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New Frontiers in the Relationship Between National and European Courts

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Abstract

The central question pervading this discussion is simply stated: whether and to what extent the European Court of Justice ("Court of Justice" or "Court") (and the European institutions more generally) can count on the courts of the Member States to perform their judicial tasks in ways that are faithful to the ground rules of European Union ("EU") law, be those rules substantive or procedural in character. Looking back over the past five decades, I am struck by the succession of different forms this question of national court "fidelity" to Community law, for lack of a better term, has taken. (The quoted term is meant to evoke precisely the general duty of loyal cooperation *526 imposed on Member States under Article 10 of the current EC Treaty.) I would suggest that we have witnessed essentially three generations of such "fidelity challenges." In the early years, the fidelity challenge–or "infidelity risk," if you prefer–ran something like this: Will national courts accept and conform to the Grundnorms of European constitutional law, that is to say, the principles of supremacy and direct effect expounded by the Court of Justice? Or, to take a second example, will national courts genuinely make preliminary references to the Court of Justice in accordance with the criteria for the making of preliminary references that have been established in the Treaty and in the case law of the Court? Considering the indispensable role that preliminary references and preliminary rulings play in the development of EU law, the importance of these ground rules should not be underestimated.

THE EUROPEAN UNION'S SHAREHOLDER VOTING RIGHTS DIRECTIVE FROM AN AMERICAN PERSPECTIVE: SOME COMPARISONS AND OBSERVATIONS

*Arthur R. Pinto**

INTRODUCTION

The European Union ("EU") has recently celebrated its 50th anniversary. This Article is based upon my presentation in the Symposium celebrating the anniversary held at Fordham Law School and sponsored by the *Fordham International Law Journal.* The Article will look at how the European Union has recently approached company law issues (usually referred to as corporate law in the United States) and particularly shareholder voting rights through the recent EU directive on the exercise of certain rights of shareholders in listed companies ("Voting Rights Directive" or "Directive").[1] My focus is on company law with regard to the corporate governance of publicly traded corporations as opposed to closely-held corporations.

While there are many different forces that influence the development of company law, I will focus on three significant themes that influence the development of company law in the United States. Those influences are the role of ownership, the focus of company law, and federalism. These have also influenced the development of EU company law, but with differences. I will discuss the themes and compare how they have influenced the U.S. and EU's agenda on company law. I will then focus on the Voting Rights Directive as it compares to the United States and reflects on these themes.

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1. Council Directive No. 2007/36, O.J. L 184/17 (2007).

I. *SOURCES OF COMPANY LAW*

In looking at company law issues both in the United States and the EU, it is not always clear what law is company law as opposed to securities law.[2] There can be significant overlap in these areas of law. From the U.S. perspective, company law is usually viewed as the law which governs the intra-corporate relationships involving corporations and their officers, directors, and shareholders.[3] Thus, issues of formation, voting, fiduciary duty, structural changes, and allocation of corporate power and internal structures have traditionally been company law issues,[4] while securities laws involve issues related to securities offerings, disclosure and the sales and trading of securities.[5] In Europe, one sees a similar distinction between company law and securities laws.[6]

In the United States, company law can be the product of legislative enactments and court decisions usually from the state where the corporation was incorporated.[7] Securities law is created in a similar manner, but has been principally a federal concern.[8] In addition, the Securities and Exchange Commission

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2. For example, both involve important disclosure obligations. *See* Malone v. Brincat, 722 A.2d 5, 11-13 (Del. 1998) (discussing both state and federal disclosure requirements). There are also stock market rules that act like company law rules. For example, the stock exchange rules in the United States require a majority of independent directors for most publicly traded corporations. *See* N.Y. STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A.01 (2003).

3. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971); 18 AM. JUR. 2D CORPORATIONS § 15 (2008). Company law has also been found to involve "five core structural characteristics . . . : (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital." REINER R. KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 5 (2004).

4. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (1971).

5. *See generally* LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION (4th ed. 2006).

6. *See* Roberta S. Karmel, *Reform of Public Company Disclosure in Europe*, 26 U. PA. J. INT'L ECON. L. 379, 379-81 (2005).

7. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971). This incorporation theory in the United States, which applies the law of the state of incorporation, is based upon application of the internal affairs doctrine, which is a conflict of law principle. *See id.*; *see also* Arthur R. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.*, 29 WM. & MARY L. REV. 699, 743-46 (1988) (discussing the extent to which the commerce clause of the U.S. Constitution recognizes the internal affairs doctrine).

8. *See* Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2006); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78mm (2006).

("SEC"), an administrative agency created by Congress, plays a significant role in the creation of federal securities law through its rulemaking and its enforcement strategy.[9] In the EU, company law is usually seen as the product of the Member States,[10] while securities laws have evolved as primarily EU law.[11] The presence of the EU in the development of company law has principally been fostered through its directives, regulations, and recommendations.[12]

II. *COMPANY LAW THEMES*

The development of company law that is concerned with publicly traded corporations is complex,[13] but three significant themes have influenced that development: the role of ownership, the focus of company law and corporate governance, and federalism.

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9. *See generally* LOUIS LOSS ET AL., *supra* note 5, at 326-474.

10. While some European Union ("EU") Member States adopt the incorporation theory for application of company laws, some reject it and instead apply company law based upon the location of the headquarters (*siège*). *See* RICHARD M. BUXBAUM & KLAUS J. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE 226-28 (1988). The *siège* principle and the difficulty to reincorporate raises issues under European Union law and the freedom of establishment. *See generally* Andrea J. Gildea, *Uberseering: A European Company Passport*, 30 BROOK. J. INT'L L. 257 (2004). It also raises issues of whether there can be competition between Member States for incorporations creating a market for charters, like the United States. *See infra* note 74 and accompanying text.

11. *See* Karmel, *supra* note 6, at 380-81.

12. A directive is an order issued by the Commission to Member States requiring that they amend their national legislation to conform with the terms of the directive. A regulation, unlike a directive, has direct effect and is legally binding on the Member States. A recommendation has no binding force. *See* Consolidated Version of the Treaty Establishing the European Community art. 249, O.J. C 321 E/37, at 153 (2006) [hereinafter EC Treaty]. For a description of the roles of the European Commission ("EC"), the Council of Ministers, the European Parliament, the European Council, and the European Court of Justice in the EU law-making process, see Nicholas P. Zalany, *The European Union Constitution and its Effects on Federalism in the EU*, 66 OHIO ST. L.J. 615, 628-39 (2005). The European Court of Justice ("ECJ") also plays a role in the development of company law through its interpretation of treaties and directives. *See infra* note 67 and accompanying text.

13. Recent changes and reforms in company law reflect the influence of globalization. For example, financial scandals, increased globalization of investors, financial markets and information, and competition tends to foster convergence in standards and goals. *See generally* Arthur R. Pinto, *Globalization and the Study of Comparative Corporate Governance*, 23 WIS. INT'L L.J. 477 (2005) [hereinafter *Pinto globalization*]. In addition, there is a need to provide shareholder protection to attract capital, enhance competitiveness, and strengthen capital markets. *See generally* ORG. FOR ECON. CO-OPERATION AND DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004), http://www.oecd.org/dataoecd/32/18/31557724.pdf [hereinafter OECD PRINCIPLES].

A. *Share Ownership*

Share ownership is a significant influence on the development of company law concerning publicly traded corporations in the United States and the EU. There are three particular aspects of share ownership that can play a role: the type of share ownership, the increased role of large institutional investors, and the political significance of share ownership.[14]

1. Type of Ownership

In looking at most publicly traded corporations in the United States and Continental Europe, we see two ownership models have emerged as the dominant model in each. The U.S. model has widely dispersed ownership where no shareholder or groups of shareholders own a significant percentage of shares.[15]

14. Another ownership difference between the United States and Europe is state ownership of corporations in Europe, particularly in some significant industries. Government ownership of corporations in the United States has not been a significant issue. *See* Patrick R. Hugg, *Transnational Convergence: European Union and American Federalism*, 32 CORNELL INT'L L.J. 43, 100-01 (1998). Transportation, banking, utilities, and other significant industries have been owned privately. The lack of government ownership clearly reflects a political and philosophical ideology that has a long history in the United States. Thus, U.S. corporate law does not focus on issues raised by such government ownership. The financial crisis of 2008 has resulted in the need for government funding of some financial institutions. Some of the funding will be equity (primarily preferred stock). Because of the high compensation paid to a number of executives of these institutions including large severance packages and public outrage, when Congress enacted the Emergency Economic Stablilization Act of 2008 to assist these institutions it mandated limits on executive compensation for those institutions that participate in the funding. *See* Phred Dvorak & Joann Lublin, *Bailout's Bid to Limit Executive Pay Will be Tough to Realize*, WALL ST. J., Oct. 6, 2008, at B5. In Europe, state ownership of some industries has been more significant. While such ownership has clearly lessened through privatization, there is still some direct and indirect presence in corporate governance. The direct is through ownership and even board representation, while the indirect is through the influence the State has tried to use in corporate governance issues. *See* James A. Fanto, *The Transformation of French Corporate Governance and United States Institutional Investors*, 21 BROOK. J. INT'L L. 1, 57-58 (1995) (discussing French privatization and the use of golden shares owned by the government to potentially veto a takeover). Even where there is no ownership, the State can try to influence corporate decisions through regulation or influence. *See* Floyd Norris, *France Backs the Merger of Two Drug Companies*, N.Y. TIMES, Jan. 27, 2004, at C2 (describing the role of the French government to encourage a takeover opposed by a French company in order to create a large a French pharmaceutical giant). The EU is also concerned over improper Member State aid to industry as violating the Treaty. *See generally* Anastasia Tsakatoura, State Aids in the EU Banking Industry (June 22, 2002), http://www.inter-lawyer.com/lex-e-scripta/articles/eu-banking-state-aid.htm.

15. The U.S. model is more complex. There are significant publicly traded corporations in which there is a control group and the public are mere minority sharehold-

This model was the subject of the famous study by Professors Berle and Means who described in the United States that in many of the large number of publicly traded corporations there was a separation of ownership from control. That was because the public shareholders may collectively own a majority of shares but their widely dispersed holdings meant that as owners they did not in fact exercise control, leaving the company managers to do so ("Berle Means corporations").[16] The European model has traditionally been seen as having more concentrated ownership where there are groups of shareholders such as families, corporate groups, or financial institutions owning significant percentages of shares.[17] Thus unlike in the United States, in Europe the majority or controlling ownership is usually concen-

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ers. They range from traditional family-owned businesses (such as major newspapers like the New York Times and Washington Post) to technology companies (such as Microsoft and Google) where control remains in the original owners. It may be more accurate to describe the American publicly traded corporation as a mixture of both dispersed and concentrated owners. *See* Ronald C. Anderson & David M. Reeb, *Founding-Family Ownership and Firm Performance: Evidence from the S&P 500*, 58 J. FIN. 1301, 1301 (2003) (identifying significant family ownership and presence in about one-third of the S&P 500 firms); Ronald C. Anderson, Augustine Duru & David M. Reeb, Founders, Heirs, and Corporate Opacity in the U.S. (Aug. 14, 2008) (unpublished manuscript, on file with the Journal of Financial Economics), *available at* http://ssrn.com/abstract=1142346 (identifying, in 2000 largest industrial U.S. firms, founder and heir ownership in twenty-two and twenty-five percent of these firms, respectively).

16. *See generally* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932). This landmark study greatly influenced the development of both securities and corporate law. It observed that many large, publicly traded corporations had evolved from concentrated and often family ownership to widely dispersed ownership where there was no large shareholder presence in order to raise large amounts of capital. Usually ownership equates with control, but in publicly traded corporations, the lack of concentrated shareholder ownership meant that the managers of a corporation had actual control, because dispersed shareholders were rationally apathetic. This separation of ownership from control was considered beneficial because of the diversification effects of dispersed ownership and the specialization of managerial expertise in running the business. The negative aspect of separation of ownership from control was the concern that managers may not always serve the interests of the dispersed owners who were usually beyond their control. Berle and Means demonstrated that economics drives law, ownership patterns matter from a policy point of view, and that dispersed ownership would evolve.

17. *See generally* Marco Becht & Ailsa Röell, *Blockholdings in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1999). Privatizations of formerly state-owned companies has contributed to more share ownership by the public shareholders in Europe. While there are many factors that have lead to these privatizations, the EU has played both a significant role through liberalization of competition and the creation of the Economic and Monetary Union, which encouraged governments to sell state assets and stakes in industrial companies in order to meet criteria for membership. *See generally* Roberto Pedersini, European Indus. Relations Observatory On-line, Privatisation

trated and, while the publicly traded shareholdings are also dispersed, they are often in the minority.[18] Thus the concentrated shareholders exercise control.[19]

This difference has influenced the development of both company law and securities regulation in the United States and EU.[20] For example, widely dispersed ownership allows for the market for corporate control and takeovers to develop. In the United States, both company law and federal securities laws developed to respond to this market years ago. For example, the passage of the Williams Act in 1968,[21] which amended the Securities and Exchange Act of 1934, was designed to protect the shareholders of target companies with disclosure and a variety of procedural and substantive safeguards.[22] In Europe, this market developed later and the EU, after many years of trying, finally passed a Takeover Directive.[23] But in comparing the regulatory approaches of the United States and the EU, the type of ownership has had an influence. For example, under EU law, unlike U.S. law, there is a mandatory bid requirement upon the purchase of a certain percentage of shares, which insures that all shareholders can opt to be bought out from the company. Gen-

and Industrial Relations (Dec. 28, 1999), http://www.eurofound.europa.eu/eiro/1999/12/study/tn9912201s.htm.

18. Scholars of comparative corporate governance have tried to examine the reasons why different corporate systems have developed, and significant theoretical and empirical work has been designed to explain the outcome of dispersed and concentrated ownership. A number of different theories have tried to explain the reasons for the different ownership patterns, concluding that dispersed ownership has advantages over concentrated ownership. These theories can be broadly described as law matters, history and politics matters, significance of interests groups, or deep causation matters. *See Pinto globalization*, *supra* note 13, at 491-96.

19. Much of the scholarship on corporate governance of publicly traded corporations in the United States and other countries has focused on agency cost issues. In the United States, the primary concerns center around issues of mismanagement and self-dealing by those who manage the business, and the harm to public shareholders. In countries with concentrated ownership, the focus is usually on self-dealing of the controlling shareholders to the disadvantage of the public minority shareholders. *See Pinto globalization*, *supra* note 13, at 483 n.22.

20. *See id.* at 491-92 ("A widely dispersed ownership model usually relies more on market financing while concentrated ownership looks more to private financing.").

21. Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2008)).

22. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 35 (1977) ("The legislative history thus shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer.").

23. Council Directive No. 2004/25, O.J. L 142/12 (2004).

erally under U.S. law partial bids are permissible. This difference reflects the need to protect minority shareholders in controlled corporations in the EU.[24]

2. Institutional Shareholders

U.S. shareholders in a Berle Means corporation have been described as passive and subject to a collective action problem. They are viewed as rationally apathetic given the costs associated with taking action to protect their interests. Further, even if the benefits of acting outweigh the costs, rational shareholders would prefer to free ride on others acting on their behalf.[25] But public share ownership in both the United States[26] and Continental Europe[27] has been evolving so that large institutional investors are more significant shareholders in both systems. Because of their size and large number of shares they often own, some of these investors are sometime more willing to take a more active role in corporate governance issues.[28] In both the

24. *See* Paul L. Davies, *The Notion of Equality in European Takeover Regulation, in* TAKEOVERS IN ENGLISH AND GERMAN LAW 9, 20-22 (Jennifer Payne ed., 2002); Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171, 191-93 (2006).

25. *See* ROBERT CLARK, CORPORATE LAW, 390-96 (1986).

26. Both the United Kingdom and the United States have widely dispersed ownership with the presence of large institutional investors who are influential yet without total control of the corporation. *See* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 331 (2004); *see also* Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2007-24 (1994) (discussing Britain's long history of institutional investors in its market). In the United States the increased ownership by institutional investors was a later development. Whereas 1950, 91% of shares were held by households, in 1996, the figure was approximately 48%. *See* N.Y. STOCK EXCHANGE, FACT BOOK 1996 DATA 59 (1997). U.S. institutional investors as a whole have increased their share of U.S. equity markets from 51.4% of total U.S. equities in the year 2000, to 61.2% of total U.S. equities in 2005. *See* Press Release, The Conference Board, U.S. Institutional Investors Continue to Boost Ownership of U.S. Corporations (Jan. 22, 2007), http://www.conference-board.org/utilities/pressDetail.cfm?press_ID=3046. Given the rise of institutional investing, it is more accurate to say that shares of "Berle-Means corporations" (corporations where majority of shares are owned by public shareholders in widely dispersed holdings, thereby leaving company managers to exercise corporate control) are now often owned in large numbers by these institutions giving them a larger presence then individuals, although not concentrated enough to actually control the corporations.

27. Europe has seen a rise of institutional ownership. *See* IRENE LYNCH FANNON, WORKING WITHIN TWO KINDS OF CAPITALISM: CORPORATE GOVERNANCE AND EMPLOYEE STAKEHOLDING: US AND EC PERSPECTIVES 114 (2003).

28. *See, e.g.*, Bernard S. Black, *Agents Watching Agents: The Promise of Institutional*

United States and Europe, one sees this phenomenon and this has clearly influenced the development of company law in the EU, the Member States and in the United States. For example, the active role of these shareholders in influencing proxy contests was specifically recognized by the SEC in 1992 when it revised the proxy rules and made it easier for large shareholders to communicate among themselves.[29] As will be discussed, the passage of the recent Voting Rights Directive in the EU reflects the activism of these shareholders.[30]

3. Political Significance of Share Ownership

The political voice of shareholders can play a significant role in the development of company law. In the United States, a large number of households own shares directly or indirectly.[31] The savings and pensions of a substantial number of people are dependent upon the stock markets.[32] In Europe, the number of

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Investor Voice, 39 U.C.L.A. L. REV. 811, 814 (1992); Dennis K. Berman, *The Game: In an Era of Activists, Look to Change*, WALL ST. J., July 8, 2008, at C1. There a variety of different institutional shareholders that include public and private pension funds, insurance companies, banks, foundations, mutual funds, and hedge funds. *See* Black, *supra*, at 815. While public pension funds were historically the most active, they have been joined by activist hedge funds. *See generally* Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 IOWA J. CORP. L. 681 (2007) (discussing the increased recent activism of hedge funds).

29. *See* 17 C.F.R. § 240.14a-1(l) (2008); John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837, 840-41 n.17 (1994).

30. *See* discussion *infra* Part V.A.2.

31. *See, e.g.*, DANIEL SCHRASS & SARAH HOLDEN, INVESTMENT CO. INST., PROFILE OF MUTUAL FUND SHAREHOLDERS 1 (2008), *available at* http://www.ici.org/stats/res/rpt_profile08.pdf. Schrass and Holden note:

> at the end of 2007, more than two in five U.S. households own mutual funds, representing more than eighty-eight million individual fund shareholders. Furthermore, mutual fund holdings represent a significant component of the savings and investments of many American households, with mutual fund assets now accounting for more than one-fifth of all U.S. households' financial assets.

Id; *see also id.* at 4 ("The largest percentage of mutual fund-owning households, 80 percent, own equity funds.").

32. *See, e.g.*, Nat'l Ctr. for Employee Ownership, New Data Show Widespread Employee Ownership in U.S., para. 1 (2007), http://www.nceo.org/library/widespread.html. According to this report,

> [n]ew data from the General Social Survey show that 20 million American workers own stock in their company through a 401(k) plan, ESOP, direct stock grant, or similar plan, while 10.6 million hold stock options. That means that 17% of the total workforce, but 34.9% of those who work for companies that have stock, own stock through some kind of benefit plan, while 9.3% of the workforce, but 18.6% of those in companies with stock, hold options.

households dependent upon shareholdings is much less[33] and in many countries private pensions are less significant because of public pensions.[34]

As a result of the greater financial stake of U.S. families in share ownership, issues of corporate governance in the United States can become significant political issues and an impetus for regulation. The corporate scandals at Enron and WorldCom which led to the quick federal passage of Sarbanes-Oxley reflected the importance of shareholder protection from both a political and economic perspective.[35] While some European corporate scandals influenced the EU, the corporate governance issues did not resonate in the same way it did in the United States.[36]

B. *Focus of Company Law and Corporate Governance*

The publicly held corporation can be viewed in purely economic terms as a means by which capital is raised from a large number of public savers and used by businesses. Under that focus, corporate governance may focus on the suppliers of capital (creditors and shareholders) and the managers, i.e., those who control management of the business. Since shareholders are owners, this view usually gives them primacy in terms of the goals of the corporation.[37] While other interests have also been recog-

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Id.; *see also* PETER BRADY & SARAH HOLDEN, INVESTMENT CO. INST., RESEARCH FUNDAMENTALS: THE U.S. RETIREMENT MARKET 2007 1 (2008), http://www.ici.org/stats/mf/fm-v17n3.pdf (reporting that over half of Americans' retirement savings are held in IRAs, and defined contribution plans represent 52% of retirement assets, compared to 39% in 1990).

33. *See* Luigi Guiso, Michael Haliassos & Tullio Jappelli, *Household Stockholding in Europe: Where Do We Stand and Where Do We Go?*, 18 ECON. POL'Y 123, 125-26 (2003).

34. *See, e.g.*, Carter Dougherty, *After Enacting Pension Cuts, Europe Weathers A Storm*, N.Y. TIMES, Aug. 6, 2008, at C1.

35. The Sarbanes-Oxley Act of 2002 was passed by the United States House of Representatives by a vote of 423-3 and by the United States Senate by a vote of 99-0. *See* Stephen Labaton, *Corporate Conduct: Accounting; New Rules on Accountants, But Also Questions*, N.Y. TIMES, July 26, 2002, at C1.

36. Examples of European scandals include the accounting problems at Shell, Ahold, and Parmalot. *See* generally Luca Enriques, *Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*, 38 WAKE FOREST L. REV. 911, 912-16 (2003) (suggesting that the scandals had less public reaction in Europe because of state aid to failing corporations, absence of public opinion, and a higher degree of disenchantment plus lessened personal greed compared to the United States).

37. *See* Amir Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 651-54 (2004) (outlining the history of the U.S.

nized, shareholders remain the primary focus of U.S. company law and federal securities regulation.[38]

In much of Europe a broader view has been reflected in company law so that concerns for other stakeholders are important to its company law. The publicly traded corporations also have an impact on other interests who do not supply capital to the business, for example, labor, which invests human capital, and the society where the business operates.[39] As a result, in some countries these interests have a direct role to play in corporate governance.[40] It may include labor membership on boards of directors and the use of labor councils for advice and consultation on important decisions.[41] The different foci have an effect on the development of company law.[42] In the United States, the primary issue of changes in the law remains the protection of shareholders balanced against the need for management flexibility. The role of labor or other constituencies in corporate governance is generally insignificant.[43] For example, in the

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stakeholder-versus-shareholder debates). The role of stakeholders can be viewed from an external or internal perspective. An external perspective sees stakeholders as outside the internal corporate governance and may suggest that their interests be protected by the concept of corporate social responsibility. In addition, corporations should also be accountable to society for the implications of corporate actions. *See* Cynthia A. Williams, *Corporate Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 711-20, 722-24 (2002). An internal perspective will look to include stakeholders more directly in corporate governance. *See generally* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283 (1998). Some scholars have suggested viewing the corporation as a "team production model" where the board serves as a mediating hierarchy among all interests. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 248-57 (1999).

38. *See generally* Lisa Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norma*, 31 IOWA J. CORP. L. 676 (2006) (discusses shareholder primacy and the increased rhetoric toward stakeholders).

39. *See, e.g.*, OECD PRINCIPLES, *supra* note 13, at 11-13.

40. Germany remains a prime example because of it dual board and co-determination where laborers serve on the supervisory board of publicly traded corporations. *See* Susan-Jacqueline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZ. J. INT'L & COMP. L. 555, 561-75 (2000).

41. The State also plays a direct role through its ownership of shares of some companies and an indirect role in some industries. *See supra* note 14.

42. An interesting comparison is executive compensation issues. Excessive compensation raises issues of corporate governance and pay inequality in society. In the United States, much of the focus has been on aligning the interests of shareholders and managers—whereas in parts of Europe, executive compensation has focused more on the social implications of pay disparity. *See* Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 478-80 (2007).

43. There may be some labor representatives on boards where employee stock ownership ("ESOP") is significant. *See* Nat'l Ctr. for Employee Ownership, A Compre-

1980s hostile takeovers were a significant phenomenon in the United States and concerns were raised about the effect of these takeovers on labor and other constituencies. A legal issue that was raised at that time was the extent to which a board of directors of a target company and its concerns for these constituencies should be protected by claims of fiduciary duty especially when implementing anti-takeover defenses. The Delaware courts, which have been significant in the development of company law,[44] clearly established the primacy of shareholders when a company is up for sale.[45] While a number of states enacted legislation to specifically allow consideration of other constituencies, the reality behind the legislation was to give incumbent management greater ability to fight a hostile takeover.[46] Delaware has not enacted such a statute and these statutes, which are generally permissive, do not seem to in practice have expanded the scope of fiduciary duty outside of this context.

In the EU, the role of labor within the corporation has had an important impact on the development of EU company law. For example, labor representation on the supervisor board of publicly traded corporations is an important part of German cor-

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hensive Overview of ESOPs, Stock Options, and Employee Ownership (2005), http://www.nceo.org/library/overview.html. If anything, laborers can play a shareholder-like role in corporate governance through their pension funds. *See, e.g.*, Mary Williams Walsh & Jonathan D. Glater, *Pension Fund Trustees Taking Aim at Safeway*, N.Y. TIMES, Mar. 26, 2004, at C4.

44. *See infra* notes 57-62 and accompanying text.

45. In *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court indicated:

> If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, employees, and perhaps even the community generally), the risk of non-consumption, and the quality of securities being offered in the exchange.

493 A.2d 946, 955 (Del. 1985). Later in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Court stated:

> A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.

506 A.2d 173, 182 (Del. 1985) (citing *Unocal*, 493 A.2d at 955).

46. *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (2008).

porate governance.[47] In the 1970s, the proposed Fifth Company Law Directive that tried to promote a variety of Europe-wide protections for public shareholders was never enacted because it also promoted labor's role in corporate governance.[48] For many years the same issue held up the adoption of the European Company, or *Societas Europaea* ("SE"), because of the concern that such a business organization would weaken labor protections.[49]

C. *Federalism*

Another theme that is an important part of understanding the development of both U.S. and EU company law is federalism. Federalism and company law in the United States has historically been concerned with the respective roles of the federal government and the States in corporate governance. In the EU, it is the issue of what role the EU[50] should play in harmonization of company law as opposed to the Member States developing the law. Federalism in both the United States and the EU raises the issue of the need for a uniform or federal law for company law-related issues. When each U.S. state or Member State produces company law, there is also the potential for a competitive system for the development of that law.[51]

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47. *See* Alfred F. Conard, *Comparative Law: The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 MICH. L. REV. 1459, 1483 (1984).

48. *See id.* at 1461-62.

49. *See* Friedrich Kubler, *A Shifting Paradigm of European Company Law?*, 11 COLUM. J. EUR. L. 219, 230-35 (2005). It was also a factor in the defeat of the proposed Takeover Directive by the European Parliament because it initially limited the ability of target companies to implement defensive tactics. *See EU Eases the Way For Merger Deals Across Borders—Compromise Legislation Protects Rights of Workers and Minority Shareholders*, WALL ST. J., Nov. 26, 2004, at A7 (noting compromise that had to be reached before passage on workers' rights issues). A Takeover Directive was finally implemented which compromised on the issue of takeover defensive tactics. *See generally* Ventoruzzo, *supra* note 24. The Takeover Directive also requires the offeree company to give its opinion of a bid including its affect on labor. *See* Council Directive No. 2004/25, art. 9, O.J. L 142/12, at 19, ¶ 5 (2004).

50. There is a debate about whether the EU is really a supranational government or more like an intergovernmental body. *See* Ernest A. Young, *Protecting Member State Autonomy in the European Union: Some Cautionary Tales From American Federalism*, 77 N.Y.U. L. REV. 1612, 1641-45 (2002) (discussing the institutions within the EU and federalism).

51. *See* Clark D. Stith, *Federalism and Company Law: A "Race to the Bottom" in the European Community*, 79 GEO. L.J. 1581, 1614 (1991).

1. The United States

In the United States, the states have played the primary role in developing company law. The federal government could have provided company law to publicly traded corporations but has opted to allow the states to play a major role in the development of that law.[52] In the United States, the primary federal presence in company law issues has been through the federal securities laws.[53] The development of federal law has been the result of significant corporate scandals and the perceived need for a federal response. The needs are related to the importance of protecting the public investors and stock markets.[54] After the stock market crash of 1929, Congress enacted federal securities regulation aimed at publicly traded corporations. The corporate scandals in 2001 involving frauds at a number of large publicly traded companies like Enron and Worldcom again led to a federal response through the passage of the Sarbanes-Oxley Act of 2002.[55] Each federal intrusion had the effect of supplementing, and in some cases, limiting the role of the states in corporate governance.[56]

U.S. companies can freely decide in which state to incorporate and can change their state of incorporation without difficulty. The company law in the state of incorporation will usually apply to the internal affairs of those corporations.[57] In terms of state law, Delaware has been the primary source of company law in the United States for publicly traded corporations. Its prominence is because so many publicly traded corporations have de-

52. While the U.S. Constitution does not explicitly give Congress the power to regulate corporations, the wide breadth of the Commerce Clause would allow Congress to legislatively preempt state law involving publicly traded corporations. U.S. CONST. art. I, § 8, cl. 3.

53. *See* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 860 (2003) ("[F]ederal securities law and enforcement via securities fraud class actions today have become the most visible means of regulating corporate governance.").

54. *See supra* note 35 and accompanying text.

55. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

56. For example, the Sarbanes-Oxley Market rules dictate that publicly traded companies trading in their markets have independent directors and certain required committees. *See* 15 U.S.C.A. § 78j-1(m)(3) (2008); *see also* N.Y. STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A.02 (2008) (defining the term "independent director").

57. *See supra* note 7 and accompanying text.

cided to incorporate there[58] and thus its company law affects large number of shareholders. The dominance of Delaware raises questions of why it attracts so many publicly traded corporations in its competition with other states for corporate charters. Does Delaware provide lower standards of protection of shareholders so that the managers select that state to protect their interests over the shareholders resulting in a race to the bottom?[59] Does Delaware actually provide optimal standards and thus it competes creating a race to the top?[60] Although much debated and researched,[61] Delaware continues to be the dominant state player in providing company law for publicly traded corporations,[62] albeit with a strong federal presence.

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58. *See* LEWIS S. BLACK JR., WHY CORPORATIONS CHOOSE DELAWARE 1 (Delaware Dep't of State 2007), http://corp.delaware.gov/whydelaware/whycorporations_web.pdf ("Of the corporations that make up the Fortune 500, more than one-half are incorporated in Delaware. It is no wonder that Delaware has become almost a brand name for the 'business' of serving as the official home for corporations."). Incorporations in Delaware produce franchise tax revenue and provide legal work for their lawyers. For example, in 2001 Delaware took in around US$600 million in franchise taxes. *See* U.S. Census Bureau, Delaware State Government Tax Collections: 2001 (2003), *available at* http://www.census.gov/govs/statetax/0108destax.html.

59. *See generally* William L. Cary, *Federalism and Corporate Law: Reflections on Delaware*, 83 YALE L.J. 663 (1974); *see also* RALPH NADER, MARK GREEN & JOEL SELIGMAN, CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS 55-70 (1976).

60. Professor Roberta Romano has described this federalism as "[t]he genius of American corporate law." *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1 (1993). While traditionally the competition is thought to be with other states, some have suggested that Delaware is not really competing with the other states but with the federal government. *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591-92 (2003).

61. *See generally* Joseph A. McCahery & Erik P.M. Vermeulen, *The Changing Landscape of EU Company Law* 24-33 (TILEC Discussion Paper No. DP2004-023, 2004), *available at* http://ssrn.com/abstract=871075 [hereinafter McCahery Paper] (discussing the competition debate and whether it is possible or probable in Europe); *see also* Robert B. Ahdieh, *The (Misunderstood) Genius of American Corporate Law* (Emory Public Law Research Paper No. 08-35, 2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105904 (offering "a distinct framework for evaluating the role of federalism in American corporate governance, which points to distinct measures of efficiency and a reinvigorated study of institutional design in corporate law.").

62. *See* Brett H. McDonnell, *Two Cheers for Corporate Law Federalism*, 30 IOWA J. CORP. L. 99, 138-39 (2004) McDonnell notes:

> The presence of one dominant state allows companies to benefit from network effects in corporate law. A multiplicity of states offering corporate law provides for experimentation and some diversity in the law offered. Even with Delaware's dominance reducing the incentive of other states to innovate in order to attract new corporations, they still have incentive to innovate in order

2. The European Union

Similar to the United States, the Member States have played an active role in providing for company law. The power of the EU to harmonize company law derives from the Treaty of Rome ("Treaty")[63] in 1957[64] which established the common market.[65] The Treaty created the "right of establishment" that, among other things, allows companies organized in one Member State to establish and maintain businesses in any of the other Member States "under the conditions laid down for its own nationals by the law of the country where such establishment is effected."[66] Most of the EU initiatives in company law[67] have been derived from this freedom of establishment and based upon two grounds:

> a) facilitating freedom of establishment of companies: the harmonisation of a number of minimum requirements makes

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> to better serve their own home corporations, or in Delaware's case, to maintain its reputation for responsiveness.

See id.

63. This term will refer broadly to the Treaty of Rome and its subsequent iterations.

64. *See* Treaty Establishing the European Economic Community, 298 U.N.T.S. 11 (1957) [hereinafter Treaty of Rome]. The EU is currently governed by an amended version of the Treaty of Rome. *See* Consolidated Version of the Treaty on European Union, O.J. C 321 E/1 (2006) [hereinafter TEU]; EC Treaty, *supra* note 12, O.J. C 321 E/37 (2006).

65. *See* Treaty of Rome, *supra* note 64, arts. 110-16; *see also* BUXBAUM & HOPT, *supra* note 10, at 4-6 (providing a comparative study of early U.S. and EU federalism).

66. *See* EC Treaty, *supra* note 12, art. 43, O.J. C 321 E/37, at 67. The Treaty also requires European institutions to attain freedom of establishment "by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 with a view to making such safeguards equivalent throughout the Union." *Id.* art. 44(g), O.J. C 321 E/37, at 60.

67. The free movement of capital, EC Treaty, *supra* note 12, art. 57(2), O.J. C 321 E/37, at 64, has also been used by the ECJ to deal with some company law issues, especially as it concerns takeovers. For example, cases have restricted the use of golden shares that allow the State to retain a minority interest in a firm with the right to veto a takeover. *See generally* Christine O'Grady Putek, *Limited But Not Lost: A Comment on the ECJ's Golden Share Decisions*, 72 FORDHAM L. REV. 2219 (2004). Recently the ECJ in its *Volkswagen* decision, Commission v. Germany, Case C-112/05, [2007] E.C.R. __ (ECJ Oct. 23, 2007), found that German law restricting voting rights to twenty percent irrespective of the amount of share owned, violated the free movement of capital provision of the Treaty. *See* Peer Zumbansen & Daniel Saam, *The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism*, 8 GERMAN L. J. 1027, 1035 (2007), *available at* http://ssrn.com/abstract=1030652.

it easier for companies to establish themselves in other Member States where the regulatory framework is similar;
b) guaranteeing legal certainty in intra-Community operations, where the presence of a number of common safeguards is key for the creation of trust in cross-border economic relationships.[68]

In addition, Article 114 of the Treaty also provides a legal basis for some EU company law by authorizing European institutions to "adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market."[69]

Concerns over the power of the EU to generally usurp Member State law led to the establishment of the subsidiarity principle, which calls for deference to the Member States and for the EU to only act if national action is insufficient to promote the objectives.[70] In addition, proportionality requires EU action should "not go beyond what is necessary."[71] These principles have been applied to the development of EU company law where a number of the company law directives merely provide minimum standards allowing member States to go beyond

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68. Commission Communication, Modernising Company Law and Enhancing Corporate Governance in the European Union—A Plan to Move Forward, COM (2003) 284 Final, at 6, ¶ 1.1 (2003), *available at* http://www.ecgi.org/commission/documents/com2003_0284en01.pdf [hereinafter CLAP].

69. *See* Treaty of Rome, *supra* note 64, art. 114; EC Treaty, *supra* note 12, art. 95, O.J. C 321 E/37, at 79. According to Professors Enriques and Gatti:

> Article 44's objective of equal protection for Members and others is also viewed as supporting the thesis that a race to the bottom among Member States should be avoided, and/or the idea that market failures should be corrected; Article [114] aims at removing barriers to free movement within the EU and at providing a single set of rules in order to get rid of the costs arising from doing business under twenty-five different business laws . . . .

Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT'L ECON. L. 939, 946 (2006) [hereinafter *Uneasy Top-Down Harmonization*].

70. *See* EUROPA, EU Decision-Making Procedures: The Subsidiarity Principle and the Role of National Parliaments, http://europa.eu/scadplus/constitution/subsidiarity_en.htm [hereinafter Subsidiarity Principle]; *see also* Young, *supra* note 50, at 1636 (describing the subsidiarity principle as a response to the expansion of community law).

71. *See* EC Treaty, *supra* note 12, art. 5, O.J. C 321 E/37, at 46; *see also* Subsidiarity Principle, *supra* note 70 ("By virtue of this principle, action taken by the Union, in terms of its form and content, does not exceed what is required to achieve the objectives set out in the Constitution.").

them.[72]

There is no European Delaware. Some commentators have argued for the need for competition for incorporations to create an optimal system of rules and allow companies to move between Member States.[73] While such a competitive market would arguably have advantages over the difficult and cumbersome harmonization process through the EU, such a result seems unlikely.[74]

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72. As Klaus J. Hopt, a member of the Winter Group, has written:

> If one looks critically at the prospects of legal harmonization of corporate governance in the EU, one must start with the premise that all legislative activism in this field is wrong. The legal principle of subsidiarity as embedded in the European Community Treaty, as well as the economic concept of competition—also among legislators—put the burden of proof on those who plead for European harmonization. Therefore, it must not only be shown that a particular legislative interference with unregulated corporate governance is legitimate—for example, because of market failure, or external effects, or the necessary implementation of the political decision of bringing about the internal market. Very often the answer and the right way will not be regulation, but rather non-regulation, or even deregulation. But it is further necessary to prove that this kind of legislation, in order to be successful, needs to be undertaken by the European Commission at the European level and not just at the level of the Member States.

Klaus J. Hopt, *Common Principles of Corporate Governance in Europe?*, *in* THE MILLENIUM LECTURES: THE COMING TOGETHER OF THE COMMON LAW AND THE CIVIL LAW 105, 128-29 (Basil S. Markesinis ed., 2000).

73. *See, e.g.*, John Armour, *Who Should Make Corporate Law? EU Legislation Versus Regulatory Competition*, *in* CURRENT LEGAL PROBLEMS 2005 (VOLUME 58) (Jane Holder & Colm O'Cinneide eds., OUP 2006); *Uneasy Top-Down Harmonization*, *supra* note 69 (the European Community should restrict its action in this field to simply reducing the barriers to corporations' freedom of movement).

74. *See* McCahery Paper, *supra* note 61, at 18-36 (arguing that an emergence of competition for incorporations in Europe is unlikely because EU company law principles encourage maintaining the status quo—not legal innovation—and Member States are unwilling to relinquish their company law-making authority); *see generally* Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725 (2006) (arguing that competition for incorporations is unlikely in Europe, however a lively competition for investments has positively transformed national corporate laws in the EU in recent years). The Delaware effect emerged for a number of reasons that may not apply in Europe. For example, in the United States, states generally recognized the law of other states which is based upon comity and constitutional principles inapplicable in the EU. *See generally* Christian Kersting, *Corporate Choice of Law—A Comparison of the United States and the European Systems and a Proposal for a European Directive*, 28 BROOK. J. INT'L L. 1 (2002). Second, the ease of movement between the states is premised on the idea that incorporation was based upon choice rather then location. *See supra* note 7. In many EU countries, the idea of the real seat doctrine looks to a company's actual domicile. *See supra* note 10. Third, Delaware's law is often created by judicially-interpreted case law, therefore courts enjoy more power and flexibility in forming company law. In contrast, most

III. *THE COMPANY LAW HARMONIZATION PROCESS*[75]

Up until 1989, there were nine company law directives and one regulation implemented.[76] From 1989 until 2001, the period has been described as one of stagnation with controversies over a variety of issues of company law such as regulation of takeovers and the SE and with no significant company law adopted at the EU level.[77]

But in the late 1990s, there was a strong EU push to improve the capital markets and improve the single market for financial services through its financial service action plan.[78] Given that

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of European nations use civil law, thus judicial activism and legal tailoring is not the norm.

75. Professors Enriques and Gatti have questioned the rationale for company law harmonization. They note that negative harmonization (i.e., the removal of barriers to the four freedoms) is often linked with positive harmonization, so that what can be gained in terms of greater freedom of establishment is usually lost in terms of decreased flexibility and increased costs. *See Uneasy Top-Down Harmonization*, *supra* note 69, at 944. They criticize the "level playing field" rationale for corporate law harmonization and argue that, "far from lowering transaction costs, to date real-world harmonization has raised them and can hardly be expected to do otherwise in the future." *Id.* They find other rationales for harmonization, such as scale economies in law production and the correction of national governments' failures, as either implausible or unconvincing. *See id.* at 966-69.

76. The process of these early directives has been described as being developed in four distinct generational stages. The first generation was more detailed and precise following a German model and involved publicity requirements (first company law directive) and legal capital requirements (second company law directive). The second generation reflected a more flexible approach with some options and involve mergers and divisions of companies (third and sixth company law directives) and financial accounting and disclosure requirements (fourth, seventh, and eighth company law directives). The third generation had shorter directives without details and included extending disclosure to branches (eleventh company law directive) and the law of single-member private limited companies (twelfth company law directive). The fourth generation was described as proposed directives that gave Member States more freedom of choice. *See* CHARLOTTE VILLIERS, EUROPEAN COMPANY LAW—TOWARDS DEMOCRACY? 31-51 (1998). Commentators have suggested that these early directives generally reflected current practice in most of Europe. *See* McCahery Paper, *supra* note 61, at 14-15 (describing the process of harmonization as beginning as "centralized federalism").

77. *See* Luca Enriques, *EC Company Law Directives: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 9 (2006); Hopt notes:

> Major projects such as the Statute of the European Stock Corporation and the draft directives of the 5th, 11th, 13th and 14th Directives were held up, some of them for decades, because the Member States (in particular Germany, which was not prepared to make compromises on labor codetermination) could not agree on a common regulatory core.

Hopt, *supra* note 72, at 18.

78. According to Luca Enriques & Matteo Gatti:

> The FSAP was launched in 1999 with the aim of promoting a fully integrated

success, in 2001 the Commission set up the High Level Group of Company Law Experts—also referred to as the "Winter Group"—to develop an action plan for company law. It was "to define new priorities for the broader future development of company law in the European Union."[79] In addition there was the need to deal with the rejection of the Takeover Directive by the European Parliament after more than a decade of attempts to enact it.[80] In the midst of its work there were the corporate scandals in the United States and the enactment of Sarbanes-Oxley.[81] The recommendations of the Winter Group became the basis of the EU Commission publishing in 2003 "Modernising Company Law and Enhancing Corporate Governance in the European Union—A Plan to Move Forward,"[82] ("CLAP").[83]

CLAP dealt with a number of broad issues including: 1) corporate governance, 2) legal capital maintenance and alteration, 3) company groups, 4) restructuring and mobility, 5) new European business forms, and 6) enhancing transparency.[84] But the main concern of the Commission was corporate governance.[85]

> European capital market. It soon became a distinctive symbol of the ambitious Lisbon strategy, whereby in 2000 the European Council announced the goal of making Europe the world's leading knowledge-based economy by 2010. The FSAP contains a wide-ranging set of measures touching upon several fields of EU law, such as securities markets, banking, pension funds, and insurance.

Luca Enriques & Matteo Gatti, *EC Reforms of Corporate Governance and Capital Markets Law: Do They Tackle Insiders' Opportunism?*, 28 Nw. J. INT'L L. & BUS. 1, 4 (2007) [hereinafter *EC Reforms*]. Since 2002, the EU has adopted thirty-four directives and regulations: twenty-one directives in accounting law, nine in securities law, and the remaining are either "core company law measures or at the crossroads between company law and accounting or securities law." *Id.* at 3.

79. Jaap Winter et al., Final Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, at 128 (2002), http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.

80. *See id.* at 128.

81. *See id.* at 129.

82. CLAP, *supra* note 68.

83. *See* Theodor Baums, *European Company Law Beyond the 2003 Action Plan* 5 (European Corporate Governance Inst., Working Paper No. 81, 2007), *available at* http://ssrn.com/abstract=973456; *see generally* Klaus Hopt, *European Company Law and Corporate Governance, Where Does the Action Plan of the European Commission Lead?*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE U.S. 118, 121 (Hopt et al. eds., 2005) (discussing the background of the plan and proposed actions).

84. CLAP, *supra* note 68, at 23-25.

85. A number of rationales were given for Commission Communication, "Modernising Company Law and Enhancing Corporate Governance in the European

IV. *THE VOTING RIGHTS DIRECTIVE*

There were several proposals on corporate governance issues that were part of CLAP[86] and some were quickly enacted[87] including the Voting Rights Directive.[88] There are a number of different reasons behind the enactment of this Directive. In much of Europe there is no long tradition of easy proxy voting directly by shareholders without a variety of constraints, and the Voting Rights Directive may now enhance that voting. There was the promotion of good corporate governance through shareholder participation in voting, the protection of EU shareholders who do not reside in the home country where their company resides, the protection of small individual shareholders, the concern that increased ownership by foreign investors could create firms with passive investors, the recognition of increased cross border investing and the importance of integrated markets.[89]

Union—A Plan to Move Forward" ("CLAP"), including increased cross-border operations activities that require common EU company law mechanisms to facilitate freedom of establishment and cross-border restructuring; integration of capital markets and the need to have equivalent corporate governance frameworks; maximization of the benefits of modern technologies on information and communication technology; the forthcoming enlargement of the EU to ten new Member States; recent financial scandals and the needs and demands of investors for protection from "shoddy, greedy and occasionally fraudulent corporate behaviour." *Id.* at 6-7.

86. CLAP also discussed other shareholder rights that should be harmonized such as a right to appoint a special auditor and a duty of institutional investors to disclose their investment and voting policies, which may be dealt with at a later time. *See* Baums, *supra* note 83, at 21 n.65.

87. The EU has implemented some other provisions from CLAP involving corporate governance-related issues with three non-binding recommendations and four directives, which have all been enacted. The three recommendations "deal with auditors' independence . . . , remuneration of directors, and the role of non-executive directors." *EC Reforms*, *supra* note 78, at 18. The four directives enacted include the Directive on Statutory Audit, a revision of the Directive on Legal Capital, the Directive on Shareholders' Rights, and the Directive on Cross-Border Mergers. *Id.* at 18-19, 23.

88. *See generally* Commission of the European Communities, Annex to the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC, SEC (2006) 181 (Feb. 2006), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/comm_native_sec_2006_0181_en.pdf [hereinafter Annex] (discussing the process leading to the Directive and comparing the directive to existing law and practice in Europe).

89. Commission of the European Communities, Explanatory Memorandum to the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered Office in a

The Voting Rights Directive recognized that prior securities EU directives have provided disclosure to shareholders, but there was also a need for certain minimum standards for protecting investors and promoting the free exercise of voting.[90] Of particular concern to the Commission and those consulted were the obstacles to cross-border voting such as "the requirement to block shares before a general meeting . . . , difficult and late access to information that is relevant to the general meeting and the complexity of cross-border proxy voting."[91] Thus the Directive was designed to provide some minimum standards.[92]

The Voting Rights Directive is a mix of principles, mandatory rules and rules that provide companies with options. The key provisions include:

Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC, COM (2005) 685 Final (Jan. 2006), at 2, ¶ 1.1, *available at* http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0685en01.pdf [hereinafter Explanatory Memorandum].

90. According to the Voting Rights Directive:

> The existing Community legislation is not sufficient to achieve this objective. Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities focuses on the information issuers have to disclose to the market and accordingly does not deal with the shareholder voting process itself. Moreover, Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market imposes on issuers an obligation to make available certain information and documents relevant to general meetings, but such information and documents are to be made available in the issuer's home Member State. Therefore, certain minimum standards should be introduced with a view to protecting investors and promoting the smooth and effective exercise of shareholder rights attaching to voting shares.

Directive No. 2007/36, O.J. L 184/17, at 17, ¶ 4.

91. Explanatory Memorandum, *supra* note 89, at 3, ¶ 1.2. According to Professor Zetzsche, "the Shareholder Rights Directive . . . failed to mandate an efficient regime governing the identification and authorization of shareholders who hold their shares within a chain of intermediaries" and he suggests remedies to be taken by future legislators. *See* Dirk Zetzsche, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, 8 J. CORP. L. STUD. 289, 297, 331-35 (2008). For a discussion of the various problems of American corporate voting, see Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227 (2008).

92. Member states are free to go beyond the standards. *See* Directive No. 2007/36, art. 3, O.J. L 184/17, at 19; *see generally* SHAREHOLDER VOTING RIGHTS AND PRACTICES IN EUROPE AND THE UNITED STATES (Baums & Wymeersch eds., 1999) (providing good background information on voting, although does not reflect changes over the last ten years).

1. Equal treatment of shareholders as to participation and voting in the general meeting;[93]
2. Required notice of general meeting of at least 30 days and certain required information;[94]
3. The right to put items on the agenda of the general meeting and table draft resolutions;[95]
4. Removal of requirements of any blocking mechanism such as share deposits that restricted shareholder participation in the general meeting;[96]
5. The right of shareholders to ask questions on agenda items which must be answered;[97]
6. Allowing and facilitating proxy voting[98] individually and

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93. *See* Directive No. 2007/36, art. 7, O.J. L 184/17, at 21. The provision refers to the requirement of equal treatment found in the Transparency Directive, which states:

> [o]ngoing information of holders of securities admitted to trading on a regulated market should continue to be based on the principle of equal treatment. Such equal treatment only relates to shareholders in the same position and does not therefore prejudice the issue of how many voting rights may be attached to a particular share.

Council Directive No. 2004/109, O.J. L 390/38, at 40, ¶ 22; *see also* Dirk Zetzsche, *Virtual Shareholder Meetings and the European Shareholder Rights Directive—Challenges and Opportunities* 68-69 (Ctr. for Bus. and Corporate Law Research Paper Series, Paper No. 29, 2007), *available at* http://ssrn.com/abstract=996434 (providing some examples of equal treatment).

94. This required information includes (1) a precise indication of the place, time and draft agenda of the meeting; (2) "a clear and precise description of the procedures that shareholders must comply with in order to be able to participate and to cast their vote in the general meeting"; (3) the applicable record date; (4) a clear and precise description of the available means by which shareholders can participate in the general meeting and cast *their* vote (or, alternatively, where such information may be obtained); and (5) how to obtain the unabridged text of the resolutions and the documents intended to be submitted to the general meeting for approval. *See* Directive No. 2007/36, art. 5(3), O.J. L 187/17, at 20. In addition, companies must post on their internet sites (1) the meeting notice; (2) the total number of shares and voting rights; (3) the texts of the resolutions and the documents for the meeting; and (4) the forms to be used to vote by correspondence and by proxy (or where and how the forms can be obtained). *Id.* art. 5(4), O.J. L 187/17, at 20-21.

95. Member States can require a minimum stake in the share capital of the issuer in order to exercise this right, but the minimum cannot exceed five percent of the share capital. *Id.* art. 6(2), O.J. L 187/17, at 21.

96. *See id.* pmbl., O.J. L 187/17, at 17, ¶ 3. The right to participate may be subject to a record date prior to the meeting as are necessary to ensure the identification of shareholders. *Id.* art. 7(2), O.J. L 187/17, at 21.

97. *See id.* art. 9, O.J. L 187/17, at 22. In 2005, amendments to the German Stock Corporation Act allowed German companies to authorize the chairman of the meeting to restrict a shareholder's right to speak and ask questions. *See* Michael Arnold & Andreas Wölfle, *Defining the Rights of Shareholders*, INT'L FIN. L. REV., May 2006, at 26.

98. *See* Directive No. 2007/36, art. 10(1), O.J. L 187/17, at 22. ("Every share-

through securities accounts.[99]

The Directive also attempts to deal with the potential of the internet[100] and thus one of its goals was to "[r]emove all legal obstacles to electronic participation in general meetings."[101] Because of concerns with technology and security, it was not made obligatory.[102] The Directive does call for the posting of some information on the internet, such as meeting notice, number of shares and voting rights, text of proposed resolutions and related documents and forms that can be used to vote.[103] Questions can also be asked by electronic means prior to the meeting and response can be given if the relevant information is available on the company's internet site.[104] Proxy holders may be appointed by electronic means[105] and Member States shall prohibit requirements, which hinder the exercise of voting rights by electronic means except if necessary for shareholder identification.[106]

A. *Some U.S. Comparisons*

Generally proxies will be sought by companies for the annual shareholder meeting or other special meetings. Because so many publicly traded corporations are Berle Means corporations and there is no controlling shareholders presence, proxies are often needed to be sure there is a quorum or a minimum number of shareholders present at the meeting in order to conduct

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holder shall have the right to appoint any other natural or legal person as a proxy holder to attend and vote at a general meeting in his name."). Member States can restrict proxy holders who may be connected to the company. *See id.* The notification to the company of the appointment of a proxy holder and the voting instructions "may be made subject only to such formal requirements as are necessary to ensure the identification of the shareholder and of the proxy holder, or to ensure the possibility of verifying the content of voting instructions, respectively . . . ." *Id.* art. 11(2), O.J. L 187/17, at 23. Proxy holders may be appointed by electronic means. *See id.* art. 11(1), O.J. L 187/17, at 23.

99. *See id.* art. 13, O.J. L 187/17, at 23-24.

100. *See generally* Zetzsche, *supra* note 91 (discussing the Voting Rights Directive, the internet, and the need for further legislation).

101. Explanatory Memorandum, *supra* note 89, at 3, ¶ 1.2.

102. *See* Directive No. 2007/36, art. 8(1), O.J. L 187/17, at 22 ("Member States *shall* permit companies to offer to their shareholders any form of participation in the general meeting by electronic means . . . .") (emphasis added).

103. *Id.* art. 5(3)(e), O.J. L 187/17, at 20.

104. *Id.* art. 9, O.J. L 187/17, at 22.

105. *Id.* art. 11(1), O.J. L 187/17, at 23.

106. *Id.* art. 11(2), O.J. L 187/17, at 23.

business and to take whatever actions are needed.[107] The frequent use of proxy voting historically in the United States was a major reason that the Securities and Exchange Act of 1934 gave the SEC broad powers to regulate proxies.[108] The federal proxy rules are very detailed, and primarily focus on disclosure requirements when publicly traded corporations solicit proxies.[109] But there is also state company law which actually provides the basis for this regulation because it establishes the rules on meetings and voting including the right to use proxies.

In addition to companies soliciting proxies, there can also be proxy fights where a shareholder group seeks votes for the shareholder meeting on issues opposed by the company's management. These fights in the United States have a long and evolving history. Proxy fights can occur generally in two situations. It can involve a challenge to the current directors by replacing them with new directors; i.e. change management if a corporation is run poorly or to facilitate an unfriendly acquisition.[110] It can also involve seeking shareholder votes on a policy issue that the directors oppose; i.e. change policy.[111] The proxy fight is viewed as creating a market mechanism to monitor managers by either their replacement or influencing their behavior.[112]

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107. For example, under Delaware law the bylaws or certificate of incorporation can set the quorum, but in no event can it be less than one-third of the shareholders. *See* DEL. CODE ANN. tit. 8, § 216 (2008). Interestingly, the same problem of finding a quorum because of increased foreign ownership of publicly traded corporations in the EU was a reason for the need of the Voting Rights Directive. *See* Directive No. 2007/36, art. 5, O.J. L 187/17, at 20-21.

108. Section 12(b) requires companies that are publicly traded on a national exchange to register. Securities Exchange Act of 1934 § 12(b), 15 U.S.C. § 781(a). Section 12(g) requires registration when the issuer has more than US$1,000,000 in assets and at least 500 shareholders. 15 U.S.C. § 781(g)(1). Section 12(g) has been modified, however, extending an exemption from registration to any issuer with assets not exceeding US$10,000,000. 17 C.F.R. § 240.12g-1; *see also* 17 C.F.R. § 240.14a-2.

109. *See generally* 17 C.F.R. § 240.14a-3 (regulating solicitation of proxies). Even if the company is not soliciting proxies, it still must provide shareholders with information prior to a shareholders' meeting. *See* 17 C.F.R. § 240.14c-2 (detailing information that must be provided to shareholders prior to every meeting or vote).

110. In the United States, in the event of a hostile takeover where the target company has a "poison pill" defensive mechanism, the offeror may seek to replace the directors who oppose the sale of the company with new directors who support the sale, thereby removing the "poison pill." *See* ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 5.05[C][2] (2d ed. 2004).

111. *See id.* § 5.05[C][3].

112. *See* Frank H. Easterbrook, Symposium, *The ALI's Corporate Governance Proposals:*

In many ways the Voting Rights Directive mirrors U.S. federal and state law and business practices, but with some significant differences. The provisions for equal treatment,[113] prior sufficient notice,[114] removal of blocking mechanisms and facilitation of proxy voting[115] are consistent with the United States. The provision that gives shareholders the right to ask questions on agenda items which must be answered finds no similar specific requirement in U.S. law. While it is common practice to have discussions of pending issues at shareholder meetings and allow shareholder questions at meetings of publicly traded corporations, if a company refused to do so it is unclear if that would violate the law in the United States.[116] But such behavior

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Law and Economics: Managers' Discretion and Investors' Welfare: Theories and Evidence, 9 DEL. J. CORP. L. 540, 543 (1985).

113. While there is no specific U.S. rule that requires equal treatment, the federal proxy rules are generally aimed at disclosure and protection for all shareholders, while under state law provisions on meetings and voting also do not discriminate among shareholders. In addition case law on protection of shareholder democracy could be used if the directors take unilateral action to thwart shareholder voting or attempt to manipulate the process to entrench management. *See* PINTO & BRANSON, *supra* note 110, § 5.05[D].

114. Both the federal proxy rules and state law provide for sufficient notice of all meetings, not just the annual meeting. *See, e.g.*, 17 C.F.R. §§ 240.14a-16 (requiring a proxy statement at least forty days before a meeting); DEL. CODE ANN. tit. 8 § 222(b) (requiring notice "not less than 10 nor more than 60 days" before a meeting).

115. Unlike some countries in Europe, the United States has generally not established mechanisms that make shareholder voting by proxies difficult. Instead, the United States uses a record date as the means of establishing the ownership of shares entitled to vote at meetings. *See, e.g.*, DEL. CODE ANN. tit. 8, § 213(b).

116. *See* David A. Drexler, Lewis S. Black Jr. & A. Gilchrist Sparks III, Delaware Corporate Law and Practice § 24.05[1] (2007) ("Statutory requirements for meetings are sketchy. While there are fairly extensive provisions dealing with such matters as record dates, notice, and quorum requirements, few directions are provided for what may or must occur at the meeting itself."). A broad view of shareholder democracy could be used. *Cf.* Hoschett v. TSI Int'l Software, Ltd., 683 A.2d 43, 46-47 (Del. Ch. 1996) (ordering an annual meeting as required under Delaware law even where there was a controlling shareholder with sufficient votes to act). The Delaware court indicated:

> [W]hile the model of democratic forms should not too strictly be applied to the economic institution of a business corporation (where for instance votes are weighted by the size of the voter's investment), it is nevertheless a not unimportant feature of corporate governance that at a noticed annual meeting a form of discourse (i.e., oral reports, *questions and answers* and in rare instances proxy contests) among investors and between shareholders and managers is possible. The theory of the annual meeting includes the idea that a deliberative component of the meeting may occur. Shareholders' meetings are mandated and shareholders authorized by statute to transact proper business because we assume that at such meetings something said may matter.

would violate accepted norms of corporate behavior and thus is unlikely.[117]

The right to put items on the agenda raises an issue of the parameters of that right. Currently not every EU Member State allows items to be placed on the agenda.[118] Under the Directive, the right is a matter of principle[119] and that would have to be resolved by the law or practice of the particular Member State and relate to a subject that shareholders have some power to effectuate. In Europe, shareholders are generally considered to have more power to act within the shareholder meeting compared to U.S. shareholders and this power relates to the shareholder ability to add to the agenda.[120] The power of setting the agenda is further enhanced by the greater ability of shareholders

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> Obviously these meetings are very far from deliberative convocations, but a keen realization of the reality of the degree of deliberation that is possible, should make the preservation of residual mechanisms of corporate democracy more, not less, important.

Id. at 45-46 (emphasis added).

117. In 2006, Home Depot violated a U.S. business norm that all directors should attend the annual meeting and shareholders have time to ask questions. The company was widely criticized, but subsequently apologized and changed its behavior the following year. *See* Michael Barbaro, *Apologetic, Home Depot Tries to Move Beyond Nardelli's Shadow*, N.Y. TIMES, May 25, 2007, at C3.

118. *See* Annex, *supra* note 88, at 130, Q. 7.3; Explanatory Memorandum, *supra* note 89, at 5, ¶2.2.2.

119. *See* Directive No. 2007/36, pmbl., O.J. L 187/17, at 18, ¶ 6. The Voting Rights Directive mandates that if Member States require a minimum stake to have the right place items on the agenda, the minimum shall not exceed five percent. *See id.* art. 6(2), O.J. L 187/17, at 21.

120. Presumably the ability to add items to the agenda would relate to the power shareholders have to vote at the annual meeting. Generally the shareholders in continental Europe have more voting rights compared to the United States. *See* Dirk Zetzsche, *Shareholder Interaction Preceding Shareholder Meetings of Public Corporations—A Six Country Comparison*, 2 EUR. CORP. & FIN. L. REV. 105, **43-44 (2005); *see also* Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 818 (2002) ("In contrast to the Anglo-American jurisdictions, both France and Germany created a mandatory governance structure with a clearly defined division of power between shareholders and directors. The corporate laws of these countries enumerate exclusive rights of the shareholder meeting, which cannot be delegated to or appropriated by the board."). For example, in Italy shareholders not only vote on the election of directors but can elect a member of the Statutory Auditors (an internal body that provides internal monitoring), approve the final budget (including dividend decision), decide the compensation for directors and internal auditors (unless the charter provides otherwise), authorize a derivative suit, and decide on the liability of directors and internal auditors. *See* Lorenzo Segato, *A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat a˜ a Case Study*, 26 NW. J. INT'L L. & BUS. 373, 394-97 (2006).

in Europe to set an agenda by their statutory right to call for meetings.[121]

In the United States, in order for something to be placed on an agenda for a shareholder meeting, it has to be a proper subject under state law.[122] The number of issues shareholders have the right to vote on and effectuate is limited. The main issue for the annual meeting is the election of directors and the agenda is usually set by the directors. Shareholders can attempt to elect directors, but must bear the costs.[123] Since shareholders are not entitled to amend the certificate of incorporation without prior board approval (unlike some countries in the EU) shareholders try to use their power to amend the by-laws to require certain actions and thus mandate policy changes.[124] These attempts to use the by-laws to mandate policy have raised significant issues of the allocation of power between the board and shareholders under state law and whether the action required improperly interferes with the directors' right to manage the corporation or is an issue of shareholder power.[125]

But in the United States, shareholders have been able to add other issues to the agenda through proxy fights that do not

121. *See* Sofie Cools, *The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697, 742-44 (2005) (noting the procedure by which French and Belgian shareholders may call a meeting).

122. Delaware General Corporation Law limits subject matter to "[a]ny other proper business" in addition to the election of directors. DEL. CODE ANN. tit. 8, § 211(b) (2007).

123. Recently, shareholders have tried to use management's proxy statement and SEC Rule 14a-8 to nominate a slate of directors to run against the incumbent directors, which would mean that they would not have to file their own proxy statement. *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 72 (2008) (discussing the legal and policy issues); *see generally* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007) (proposing reforms to process by which directors are elected).

124. In seeking to change policy, shareholders have the option of using management's proxy statement to propose resolutions pursuant to SEC Rule 14a-8. *See* 17 C.F.R. § 240.14a-8 (2008). Shareholders may also solicit proxies at their own expense using their own proxy materials, which are not subject to the limitations of the rule. *See* 17 C.F.R. § 240.14a-7 (2008). While many of these proposals do not receive majority support, they are a means of influencing the managers to make changes. *See, e.g.*, *infra* note 128.

125. *Compare* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 913-14 (2005) (arguing for increased shareholder power to allow for more shareholder intervention), *with* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1735-36 (2006) (expressing concern that increased shareholder power will hurt the corporation and the need for director primacy).

mandate but instead try to change and influence policy.[126] These fights involve proposing a non-binding resolution to influence the board, which is a right of expression.[127] Because these resolutions do not mandate company action but try to influence the board through recommendations, they do not directly challenge the board's legal authority as raised in mandatory by-laws. These fights can involve corporate social behavior, corporate governance issues and corporate strategy. This right of expression has influenced company behavior.[128]

The increased use of the internet as reflected in the Directive also generally reflects U.S. law. For example, Delaware allows the participation in shareholder meetings using remote communications or the use of online meetings.[129] In addition a

126. Proxy fights do occur in some countries in Europe but usually to change management as opposed to proxy fights to change policy. *See* Natalie De Filette, Risk & Governance Blog, Investor Engagement on the Rise in Europe RiskMetrics Group (July 19, 2006), http://blog.riskmetrics.com/2006/07/investor_engagement_on_the_ris.html (noting that fifty-seven percent of shareholder proposals during the first half of year 2006 dealt with board membership-related issues); *see also Revolution of Sorts*, THE ECONOMIST, July 5, 2008, at 76-77, *available at* http://www.economist.com/business/displaystory.cfm?story_id=11671509 (describing recent shareholder voting activism in France).

127. The right to propose these resolutions are not specifically authorized by statute but were developed by courts under state law promoting shareholder democracy. SEC Rule 14-8 has facilitated this right by allowing some of these proposals to be placed in management's proxy statement. *See* PINTO & BRANSON, *supra* note 110, § 5.05[F].

128. For example, in 1996 two different groups of shareholders tried to convince RJR Nabisco to split off the tobacco business from its food operations through non-binding votes. Some Catholic priests used SEC Rule 14a-8 while other large investors used their own proxy statement to get shareholder support. *See* David Usborne, *Priests Join in the Pressure to Force Split of RJR Nabisco*, THE INDEPENDENT (LONDON), Jan. 4, 1996, at 18. Eventually RJR Nabisco did split off the tobacco business. *See RJR Nabisco to Split Food and Tobacco Business*, WEEKLY CORPORATE GROWTH REPORT, Mar. 15, 1999, http://findarticles.com/p/articles/mi_qa3755/is_199903/ai_n8851404/print?tag=ArtBody;coll.

129. *See* DEL. CODE ANN. tit. 8, § 211(a)(2) (2007). The statute establishes certain requirements for online shareholder meetings to protect their integrity and requires corporations to take reasonable steps to ensure that those who attend online meetings have "a reasonable opportunity to participate" and to vote. *Id.* Corporations, therefore, must give online attendees the chance to follow the meetings in real-time. There is also a duty on corporations to keep records of shareholders' and proxy votes and actions at meetings that take place through remote communication to prevent potential fraudulent voting. *See* Daniel Adam Birnhak, *Online Shareholder Meetings: Corporate Law Anomalies or the Future of Governance?*, 29 RUTGERS COMPUTER & TECH. L.J. 423, 428 (2003). Concerns over internet-only meetings contributed to the defeat of a bill in Massachusetts to change its corporate law. *See id.* at 443-44. Some shareholder activists "condemn[ed] it as a backdoor effort to insulate company executives from unhappy share-

shareholder can designate the proxy holder by electronic means.[130] Similar to the Directive, the federal proxy rules mandate e-proxy rules, which require companies and other soliciting persons to post their proxy materials on a publicly available internet website and provide shareholders with a notice regarding the availability of proxy materials on the internet.[131] Shareholders may now choose the means by which they access proxy materials either from the internet or paper copies and companies have some choice on how to deliver proxy material if the shareholder does not opt for paper delivery.[132] Issuers and others that use the internet may be able to lower the costs of their proxy solicitations although the amount of disclosure required under the proxy rules remain and possible liabilities for violating the proxy rules remain unchanged.[133] Interestingly, in the United States a number of companies have opted to continue to use paper materials because the use of e-voting actually reduced participation by individual shareholders which could give more power to larger institutional investors.[134]

In looking at the Voting Rights Directive and comparing it to the United States, many of its provisions generally mirror U.S. law and practice but the overall approach exhibits some significant differences. Unlike the extensive federal presence in the United States through its proxy rules,[135] the Directive is not seeking a particularly large or significant EU presence in shareholder voting issues. Further, the lack of an EU wide regulatory agency like the SEC that regulates the area not only through rules but through enforcement further limits the EU federal presence.[136]

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holders." *Id.* at 444 (quoting Ralph Ranalli & Peter J. Howe, *OK Is Near for Online Shareholder Meetings*, BOSTON GLOBE, Aug. 23, 2001, at A1).

130. *See* DEL. CODE ANN. tit. 8, § 212(c)(2) (2007).

131. *See* 17 C.F.R. § 240.14a-16 (2008).

132. *See id.*; *see also* Jeffrey N. Gordon, *Proxy Contests in an Era of Increasing Shareholder Power: Forget Issuer Proxy Access and Focus on E-Proxy*, 61 VAND. L. REV. 475, 495-96 (2008) (arguing that e-proxy can help shareholder activism).

133. The SEC has attempted to encourage the use of electronic shareholder forums by trying to clarify when their use could violate federal proxy rules. *See* 17 C.F.R. § 240.14a-17 (2008).

134. *See* Kara Scannell & Matt Phillips, *Shareholder Voting Declines as Companies Adopt Web Ballots*, WALL ST. J., Apr. 23, 2008, at D1 (noting that "[o]n average, just 4.6% of individual shareholders voted using e-proxy compared to 19.2% who voted in the year-earlier period" when paper ballots were used).

135. *See supra* Part II.C.1.

136. *See generally* Roberta S. Karmel, *The Case for a European Securities Commission*, 38

The more limited role of the courts and private litigation in the EU differ greatly from the United States,[137] where proxy fights are often fought through litigation under either federal proxy rules or state company law.[138]

V. *THE THEMES OF THE VOTING RIGHTS DIRECTIVE*

As discussed, three significant themes have historically influenced the development of company law in the United States and the European Union. Those themes are the role of ownership, the focus of company law and corporate governance and federalism. The Voting Rights Directive, which tries to facilitate shareholder voting, also reflects on those themes but in some ways differently reflecting changes within Europe.

A. *Role of Ownership*

The development of company law has been significantly influenced by three particular aspects of share ownership: the type of share ownership, large institutional investors, and the political significance of share ownership. In the EU, changing ownership seems to have influenced the Voting Rights Directive.

1. Type of Ownership

In terms of type of ownership, the U.S. publicly traded corporation is characterized as having substantial Berle Means companies with widely dispersed ownership resulting in the separation of ownership from control. Continental Europe has been described generally as having publicly traded corporations with concentrated ownership and thus the public shareholders often are the minority shareholders.

There have been changes in Europe in terms of shareholder ownership with an increase in Berle Means companies with more widely held ownership.[139] In addition, companies may have

COLUM. J. TRANSNAT'L L. 9 (1999) (arguing for the establishment of a single securities regulatory body in order to spur the creation of a European equity market).

137. *See generally* Segato, *supra* note 120 (comparing the American and Italian approach to the protection of shareholders, including through litigation).

138. *See* PINTO & BRANSON, *supra* note 110, § 7.06.

139. Another trend over the decade is in the growth of widely held listed firms across France, Germany and Italy. We show that one of the stylized facts of corporate finance has significantly diminished over the decade. Ten years ago the typical company had a large controlling shareholder. This is much

large shareholders who do not have majority control or groups of shareholders none of which are in control. Thus the Directive, by facilitating proxy voting, may help to enhance shareholder rights in these situations where control remains fluid. Facilitating shareholder voting which lowers the cost of voting could also encourage more proxy fights that try to change management or change policy.[140]

But concentrated ownership still remains significant in Europe. Arguably, facilitating voting rights for minority shareholders can be irrelevant when there is a controlling shareholder.[141] The fact that a controlling shareholder has the votes does not mean that shareholder voting is irrelevant. In some countries, minority shareholders have specific rights to protect themselves by voting on certain issues[142] or there may be a super majority

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> less so today. In 2006, in Germany the most frequent form of ownership is widely held; the proportion has increased from 26% to 48%. A similar trend occurred in France and Italy, from 21% to 37% and from 2.5% to 22%, respectively. About one third of this increase coincides with a decline in family controlled companies in all three countries. The rest is largely explained by the unwinding of majority blocks of widely held parent firms as well as privatizations of state owned companies. This pattern suggests that although family ownership continues to be an important form of ownership, there is a marked decline accompanied by a common movement across the large European capital markets to widely held ownership status.

Julian Franks et al., *Evolution of Family Capitalism: A Comparative Study of France, Germany, Italy and the UK* 4-5 (Am. Fin. Ass'n 2009 San Francisco Meetings Paper, 2008), *available at* http://ssrn.com/abstract=1102475; *see also* Christoph Van der Elst, *Shareholder Mobility in Five European Countries* 7-9 (Eur. Corp. Governance Inst., Paper No. 104, 2008), *available at* http://ssrn.com/abstract=1123108 (noting that over the last eight years ownership concentration decreased at a moderate pace in three countries—France, Italy, and Belgium—but increased in Spain and the U.K.).

140. The EU Commission makes a strong case for the importance of shareholder voting and proxy contests as a means to promote better resource allocation and higher economic growth by "a direct channel of superior company management—with proxy voting providing a supportive control tool, and . . . an indirect channel through broad and liquid financial markets generated by shareholder rights." Annex, *supra* note 88, at 6, § 3.1.

141. *But see* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1645 (2006) (distinguishing between efficient and inefficient controlling shareholders and arguing that the appropriate dichotomy is between countries with functionally good law, which support companies with both widely held and controlling shareholder distributions, and countries with functionally bad law, which support only controlling shareholder distributions).

142. For example in Italy, the minority shareholders can elect one of the statutory auditors whose functions is to monitor. *See* Andrea Melis, *On the Role of the Board of Statutory Auditors in Italian Listed Companies*, 12 CORP. GOVERNANCE 74, 79 (2004). In 2005, reforms gave additional rights to minority shareholders in Italy, including the

vote required for a particular action to be taken which requires the votes of the minority shareholders. The controlling shareholders may also consist of blocks of different shareholders who may not always act together and thus empower the minority in a given case to supply the needed votes. But even if the vote of the minority shareholders will not affect the decision directly because of the control, the fact that a vote needs to be taken could change the behavior of those in control.[143] The increased use of independent directors on the boards of such companies may also serve as a means to have those views of the public shareholders taken seriously.[144]

Controlling shareholders may also consider the views of the public minority shareholders to enhance its ability to attract equity capital through good corporate governance.

2. Institutional Shareholders

In the United States, the changing nature of public shareholders means that large institutions now own significant numbers of shares and some of them take a more active role in corporate governance. In Europe, there has also been a rise of both foreign and particularly institutional ownership,[145] which was

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right to elect one director and the use of a list-based system of voting. Each shareholder can propose a full list of candidates for directors and statutory auditors. *See* Domenico Fanuele & Tommaso Tosi, *Power to the Minority*, INT'L FIN. L. REV., June 2008, at 48.

143. Adverse publicity could result, which may influence those in control. In addition, the disclosure associated with voting could have an impact. *See* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 384 (2d Cir. 1974). The Second Circuit noted that:

> By virtue of the disclosure either modification or reconsideration of the terms of the merger by those in control might be effectuated. We cannot assume that even a rapacious controlling management would necessarily want to hang its dirty linen out on the line and thereby expose itself to suit or Securities Commission or other action—in terms of reputation and future takeovers.

Id.

144. As a result of CLAP, an E.C. Recommendation on the role of non-executive or supervisory directors of listed companies and committees of the supervisory board opined that company directors with controlling shareholders should take into account the interests of minority shareholders. *See* Jaap Winter et al., *supra* note 79, at 59-60.

145. *See* Explanatory Memorandum, *supra* note 89, at 2. ("[T]he cross-border nature of equity investment increases, which is further stimulated by the drive towards creating integrated financial markets in Europe and beyond. The growing proportion of share ownership by foreign investors is already posing the threat of EU listed companies being owned by a passive shareholder base."); *see also supra* note 27. According to the Federation of European Securities Exchanges ("FESE"), the weighted average of the non-resident investors' proportion of the listed shares of European markets was

one of the primary reasons behind the Voting Rights Directive.[146] In lowering the costs of voting[147] by the removal of barriers to voting, providing easier disclosure, and the potential use of the internet, it may foster greater institutional shareholder participation in voting.[148] If shareholder voting is enhanced, it could encourage more proxy fights that try to change management or policy.[149] Increasing shareholder democracy and activism[150]—which often means greater shareholder voice—is not uncontroversial, but it has become an international phenome-

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twenty-nine percent in 2003. *See* Annex, *supra* note 88, at 41; *see also* Zetzsche, *supra* note 91, at 11 ("Since 2005, foreign investors constitute the majority of shareholders in EC Member States, owning on average 33 percent of the total market capitalization in EC countries."). Nonresident institutional investors make up a sizeable portion of these foreign shareholders. *See* Annex, *supra* note 88, at 8, ¶ 4.1.

146. The main beneficiaries from the proposal, in the short term, will be institutional investors that currently own cross-border shares in their portfolios. The existence of costs, associated with obstacles to cross-border voting means that investors are unable to become as actively engaged in the governance of companies as they may wish.

Commission of the European Communities, Opinion of the European Economic and Social Committee on the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC, O.J. C 318/42, at 43, ¶ 4.1.1 (2006) [hereinafter Opinion].

147. The effect of barriers to voting in foreign shares means higher value and investment bias to home country shares, which can result in an inefficient allocation of investments. *See* Annex, *supra* note 88, at 16.

148. The voting by institutional investors "seems to be sensitive to the presence of control-enhancing mechanisms, ownership concentration, and to the origin of the national legal system." Paolo Santella et al., *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US*, 40 (2008), http://ssrn.com/abstract=1137491.

149. Institutional investor activism has also been encouraged in recent times by the rising number of hedge funds that have a equity portfolio focused in a limited number of companies, in which they hold significant share holdings. Such a trend is more visible in the US, but is also beginning to spread in the EU. The specificity of this kind of investors translates in the higher propensity, vis-à-vis "traditional" institutional investors such as pension funds and mutual funds, to put in place proxy fights.

Id. Recently European institutional investors have exercised their power in the United States by litigating in the United States. *See* Darren J. Check, *Shareholder Activism: On the Way to Europe*, INT'L FIN. L. REV., Nov. 2006, at 60.

150. *See* De Filette, *supra* note 126; *see also* Carter Dougherty, *Deutsche Börse Drops its Offer to Buy LSE International*, INT'L HERALD TRIB., Mar. 8, 2005, at Finance 1R, *available at* http://www.iht.com/articles/2005/03/07/business/LSE.php (explaining that pressure from hedge funds to replace directors led to Deutsche Börse withdrawing its bid for the London Stock Exchange).

non.[151]

3. Political Significance of Share Ownership

The politics of ownership are important because as shareholder ownership becomes an important source of societal wealth and savings,[152] the interests of shareholders become more important to the political institutions that create law. In Europe, there is a growth in shareholder ownership by its citizens[153] and the Voting Rights Directive attempts to facilitate the voting rights and influence of shareholders. But unlike the United States, the pressure for the changes brought about by the Directive has less to do with the political strength and concerns for public shareholders then other concerns such as the economic advantages to improved shareholder voting.[154] If anything it was concern for foreign shareholders, particularly institutional investors, that was the major impetus for the Directive.[155] But enhancing shareholder voting could encourage more share ownership,[156] which

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151. *See* Lisa M. Fairfax, *Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power*, 3 VA. L. & BUS. REV. 1, 12-21 (2008). According to the European Social Investment Forum:

> When all else fails, investors may even submit their own resolutions or call for Extraordinary General Meetings (EGMs). At present, this is a rather uncommon and very confrontational practice in Europe. Nevertheless, the growth of active share ownership—reinforced by examples of the practice in the United States—is beginning to make this concept less alien to investors.

EUROPEAN SOCIAL INVESTMENT FORUM, ACTIVE SHARE OWNERSHIP IN EUROPE, 2006 EUROPEAN HANDBOOK 11 (2006), *available at* http://www.eurosif.org/publications/active_share_ownership_handbook.

152. *See* Jack Ewing et al., *Europe's Shareholders: To the Barricades*, BUS. WK., Mar. 19, 2001, http://businessweek.com/magazine/content/01_12/b3724147.htm.

153. *See* Guiso et al., *supra* note 33, at 141-42.

154. *See* Annex, *supra* note 88, at 20, ¶ 5 ("Removing obstacles to domestic and cross-border shareholder rights is a key prerequisite for the development of stock markets in the EU and to facilitate financial market integration in the EU.").

155.
> The main beneficiaries from the proposal, in the short term, will be institutional investors that currently own cross-border shares in their portfolios .... Over the longer term, the proposal may encourage smaller investors, who are currently deterred from holding cross-border shares by the high costs associated with voting, to increase their holdings in such shares. This will enable them to further diversify their portfolios so reducing risk. Overall, in the longer term, the proposal should give rise to greater liquidity in European capital markets.

Opinion, *supra* note 146, at 43, ¶¶ 4.1.1-4.1.2.

156. Financial economists who studied different legal systems concluded that law determines the ownership structure and systems of corporate finance and governance. The more protective the law, the more likely that a widely dispersed ownership system

could then provide additional support for improved corporate governance.

B. *Focus of Company Law*

The focus of company law raises the issue of the extent to which constituencies other than shareholders should be the focus of protection under company law. In a number of countries within the EU the interests of labor are protected. This has in the past played a significant role in the creation of EU company law.[157] The role of other constituencies appeared to have played no role in the enactment of the Voting Rights Directive which was clearly aimed at enhancing shareholder power within the company.

The general idea that shareholders who have the right to vote should be facilitated on its face is uncontroversial as seen from the quick enactment. Unlike other EU company law initiatives,[158] the Voting Rights Directive did not directly threaten labor participation in some Member States. But if one views the debate about company law focus as a power struggle between different stakeholders, then any enhancement of one arguably lessens the power of the other.[159] If the Voting Rights Directive does increase shareholder voting, particularly through institutional shareholders, then there may be more pressure for companies to focus on shareholders' interests and thus have an effect on other stakeholders.[160]

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will emerge. *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 511-13 (1999); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1114-17 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1131-32, 1149 (1997). Subsequent research suggested that increased legal protection and dispersed ownership is in fact beneficial compared to the concentrated ownership system. Increased legal protection encourages not only dispersed ownership but also the related depth of the capital markets, which can lower the cost of capital for corporations. *See* Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147, 1147-48 (2002). One could view the Voting Rights Directive, which enhances shareholder voting, as a means to encourage shareholder dispersion through lawmaking.

157. *See supra* Part II.B and notes 39-41 and accompanying text.

158. *See id.*

159. A German official concerned with corporate restructurings described some foreign investors as "locusts." *See, e.g.*, Bertrand Benoit, *German Deputy Still Targets 'Locusts'*, FIN. TIMES, Feb. 14, 2007, http://www.ft.com/cms/s/55437712-bc4e-11db-9cbc-0000779e2340.html.

160. *See* Annex, *supra* note 88, at 7, ¶ 3.2 ("Good corporate governance can also be considered to facilitate corporate restructuring, as companies turn more quickly to new

C. *Federalism*

Unlike the United States, the EU has no long standing tradition of a federal presence in issues related to shareholder voting. The Voting Rights Directive is an attempt to facilitate voting. Some Member States had already taken steps since then to enhance shareholder voting, remove barriers to voting, and improve their proxy system; and thus it may be unclear that the EU needed to act.[161]

In many ways the Voting Rights Directive was careful not move too far forward leaving the Member States as the primary source of voting rights issues. It avoided controversial yet important issues of voting such as promotion of one share one vote principles.[162] The EU decided not to use a regulation with its uniform treatment of voting rights, but went forward with a directive to allow for flexibility in approaches.[163] The Voting

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areas of growth, whereas bankruptcy may ensue when management fails to invest resources profitably."). *But see id.* at 38, ¶ 7.

> As for other remaining stakeholders, such as issuers' employees, it is not possible to give an estimate of the effect of the present proposal. As said, the impact of the present proposal is to reduce cross-border voting costs, to increase shareholder participation in company life and the quality of company management. This should lead to more efficient listed companies, which in principle should have a positive effect on employment. However, the chain of causalities being very long, it is not possible to propose quantitative estimations, although it would be possible to say that a more efficient corporate Europe should have a positive effect on employment. Moreover, there is no environmental impact of the present proposal.

Id.

161. Professors Enriques and Gatti have argued that there were insufficient reasons to justify the Voting Rights Directive. They see the Voting Rights Directive as having two goals—the removal of national barriers to voting and strengthening shareholder rights—and that the former is the only legitimate goal for the EU. But they think that the Voting Rights Directive goes beyond what was needed to accomplish that goal. *See Uneasy Top-Down Harmonization*, *supra* note 69, at 983-91.

162. In 2003, CLAP had proposed a study on the deviations from the principle of proportionality between capital and control (the issue of requiring one share one vote for companies) existing in the Member States of the European Union. In 2007, the Commission published an impact statement on the issue and concluded that there is no need for action at EU level on this issue. *See* Commission of the European Communities, Impact Assessment on the Proportionality between Capital and Control in Listed Companies, SEC (2007) 1705 (Dec. 2007), at 4-6, http://ec.europa.eu/internal_market/company/shareholders/indexb_en.htm.

163. The Commission believes that the costs of a regulation could be significant since it would not be possible to offer flexibility across the differences that characterise legal traditions in EU Member States. A Directive would allow for differences in Member States' practices, preventing imbalance be-

Rights Directive was a mix of mandates and recommendations and more of a framework model with little details leaving it up to Member States to implement.[164] When there were mandates, they were minimum standards. Thus, federalism concerns influenced the final Voting Rights Directive.

CONCLUSION

As described, three themes have influenced the development of company law both in the United States and the EU—the role of ownership, the focus of company law and corporate governance, and federalism. The recent EU Voting Rights Directive was designed to facilitate shareholder voting reflects those themes but also changes that have occurred in Europe. The primary change within the themes that seems particularly significant has been with the role of ownership where there are more Berle Means corporations, increased importance of shareholders rights, and the rise of institutional shareholder ownership and activism. Enhanced voting and more shareholder activism may also increase shareholder power and focus company law more towards shareholders. The Voting Rights Directive also reflects EU federalism concerns by providing minimum standards without any pervasive regulatory framework like in the United States and still leaves much for the Member States to decide and implement.

> tween different classes of shares and shareholders and favouring basic, minimum standards.

Opinion, *supra* note 146, at 43, ¶¶ 3.3-3.4; *see also* Annex, *supra* note 88, at 22-25, ¶ 6.1.2 (outlining four possible options for policy-making: maintaining the status quo, adopting a recommendation, adopting a regulation, or implementing a directive).

164. This is consistent with the subsidiarity principle that brought about a "democratic federalism" in the EU. *See* McCahery Paper, *supra* note 61, at 15-16.

> At the national level, there are noticeably few incentives for lawmakers to modify regulatory design or reform inefficient rules because of legislative inertia and special interest. Very generally, the differences in the normative arrangements between the continental and common law systems partly explain the deeply rooted conflict between the member states over the direction and pace of the harmonization program. These insights provide key clues as to why only a relatively small number of EU-level initiatives have been heralded as major breakthroughs in the field of company law.

Id. at 16.