount, which would probably be considered a breach of the directors' fiduciary duties. Accordingly, preemptive rights may not be as important in the U.S. as elsewhere.

²⁸³ For France: 2 Ripert & Roblot, *supra* note 52 at 622. For Germany: Vagts, *supra* note 21, at 600.

The last anti-director right, the ability to call a meeting for shareholders who together or individually represent 10 percent of the company's stock, is probably most deeply influenced by the difference in economic structure and legal fundamentals. First of all, under Delaware law the board can undertake more actions without formal shareholder consent. In Continental Europe, some of those actions necessitate consent in a shareholders' meeting. Thus, the board will more often itself take the initiative to call a meeting, or otherwise, it will have to deal with more issues at the annual meeting. Stockholders less often experience a need to call a meeting themselves.

Viewing the situation from the perspective of the directors and managers, one reaches the same conclusion. The convening of a meeting can have a more drastic impact in Continental Europe than in the U.S., so this right must be assigned with prudence. When shareholders convene a meeting, the board is obligated to include their proposals in the meeting's agenda. These proposals can relate to a much broader range of issues than in the US, since a shareholders' meeting can decide more issues in Continental Europe. Thus, once a meeting has been convened, the ball starts rolling and the board does not have control over its direction and endpoint.

In addition to the legal factor, namely the different impact of the shareholders' meeting, the economic factor also affects the threshold that should be set for calling a meeting. It is evident that in a dispersed ownership structure, it is more difficult to reach a 10 percent threshold than in a structure where the stakes are generally larger. As mentioned above, in Belgium the first ten voting blocks typically each represent more than 4 percent of the company's equity. In such circumstances, a 20 percent threshold may be easier to meet than is a 10 percent threshold where shareholders are diffuse.

C. The Relationship with Ownership Structures and Many Other Elements

The anti-director index is only one of many elements that are more intelligible in light of the theory of distribution of legal powers. The most important of this array of elements is the difference in stock ownership structures between the U.S. and Continental Europe. Indeed, there is a strong conceptual relationship between the allocation of legal powers in a country and the typical ownership structure of its companies. It is on this point that the benefits become clear of using the allocation of legal powers as a starting point rather than investor protection.

Consider the following scenario in order to explore the logical relationship going from the allocation of legal powers to ownership structures. A company always starts off with an entrepreneur, a group of entrepreneurs, or one or more entrepreneurs together with a venture capitalist. Since they have control over the company, they will hereafter be called “the original controllers.”²⁸⁴ If successful, the company at a certain point in time may need more additional capital than can be privately raised, or for other reasons the original controllers decide to go public. How public? Here is the big difference. In the U.S., where the balance of legal powers tilts towards the board, the original controllers can sell out virtually all equity without losing control. Once the original controllers have appointed themselves or their straw men as directors, they can take all decisions in the normal life of the corporation without needing the formal support of the shareholders’ meeting every now and then. The controllers also do not have to worry very much that shareholders will initiate a vote on and approve a dissident proposal. In addition, U.S. boards can safely entrench themselves. Thus, there is no compelling need for the original controllers to retain a large share of the company’s equity,

²⁸⁴ It does not make a difference for the following analysis whether all individuals have control together or only one or a few of them. The term “original controller” refers to those who effectively have control.

which is a costly thing to do.²⁸⁵ They can safely sell off stock or increase capital without subscribing to it themselves, and at the same time maintain control over the business.²⁸⁶ Of course, they may decide to transfer control to some specialized managers, but they will always *control where control is going*. They do not just let it go to the public at large and see who grabs it. Control over a company is too valuable for that to happen.

The same firm would be forced to act differently in a Continental European setting. Once the original controllers have decided to go public, they need to determine how much equity they will put up for sale to the public. Here again, the importance of the allocation of legal powers is evident. If they sell out their controlling stake, they will depend on the shareholders' benevolence even for some regular and frequently-occurring decisions. Obviously, this is not an appealing prospect. Directors and managers do not want to be bothered by meddlesome shareholders who do not know as much about the company's business as they do. They do not want to be dependent upon their permission for every action they undertake. What makes this prospect even worse is that those shareholders can at any moment decide to replace directors they dislike. Not surprisingly, many original controllers, horrified by this uncertain future, decide to retain a considerable part of the voting rights in order to avoid it.²⁸⁷ If they do not, another shareholder or group of shareholders can easily grab control over the company. The stable situation is thus one where the board is, or is trusted by, the holder(s) of the majority of the stock.

²⁸⁵ A large stake creates the risks associated with an undiversified portfolio, and renders it less worthwhile to divert firm profits. It also places a limit on the ability to increase capital, and hence debt financing, and hence firm growth.

²⁸⁶ Of course a determined shareholder could acquire a majority and replace the board, even though that process might take more than a year. Bebchuk et al. have shown that this hypothesis is highly unlikely (Bebchuk et al., *supra* note 267). Therefore, the high costs associated with holding a large stake do not weigh against the low probability of a successful proxy contest.

²⁸⁷ The higher some important voting requirements, the larger this stake must be. However, the fortified majority requirements generally apply to "extraordinary" situations, such as mergers and winding-up, for which a U.S. board would also need significant shareholder approval. Given the exceptional occurrence of these events, the founders will probably not take into account these higher thresholds in determining the stake that is to be retained.

The U.S. courts have well understood that entrenchment promotes dispersed ownership.²⁸⁸ In *Paramount v. QVC*²⁸⁹ for instance, the court held that incumbents are also in *Revlon* mode when a controlling shareholder will emerge in the surviving corporation. This was why the court did not want to protect the planned sale by merger, even though the facts of the case were otherwise very similar to those of *Paramount v. Time*.

Thus, the reaction of the original controllers to the existing allocation of legal powers pushes towards a specific ownership structure. It is their incentives that will determine ownership structure in the first place. In Continental Europe, the original controllers will not sell out enough stock for the ownership structure to become dispersed. The need to retain a large stake outweighs its costs.²⁹⁰ Potential investors do not even have a chance to buy a stake that imparts control. But stock does entitle them to voting on certain matters, and, as a consequence, the voting blocks other than that of the original controllers together are also significant.²⁹¹ In the U.S., outside investors do have the possibility to buy a large stake. However, it would not give them a say over anything but a theoretical input in the election of directors and the amendment of bylaws. It has been shown above, however, that even with a majority stake, this power is meaningless as long as one does not have sufficient seats on the board – also typically for the election of directors.²⁹² In short, ownership is determined by the *need for incumbents* to maintain control through voting rights within a given framework of legal powers rather than, as LLSV contend, by the *willingness of shareholders* to buy shares in a dispersed ownership structure.

²⁸⁸ Nicholas L. Georgakopoulos, *Corporate Defense Law for Dispersed Ownership*, 30 Hofstra L. Rev. 11, 39-41 & 47-49 (2001).

²⁸⁹ *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1993).

²⁹⁰ See *supra* note 288

²⁹¹ See the figures for France and Belgium in section II.B.

²⁹² With regard to the takeover context: Bebchuk et al, *supra* note 267 With regard to annual elections and removal during the term, see section II.C.5 of this paper.

Conceptually, the relationship between the distribution of legal powers and ownership structures could also go in the other direction. Once a concentrated ownership structure has come into existence, majority shareholders can lobby the legislator to enact provisions that will make the board dependent upon the stockholders.²⁹³ This way, a majority shareholder can not only appoint her straw men to the board, but she can also make sure that the directors will *remain* loyal to her. Conversely, the U.S. corporate setting would lead management to push for legislation in the direction of considerable directorial and managerial independence. This would explain not only the above-identified fundamental differences with Continental Europe, but it would also explain some technical rules. For instance, it has been shown above²⁹⁴ that the proxy mechanism is best developed in the U.S., where it puts management at an advantage. In contrast, a reference shareholder in a typical continental European corporation has every interest in keeping the proxy mechanism virtually unused. The reason is that the stake of the reference shareholder is often not large enough to push through a decision if all shareholders show up at the meeting. Since the majority or enhanced majority requirements hold within the shares represented at the meeting,²⁹⁵ it is in the reference shareholder's interest that not too many other and possibly dissenting shareholders attend the meeting. Consider an annual meeting where only 40 percent of the stock is represented. If the reference shareholder votes in favor of a proposal with a stake of 21 percent, the proposal has received a simple majority. In principle, enough shareholders should attend the meeting in order to meet quorum requirements. However, these quorum requirements are usually not dreadfully high, and if they are, it is in the advantage of the reference shareholder that they are not met, so that

²⁹³ See for Germany: Donald, *supra* note 218 (suggesting that majority shareholders pushed the legislator for more shareholder rights, although not arguing that this was with the purpose of making the board dependent).

²⁹⁴ See section III.B.

²⁹⁵ For France: Commercial Code Article L. 225-98 (simple majority of the represented shares in an ordinary meeting) and Article L. 225-96 (majority of two thirds of the represented shares in an extraordinary meeting). For Belgium: Companies Code Article 63 (simple majority of the represented shares by application of general rules of deliberation) and Article 558 (majority of three fourths of the represented shares in an extraordinary meeting).

a second meeting must be convened for which no quorum or a lower quorum is required.²⁹⁶ In that case, a reasonably small stake will be sufficient to approve a decision. Does there need to be more explanation of why a successful proxy mechanism is not on the wish list of a reference stockholder in Continental Europe?

The empirical correlation between the distribution of legal powers and ownership structures is obvious for the U.S. and Continental Europe. The situation is somewhat more complicated for the U.K. and Australia, which for several reasons should be considered a group separate from the U.S. in the field of corporate law.²⁹⁷ The causal relationship remains to be fully explored through a historical analysis, but the reflections above provide us with some indications. First, the principle that the board in the U.S. is the holder of primary management power goes back to old case law from the beginning of the twentieth century,²⁹⁸ while the distribution of legal powers in Continental Europe seems always to have gravitated toward giving more powers to the shareholders than in the U.S. Second, board entrenchment is often but incorrectly considered to be a recent evolution. This paper has shown that entrenchment against takeovers is not the only thing that matters. The question whether shareholders can remove directors without cause is even more important. Again, this is a point on which the U.S. and Continental Europe have differed for a long time. At common law, the impossibility for shareholders in the U.S. to remove directors without cause was even an absolute principle, though more recently, some exceptions have been made to this rule. In

²⁹⁶ For France: Commercial Code Article L. 225-98 (no quorum for the second convening of the ordinary meeting) and Article L. 225-96 (quorum of one fourth for the second convening of the extraordinary meeting). For Belgium: Companies Code Article 558 (no quorum for the second convening of the extraordinary meeting). Since there is no quorum requirement for the ordinary meeting in Belgium, the meeting does not need to be convened a second time.

²⁹⁷ The U.K. and Australia present several elements of the Continental European legal systems and a few elements of the U.S. legal system. The typical ownership structure in these countries is one of dispersion, although to a lesser extent than in the U.S. (Barca & Becht, *supra* note 190). In addition, legal provisions such as the mandatory bid hinder the concentration of ownership.

²⁹⁸ See *supra* note 196.

Continental Europe, the removal of directors at will by the shareholders is also a longstanding principle.

Presumably, the legislator started to distribute powers differently in the U.S. and in Continental Europe on the basis of some different underlying principles. The effects of technical legal rules further pushed ownership structures to develop in different ways on each side of the Atlantic.²⁹⁹ Subsequently, the controllers – to be understood as board and management in the U.S. and as the reference shareholder in Continental Europe – exercised their influence on the legislator to enact provisions that locked in their respective positions. This interplay between ownership structures and allocation of legal powers has caused the U.S. and Continental Europe to evolve further in different directions. To the extent that this different distribution of legal powers was not the exclusive cause, it was and remains at the very least a factor that keeps existing ownership structures in place. New companies are starting up in a given legal framework that now more than ever pushes them towards a given ownership structure. This account finally gives path dependence a concrete face.³⁰⁰

Recall the investor protection explanation for different ownership structures. LLSV find that countries with better anti-director rights “have a statistically significantly lower concentration of ownership.”³⁰¹ They identify two reasons why ownership in countries with poor investor protection, which encompasses both anti-director rights and creditor rights, would be more concentrated. First, shareholders would be willing to forego a stake that would

²⁹⁹ One example is the following. In 1934, the Belgian legislature made unlawful the so-called “mixed bank,” which engages in both banking and stock holding and selling. As a reaction, banks split up divested themselves of their securities business but brought both these in a holding company which also owned than “real” bank. (Koen Geens, *Corporate Governance: wat is mode en wat beklift?*, in *Knelpunten van dertig jaar vennootschapsrecht* 733, 744 (1998)) This did not happen in the U.S. despite a similar severance of the securities and banking lines of business one year earlier by the Glass-Steagall Act, after in 1956 the Bank Holding Company Act proscribed the affiliation of banks with any commercial firm, including holding structures. (Roe, *Strong Managers, Weak Owners*, *supra* note 4, at 98) Needless to say that such prohibition did not exist in Belgium. There, holding companies were also used to circumvent the no longer existing provision that nobody could exercise more than 20 percent of the existing votes.

³⁰⁰ Bebchuk & Roe, *supra* note 4 (rule-driven path dependence).

³⁰¹ La Porta et al., *Law and Finance*, *supra* note 6, at 1150.

impart significant control only if the law protects them sufficiently against expropriation. If such protection did not exist, they would discount that in the share price and/or need a majority shareholder to monitor the board and management. Second, poor protection of investors would make it feasible to expropriate on a substantial scale. Therefore, shareholders would want a larger stake in order to control management and avoid being expropriated.³⁰²

Without denying the importance of protecting investors, the above analysis shows the problem with this link between investor protection and ownership structures. It arises from LLSV's assumption that shares impart control, and hence the possibility of expropriating. This is indeed the case for Europe, but not for the United States. Part II has demonstrated that in a U.S. corporation, the original controller does not need to retain a majority stake in order to expropriate. Just as much as for well-intended decisions, board and management can act relatively independently from the shareholders when engaging in less well-intended activities. Conversely, in Continental Europe, this is difficult when the board and the majority shareholder(s) do not cooperate. Poor protection of investors will therefore reinforce the tendency for European corporations to concentrate ownership, but will not encourage such a process in the U.S. Shareholders worry about whether or not they are expropriated, not about whether this is done by a controlling shareholder or by an independent management.

The implications of the new insight into the distribution of powers do not end with a revision of the anti-director index and its alleged implications for ownership structures. The value of control, for instance, takes on a new dimension. It is no longer limited to the possibility of extracting private benefits of control, but also includes the ability to manage the corporation's affairs in an untroubled – and more efficient? – way. In order to achieve independence in Continental Europe, the board and management have to rely on a large share

³⁰² La Porta et al., *Law and Finance*, *supra* note 6, at 1145; La Porta et al., *supra* note 12, at 13.

of the stock. In the U.S., in contrast, a large stake is not necessary to run the company relatively independently. As a consequence, private benefits of control in the U.S. cannot be measured simply by looking at the price that buyers are prepared to pay for a majority stake. This would underestimate the value of control and could explain why many studies have found that private benefits of control are smaller in the U.S. In the U.S., it is the board positions that count.

Martin Lipton and Steven Rosenblum argue fiercely that the lower degree of intervention by shareholders could in some cases increase the efficiency of the management of the corporation.³⁰³ This may sometimes be the case, at least in companies with ideal managers. But the distribution of powers theory can explain firm growth in a way that does not fully depend on the quality of the manager. The need in Continental Europe to retain a majority stake seriously limits the ability of corporations to raise capital in the market, which is often the basis for additional debt financing.³⁰⁴ Along these lines, the distribution of legal powers could explain firm growth and firm size, factors that have often been associated with better legal protection of shareholders.³⁰⁵ These, in turn, reinforce the divergence in ownership structures. It requires a more substantial investment to hold a majority stake in a company that has a large amount of stock outstanding than in a typical European firm where the amount of stock is limited by the financial strength of the controllers. The need to retain control may also help us to understand why in Continental Europe stock markets are less developed in Continental Europe. First, it will prevent many companies from applying to the

³⁰³ Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea whose Time Has not Come*, 59 Bus. Law. 67 (2003).

³⁰⁴ Thorsten Beck et al., *Law and Firm's Access to Finance*, NBER Working Paper 10687 (2004), at <http://dsl.nber.org/papers/w10687.pdf> (last accessed September 2, 2004).

³⁰⁵ Krishna Kumar et al., *What determines firm size?*, NBER Working Paper 7208 (1999), at <http://www.nber.org/papers/w7208.v5.pdf> (last accessed September 6, 2004).

stock exchanges for listing.³⁰⁶ Second, the existence of majority stakes renders the stock of the company less liquid.

Of course, in a Continental European setting the participation of the controllers can be smaller where corporate law permits the issuance of stock without voting rights or with more voting rights. This may explain why concentration of share ownership (as opposed to voting blocks) is a little lower in the Netherlands, where shares can be “certificated,” i.e. divested of voting rights, and in France, where shares with double voting rights can be issued. Another phenomenon that could be related to the way powers are allocated in a legal system is the frequent use in the U.S. of stock options. This is so successful only because a rational director does not spontaneously hold much of the company’s stock. All of the above are suggestions that need more research. It would be an interesting undertaking to reassess many other aspects of corporate law in light of the allocation of legal powers in a given jurisdiction.

D. Underlying Principles

Before winding up, one should ponder what the distribution of powers uncovers about the more general principles of a country’s business environment, or how it fits into those principles. The reasoning in the following paragraphs starts from the unequal distribution of legal powers between stockholders, on the one hand, and the board and management on the other; subsequently broadens this viewpoint to consider the numerous relationships among all of the corporation’s constituents; and ends by suggesting a link with a difference in culture, or ideology, between the U.S. and Continental Europe.

The distribution of legal powers between the board and the shareholders in the U.S. tilts towards the board. Is this in contradiction with a common view among U.S. lawyers that

³⁰⁶ Indeed, in Continental Europe few companies are listed on stock markets. Barca & Becht, *supra* note 190, at 2.

their system is one of shareholder primacy? The answer depends on what exactly they mean by shareholder primacy. As Stephen Bainbridge points out, the term “shareholder primacy” is often misunderstood. He writes:

[t]he term shareholder primacy typically connotes two distinct principles: (1) The shareholder wealth maximization norm, pursuant to which directors are obliged to make a decision based solely on the basis of long-term shareholder gain. (...) (2) The principle of ultimate shareholder control. Although shareholders do not wield day-to-day authority, they purportedly exercise ultimate decision-making authority through proxy contests, institutional investor activism, shareholder litigation, and the market for corporate control.³⁰⁷

Shareholder primacy in the U.S. obviously refers to the first principle. Shareholder wealth maximization is a fundamental tenet of U.S. corporate governance, but this aim is to be pursued by the board, acting for the shareholders as a “sort of Platonic guardian.” Bainbridge rightfully believes that since the vast majority of corporate decisions are assigned to the board, the U.S. does not, in fact, follow a shareholder primacy model. Indeed, where a board has to maximize shareholder value but can act almost independently, one should rather speak of a board primacy, or more realistically, management primacy. As an example of a shareholder primacy model, Bainbridge names Slovenia, not coincidentally a Continental European country.³⁰⁸ Indeed, in Continental Europe the second principle definitely holds: control is in the hands of the shareholders.

³⁰⁷ Bainbridge, *supra* note 200, at 45-46.

³⁰⁸ Bainbridge, *supra* note 200; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, at <http://ssrn.com/abstract=300860> (last accessed September 5, 2004).

Shareholder primacy is not the only and highest norm in Continental European corporate law. It may seem that Continental Europe is here being associated with a proprietary point of view, according to which shareholders own the corporation and therefore retain fundamental decision-making power. That is not so. Such a claim would fail to explain why almost all Continental European legislation explicitly states that the “interests of the firm” is the central aim in the operation of a firm and does not restrict that aim to the pursuit of shareholder interests.³⁰⁹ It would ignore the existence of the codetermination system in Germany and of workers participation in the Netherlands. Also in France, Belgium, Italy and many other countries, employees do have a say, albeit the legal provisions for that are often to be found in labor law rather than in corporate law. Similarly, in Bainbridge’s example of a shareholder primacy model, Slovenia, a civil law country of German origin, labor happens to be involved in corporate decision-making.³¹⁰ Stakeholders thus have more input in a corporation’s decision-making than in the U.S. This difference recently became painfully acute in the derailment of the revision of the OECD principles of corporate governance earlier this year when, much against the will of the United States, France insisted on making employee participation “encouraged” rather than simply “permitted.”³¹¹

Then again, stakeholders’ input is not the highest principle of Continental European corporate law either. Europe’s peculiarity is not in the first instance that it is a stakeholder economy in contrast to the shareholder economy of the U.S., as is often reported. The U.S. cannot be contrasted with Continental Europe in terms of whether shareholders are the ultimate owners of the company versus only one of many factors of production, or

³⁰⁹ For France: Viénot Report p. 2; Fanto, *supra* note 148, at 48 & 52. For Germany (“Unternehmensinteresse”): Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, ECGI Law Working Paper No. 17/2003, 3 (2003), available at <http://papers.ssrn.com/abstract=473185> (last accessed April 9, 2004); Rolf Birk in Pinto & Visentini, *supra* note 192, at 67.

³¹⁰ Bainbridge, *supra* note 200, at 53-55.

³¹¹ *U.S. and France Apparently at Odds Over Labor Rights*, New York Times B-3 (March 27, 2004).

contractarianism versus communitarianism. This would be inconsistent with the finding of this paper that shareholders' authority is larger in Continental Europe than in the U.S.

What then is the ultimate distinguishing characteristic between corporate law in the U.S. and that in Continental Europe? It is how much interference the board and management must tolerate. In Continental Europe, both shareholders and stakeholders have considerable involvement in decision-making in the company. Put negatively, in its operation the board and the management can be bothered by almost anyone who has something at stake in the corporation. In the U.S., the board is more independent and must obtain shareholder approval only for the most vital decisions. "[T]he board of directors thus is not a mere agent of the shareholders, but rather is a *sui generis* body."³¹² Shareholders' input is basically limited to the election of directors, which is "the ideological underpinning upon which the legitimacy of directorial power rests."³¹³ By comparison with Continental Europe, the U.S. has a "managerial culture." Management (and the board) can focus on its duty of shareholder wealth maximization. It does not have to worry about shareholders and stakeholders except in extraordinary circumstances.³¹⁴ Managers are considered capable persons whose extraordinary skills must be rewarded handsomely. European managers can only dream of their high salaries.

A broadening of perspective on the essential difference in ideas on the role of the board and management, not only vis-à-vis shareholders, but also in relation to stakeholders in general, helps us to account for many aspects of corporate life. An example is the strong

³¹² Bainbridge, *supra* note 308.

³¹³ *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Not everyone agrees that this is sufficient. Bebchuk, for example, argues that directors should be more dependent on shareholders: Lucian A. Bebchuk, *Making Directors Accountable*, (November December 2003) Harvard Magazine 30.

³¹⁴ A clear surfacing of this attitude is the abolition in the U.S. of preemptive rights, where they are considered as a restraint on future financing of public companies. Cox & Hazen, *supra* note 54, at 1088.

correlation Mark Roe finds between employee rights and ownership concentration.³¹⁵ Where board and management are allowed to act independently and ownership is dispersed, not only will shareholders have little power, but employees will also have limited rights. Conversely, in a jurisdiction where the board is given considerably less deference, ownership will tend to be more concentrated and shareholders and employees will have more rights. A focus on the board's role in the corporation also accommodates Mahoney's theory that concentrated ownership arises where the state is interventionist.³¹⁶ There are many more such relationships, which unfortunately go beyond the scope of this paper. A focus on the different role of board and management in the U.S. and Continental Europe promises to open up many questions for further research and may even reach as far as differences in social theories.

CONCLUSION

This paper shows how important it is to study a broad array of sources of law and social and economic phenomena when practicing comparative law. It is a widespread assumption in the field of comparative corporate law that investor protection is of better quality in common law countries than in civil law countries. A meticulous study of the corporate laws of the United States, France and Belgium strongly suggests that if there is such a difference, it is much smaller than is often assumed. This finding jeopardizes the countless studies that assume a different degree of investor protection.

The study also argues that the fundamental difference in corporate law between the U.S. and Continental Europe lies in the typical distribution of powers within a corporation. In the U.S., the board, or better, management, has the necessary legal powers to run the corporation without many possibilities for other constituencies of the corporation to intervene.

³¹⁵ Roe, *Political Determinants*, *supra* note 4.

³¹⁶ Mahoney, *supra* note 4.

In Continental Europe, the law confers much more authority upon stockholders, in fact, so much more that the board cannot possibly ignore their point of view. A board that is determined to run the corporation independently and without unforeseen interventions by others must retain or act in concert with – which may be understood as being appointed by – a majority shareholder. The result – and partially also the cause – is that a concentrated ownership structure prevails in Continental Europe, whereas ownership is usually dispersed in the United States.

This difference in the way corporate law distributes the powers within a corporation has too often been neglected in legal and economic scholarship. Its influence reaches beyond the technical rules of investor protection. Revising received theories from this new angle therefore promises to yield many new insights. A number of aspects of corporate life that have troubled scholars would become more intelligible against the backdrop of the distribution of legal powers. This paper has suggested relationships between the allocation of legal powers and firm growth and firm size, stock market development, the value of control, the magnitude of executive pay, and the function of stock options.

In addition to laying new paths for further research, a comparison between the distribution of legal powers in U.S. and Continental European corporations would foster legal reform initiatives. Such initiatives in Europe often aim to reduce ownership concentration and to decrease the control of reference stockholders. This paper suggests how difficult it may be to accomplish these ambitions if shareholders continue to hold the lion's share of power in the corporation. The new insights of this paper could also lead to a more constructive contribution to recent projects in the U.S. The recent SEC proposal on Security Holder Director Nominations, the revised OECD Principles of Corporate Governance (2004), and Bebchuk in several articles are making or advocating cautious steps in the direction of empowering shareholders in the U.S. What they do not always stress sufficiently is how important this

empowering of shareholders is for success in involving them in corporate decision-making. A careful study of European law shows that there is still a long road ahead if shareholder activism is the new goal of corporate law reform in the U.S.