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Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light

Law Working Paper N°.165/2010

September 2010

Martin Gelter

Fordham University School of Law and ECGI

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Abstract

In this article, I provide a comparative historical account on the debate of whether corporations should exclusively be run by the company in the interest of shareholders, or whether managers should be permitted or required to take the interests of others groups (stake-holders) into account. The comparison focuses on the US, Germany and France and traces the debates through the most important formative periods of these countries' corporate governance systems.

It is generally assumed that shareholder primacy has a stronger following in the US and the UK than in Continental Europe, where the stakeholder view is thought to be more influential. Without doubt, the respective political histories and cultures of these countries have influenced this divergence. Without ignoring the significance of these factors, this article emphasizes a core issue that has so far been largely overlooked in comparative analysis. I argue that the respective historical debates exhibited important differences that can be attributed to the shareholder-manager balance of powers and differences in stock ownership structure across countries. Scholars in the US, Germany and France were therefore arguing about different issues due to different economic circumstances, which is why it is problematic to equate adherents of shareholder primacy or a stakeholder view of the firm with their counterparts in other corporate governance systems.

In the US, Berle and Means famously identified the prevalence of a strong separation of ownership and control in 1933. US-style dispersed ownership has always generated debates about the question of how to best address what is today described as an agency cost problem, but also to what extent managerial power is legitimate.

By contrast, larger blocks of share ownership prevailed around 1930 in Continental Europe, as they still do today. Participants in the German and French debates were therefore concerned with issues of controlled companies and corporate groups, which undermined the power of the board of directors. At the same time, the comparatively strong influence of shareholders raised other concerns that were rarely an issue in large US corporations, such as blockholders' private benefits of control and conflicts between competing groups of shareholders that arguably harmed business development. Institutional theories of the corporation, which are traditionally hospitable to stakeholder concerns, seemed to provide a defense of the corporation against its shareholders.

The different nature of the main issues put pro-management and pro-shareholder on different sides of the shareholder-stakeholder debate on the two sides of the Atlantic. In the US, reformers typically had the goal of limiting the power of management to the benefit of shareholders, thereby "taming" the large corporations, whose power was (and is) often identified with that of top management. In France and Germany, critics of the prevailing allocation of control advocated an institutional theory of the corporation to protect the "business in itself" in Continental Europe, and by proxy, its stakeholders from destructive shareholder influence. Continental critics of the status quo therefore sought to limit allegedly excessive influence of shareholders and capital on corporate management.

Keywords: shareholder primacy, stakeholders, corporate theory, theory of the firm, Rathenau, Unternehmen an sich, interet social, codetermination

JEL Classifications: J53, K22, L22, N12, N14, P16, P52

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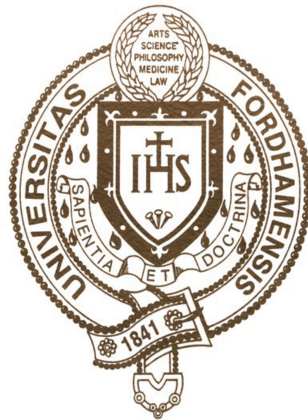

August 2010

"Taming or Protecting the Modern Corporation? Shareholder - Stakeholder Debates in a Comparative Light"

By

MARTIN GELTER
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WORKING PAPER SERIES

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"In the last seven deals that I've been involved with, there were 2.5 million stockholders who have made a pretax profit of 12 billion dollars. … The point is, ladies and gentleman, that greed, for lack of a better word, is good."

- Gordon Gekko in "Wall Street"[1]

"It is infidelity of the lord to the vassal for Siemens to ax 12000 jobs, while at the same time broadcasting a 20% increase in profits."

- Rolf Hochhuth, "McKinsey is coming"[2]

1. Introduction

What is, and what should the ultimate purpose of the corporation be? What goals should directors by required or permitted to pursue? While there is widespread agreement that ultimately "corporate enterprise should be organized and operated to serve the interests of society as a whole",[3] there are two opposing philosophies how this objective can best be advanced. The majority of US corporate law scholars today would probably side with Gordon Gekko, the fictional 1980s takeover artist who, like his real-life counterparts, broke up firms to make money for shareholders. Milton Friedman, in a 1970s essay, provided a succinct summary by stating that "[t]he Social Responsibility of Business is to Increase its Profits."[4] According to the contemporary standard explanation, the maximization of long-term shareholder value should indeed be the goal of corporate law, whereas the protection of the interests of other stakeholders such as employees, suppliers, costumers, local communities etc. should be left to

[1] WALL STREET (20th Century Fox 1987).

[2] "Untreue des Herrn gegen den Knecht ist, wenn Siemens 12 000 Stellen abbaut, doch zugleich eine Gewinnsteigerung um 20 Prozent ausposaunt!" (own translation). ROLF HOCHHUT, MCKINSEY KOMMT. MOLIÈRES TARTUFFE 76 (4th ed. 2004).

[3] *E.g.* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law,* 89 GEO. L. J. 438, 441 (2001).

[4] Milton Friedman, *The social responsibility of business is to increase its profits,* NEW YORK TIMES, SUNDAY MAGAZINE, Sept. 13, 1970, at 17.

contracts, or other fields of law, given that shareholders are residual claimants.[5]

The quotation from Rolf Hochhuth's controversial 2004 play casts the social role of the corporation in an entirely different light: Like the medieval feudal lord, who was expected to protect his vassals, the corporation owes a responsibility to protect its employees and to provide them with benefits and a secure livelihood. The broader issue is that the goal of corporate activity should be to increase the welfare of all groups that closely interact with the firm and have an interest in its continuous well-being (its so-called "stakeholders"). The German origin of the quotation betrays that this philosophy is understood to enjoy a much larger following in Continental Europe than in the more market-oriented economies of the US and the UK.[6]

Nevertheless, this question has stirred debate among scholars and practitioners in much of the developed world. The participants of such debates sometimes knew about debates in other countries. In the US, Adolph Berle engaged in a famous exchange with Merrick Dodd that is typically seen as foreshadowing later shareholder-stakeholder discussions in 1932. Berle must have been aware of at least some ideas of Walther Rathenau, the forerunner of the German debate, given that he cites Rathenau in his seminal book with Gardiner Means.[7] Although these debates have repeatedly been subjected to retrospective analysis by academics and policymakers in the respective countries, a true comparative understanding of the intellectual history of corporate law has yet to emerge. The objective of this paper is to fill in part of this gap and suggest a specific theory to explain differences between the US debate on the one hand, and the German and French

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[5] Hansmann & Kraakman, *supra* note 3, at 449.

[6] *E.g.* Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 AM. J. COMP. L. 497, 500-501 (2001); Hansmann & Kraakman, *supra* note 3, at 443-449; Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style,* 29 DEL. J. CORP. L. 649, 733 (2004); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance,* 50 HARV. INT'L L.J. 129, 131 (2009); Christopher M. Bruner, *Power and Purpose in the "Anglo-American" Corporation,* 50 VA. J. INT'L L. 579, 581 (2010).

[7] ADOLF A. BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 352 (1933).

debates on the other. The truth that the conventional wisdom of Continental Europe is more stakeholder-oriented is debatable, despite frequently cited examples such as German codetermination.[8] However, the intellectual history seems to support a greater focus on shareholder welfare in the US: Shareholder primacy seems to have had a larger following.

One explanation could be that (Continental) Europeans are more socialistic than Americans.[9] Indeed, it is often thought that stakeholder theories were popular among those who sought government intervention in the economy. However, this is not an entirely satisfactory explanation: The US has had its fair share of political populism that was often directed against powerful players in corporate governance.[10]

The "varieties of capitalism" school of economic sociology provides the basis for another hypothesis. This literature distinguishes between liberal and coordinated market economies, with liberal ones relying primarily on markets and hierarchies to organize economic activity, and coordinated ones relying on long-term relationships.[11] A stakeholder view of corporate law and a corresponding duty of directors could be seen as an instrument of protecting long-term relationships.[12] While the respective national manifestations of the debate were certainly influenced by cultural and economic circumstances in

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[8] *E.g.* Klaus J. Hopt, *Labor Representation on Corporate Boards: Impact and Problems for Corporate Governance and Economic Integration in Europe,* 14 INT'L REV. L. & ECON. 203, 208-209 (1994).

[9] *Cf.* Marco Becht & J. Bradford DeLong, *Why Has There Been so Little Block Holding in America?* in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 613, 613 (Randall K. Morck ed. 2005) (citing German economist Werner Sombart about why the US had no socialism 100 years ago); MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003) (explaining the persistence of block ownership in Europe with the presence of strong political pro-labor pressure).

[10] MARK J. ROE, STRONG MANAGERS – WEAK OWNERS 51-124 (1994).

[11] Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism,* in VARIETIES OF CAPITALISM 1, 8-9 (Peter A. Hall & David Soskice eds. 2001).

[12] Katharina Pistor, *Legal Ground Rules in Coordinated and Liberal Market Economies,* in CORPORATE GOVERNANCE IN CONTEXT 249, 259, 269-270 (Klaus J. Hopt, Eddy Wymeersch, Hideki Kanda & Harald Baum eds. 2005).

general, the explanation proposed in this article relates to this argument, but differs in an important respect. I argue that cross-country differences in corporate ownership structure, played a decisive role for why movements against the prevailing powers in corporate governance took different shapes, given the impact that the existence of large ownership blocks have on the relationship between different groups of shareholders, and between shareholders and stakeholders.

In the US, "stakeholder" arguments and institutional theories of the corporation tended to be brought forward in defense of the status quo, which is characterized by an unusual degree of managerial power. By contrast, similar theories in France and Germany served as a possible argument to constrain large firms there, namely large blockholders, and to prevent them from using their influence in a way that hurts the firm, minority shareholders, and other stakeholders. In other words, "pro-stakeholder" arguments stood on two different sides of the debate: Perhaps critics of prevailing corporate structures had better reasons to advocate stakeholder protection than their American counterparts.

Today, the US and the UK are normally thought to be characterized by dispersed ownership, while in most other countries' economies concentrated ownership persists even in most of the largest firms.[13] While the exact time that dispersed ownership developed is far from clear[14] and the actual prevalence of dispersed ownership is even disputed by some,[15] the study of comparative intellectual history

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[13] According to the conventional wisdom, the US and the UK have dispersed ownership in most large firms, whereas elsewhere, concentrated ownership prevails. *E.g.* Raphael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate ownership around the world,* 54 J. FIN. 471 (1999).

[14] When the UK developed dispersed ownership is disputed. Most scholars believe that dispersion occured some time between the 1950s and the 1980s. *See e.g.* Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom,* 30 J. LEGAL STUD. 459, 466-468 (2001); ROE, *supra* note 9, at 100; *but see* Julian Franks, Colin Mayer & Stefano Rossi, *Ownership: Evolution and Regulation* (2006)*,* 29 REV. FIN. STUD. 4009 (2009) (arguing that dispersed ownership was already present in the early 20th century).

[15] Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009) (arguing that, contrary to the conventional wisdom

reveals that conventional wisdom about ownership structures influenced shareholder-stakeholder debates. Following the emergence of the large, "modern corporation" (in the words of Berle and Means[16]), scholars and practitioners attempted to make sense of what they observed in practice, and to influence policy. Their respective perception of ownership structure was sometimes an explicit, sometimes an unspoken premise that shaped the debates and the views expressed therein.

I further highlight how the shareholder-stakeholder controversy is intimately linked to the balance of powers between management and directors on the one hand, and shareholders on the other. As a consequence of perceived corporate governance failures during the scandals of the early 2000s and the current financial crisis, US corporate law policy finally seems to be moving in the direction advocated by most academics by increasing shareholder power,[17] apparently undergoing a "seismic shift."[18] This issue takes us back to the old controversy between proponents of "contractual" and "institutional" theories about the nature of the corporation. With the foundational contract between shareholders fading into the background in institutional theories, the latter is more amenable to greater independence from shareholders, which also allows a stronger role for stakeholders such as workers.

I argue that the positions of the proponents of either view on one side of the Atlantic cannot easily be equated with their purported equivalents on the other side, given that they brought forward arguments against the backdrop of very different economic patterns and

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and most other empirical evidence, dispersed ownership is not more prevalent in the US than elsewhere).

[16] BERLE & MEANS, *supra* note 7.

[17] *See* most prominently, the proposed Shareholder Bill of Rights Act of 2009, S. 1074 111th Cong. (requiring a mandatory shareholder vote on executive pay and a greater input of shareholders in board elections), and the proposed SEC Rules Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29024-01 (SEC proposed June 18, 2009) (requiring the inclusion of shareholder nominees in the management proxy statements).

[18] Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World,* ECGI LAW WORKING PAPER NO. 152/2010, 3 (2010), at http://ssrn.com/abstract=1582258.

therefore were concerned with different political and economic issues. Since Berle and Means discovered dispersed ownership in the US in 1932, scholars argued about the strong position of managers, its consequences, and possible remedies to the problems it caused. A considerable degree of institutional independence of the corporation from shareholders was always evident, and the economic and political power of "big business" seemed to be concentrated in the hands of a managerial elite. The main concern therefore was whether and how managers should be constrained. While some hoped to commit them to shareholder value, others wanted to enlist them as guardians for the interest of all corporate constituencies. Members of the opposing camp were more optimistic about managers' ability and willingness to consider stakeholder concerns. Even today, the defining characteristic around which all debates revolve is managerial power. "Stakeholder" and "institutional" arguments tend to serve the purposes of corporate insiders, specifically to defend their entrenched position from assaults of outside investors and policymakers hoping to hold them more accountable.

By contrast, participants in the German and French debates addressed issues of controlled with larger blocks of shares. In the absence of an atomized shareholder structure, the potential for conflict between competing groups of shareholders became a major concern. At least according to some, it impeded the creation of welfare by large corporations, and its ability to serve the public interest. Obviously, conflicts among shareholders are more important when there are large blocks, particularly when ownership structures became fluid in an unstable economic environment.

As a consequence of the difference in the relative importance of these two concerns, the roles of contractual and institutional theories were reversed in the US and the two Continental European countries, with the "reformist" camp ending up on two different sides. In the US, excessive shareholder influence remained a non-issue. Scholars were (and still are) concerned with excessive managerial power that was criticized as lacking legitimacy and later as causing large agency costs. "Institutionalist" or pro-stakeholder arguments tended to be a defense for managers (unless they were coupled with regulato-

ry intervention[19]), while critics of the current status quo tended to be the ones emphasizing shareholder interests and assailing the managerial stronghold. Contrariwise, in Germany and France, analysts who sought to change the status quo by limiting the excessive influence of the apparently power-wielding group needed to constrain shareholder influence, and thus advanced theories emphasizing the "institutional" character of the corporation, which are typically more hospitable to stakeholder concerns. These were intended to defend the corporation against the effective controllers of the firm – large shareholders – in order to limit outside influence that was sometimes detrimental. Institutional theories were suggested to defend corporations against their shareholders. The "interest of the corporate entity" – a core concept in Germany and France– was originally intended as a mechanism to balance conflicting interests and to avoid abuses, although the practical significance has remained limited.

This article proceeds as follows. Section 2 sets the scene by describing the relevant economic theory and the stakes of the debate, focusing particularly on US corporate governance and showing why the historical comparison is important for the current discussion in shareholder empowerment: Why does the balance of powers between shareholders and managers matter so much? What effects does it have on stakeholders, and why does the debate about the institutional or contractual understanding of the corporation matter? This section also introduces the historical vehicle of these conflicts of interest, namely the controversy about the "legal nature" of the corporation. Section 3 briefly describes the historical development of the US debate relating to the shareholder-stakeholder controversy and seeks to contextualize it against the backdrop of dispersed ownership. Sections 4 and 5 provide relatively detailed accounts of the historical German and French debates, emphasizing how the presence of blockholders and intra-shareholder conflicts of interest resulted in a different debate. Section 6 puts the pieces of the puzzle together and develops the comparative theory of this paper. Section 7 concludes.

[19] An example would be RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION (1976).

2. What's at stake? The underlying conflicts of interest

This section provides an overview of the US development of the balance of power between managers and shareholders, both in its historical dimension and the contemporary discussion; in doing so, it introduces the underlying conflicts of interest, and explains how managerial power and shareholder-stakeholder issues are connected. US corporate law seems to be currently undergoing a shift from a system with shareholders that are powerless vis-à-vis managers (described in section 2.1) to one where their significance grows (this trend is described in section 2.2). Section 2.3 looks at the arguments against shareholder empowerment, and section 2.4 introduces the debate between "contractual" and "institutional" theories of the corporation. Both are important for the comparative study, since more arguments against shareholder empowerment often resemble historical European ones.

2.1. Powerless American shareholders?

Historical discussions of US corporate governance often begin with Berle and Means. Adolph Berle, a Columbia law professor on his way to becoming the doyen of American corporate law, and the young economist Gardiner Means famously identified the "separation of ownership and control" in their 1932 book:[20] Having conducted a meticulous empirical study[21], the two authors found that a large proportion of the publicly traded firms were owned by a large number of widely dispersed, but powerless shareholders, and de facto controlled by a managerial oligarchy. Berle and Means' seminal study became the fundament on which economists and legal scholars have built their debates upon until today. Dispersed ownership, which they identified as the predominant structure among large, publicly traded firms,

[20] BERLE & MEANS, *supra* note 7.

[21] Gardiner C. Means, *The Diffusion of Stock Ownership in the United States,* 44 Q. J. ECON. 561 (1930); Gardiner C. Means, *The Separation of Ownership and Control in American Industry,* 46 Q. J. ECON. 68 (1931).

continues to be seen as a defining characteristic of US-style capitalism.[22]

Following the Depression, the New Deal and World War II, the US economy entered a period of growth. American firms developed into large conglomerates that not only extended into various industries and behemoths of worldwide importance. The internal structure of these firms, however, remained relatively stable, as they developed into large bureaucracies governed by managerial elites.[23] In that period, top management may have grown even more distant from any influence of shareholders, who continued to be considered the owners of the firm by legal doctrine.[24]

Things changed dramatically around 1980. Triggered by innovations in banking, such as the development of junk bonds and the proliferation of leveraged buyouts, a wave of hostile takeovers shook the economy.[25] For a while, this new market for corporate control resulted in many firms being taken over and restructured. Some praised the qualities of this market for reducing inefficiencies by aligning managerial interests with those of shareholders, thus reducing agency cost.[26] Others were concerned about stakeholders of firms,

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[22] *But see supra* note 15 and accompanying text.

[23] *E.g.* DAVID SKEEL, ICARUS IN THE BOARDROOM 108-111 (2005); GERALD F. DAVIS, MANAGED BY THE MARKETS 72-77 (2009) (describing managerial dominance during this period); for contemporary accounts of the "managerial revolution" *see* ALFRED DUPONT CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977); JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE (1st ed. 1967; 4th ed. 1985; reprint 2006).

[24] *E.g.* Hansmann & Kraakman, *supra* note 3, at 444 (suggesting that legislative developments of that period tended to further entrench managers).

[25] *See* Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law,* 69 U. CHI. L. REV. 871, 884, 873-874 (2002) (providing empirical evidence about the takeover wave); SKEEL, *supra* note 23, at 111-116: John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation,* 95 GEO. L. J. 1727, 1755 (2007); DAVIS, *supra* note 23, at 81-87.

[26] Henry Manne, *Mergers and the Market for Corporate Control,* 73 J. POL. ECON. 110 (1965); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management to a Tender Offer,* 94 HARV. L. REV. 1161 (1981); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tac-*

such as creditors whose claims declined in value because of junk debt issues, communities where factories were closed, and employees losing their jobs.[27]

On one level, the change was only temporary: takeover artists did not typically retain a controlling stake in the firm, so that ultimately most companies remained management-controlled (even though the companies emerging from a hostile takeover were often very different from their predecessors). Managers and lawyers representing them learned how to defend against hostile takeovers, and after some years of back and forth in the Delaware courtrooms, the courts acquiesced to granting directors wide latitude to defend against hostile takeovers.[28]

On another level, the American economy was deeply affected. Observers often attribute a paradigm shift from a "managerial" to a "shareholder-centric" corporate economy that happened to this period. Following the development of agency theory in corporate finance,[29] the idea that managerial agency cost was the main problem of corporate law and that managers should work only in the interest of shareholders gained widespread acceptance.[30] The proliferation of defined contribution pension plans, which essentially made Americans dependent on the stock market, may have been a contributory

tics in Tender Offers, 33 STAN. L. REV. 819 (1981);Michael C. Jensen, *Agency Cost of Free Cash Flow, Corporate Finance, and Takeovers,* 76 AM. ECON. REV. 323, 327-329 (1986)..

[27] Andrei Shleifer & Lawrence Summers, *Breach of Trust in Hostile Takeovers,* in CORPORATE TAKEOVERS. CAUSES AND CONSEQUENCES 33, 37 (ALAN J. AUERBACH ed. 1988); Morey W. McDaniel, *Stockholders and Stakeholders,* 21 STETSON L. REV. 123, 123-126 (1991).

[28] *Infra* note 37-41 and accompanying text.

[29] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. FIN. ECON. 305 (1976); *see* RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS 317-326 (2007).

[30] *E.g.* Hansmann & Kraakman, *supra* note 3, at 440-441; (arguing that a shareholder-based corporate governance system replaced a managerial system during that period); DAVIS, *supra* note 23, at 87-95; KHURANA, *id.,* at 297-305.

factor.[31] A changing culture in business education and managerial social norms seems to have been a collateral consequence.[32]

Nevertheless, managers remained steadfastly in control of firms, as the hostile takeover market declined in the early 1990s. However, this was followed by an increase in incentive-based executive compensation, which some have interpreted as an adaptive response by the market to align managers' incentives with shareholder interests.[33]

Despite this apparent shift, Berle and Means' "separation of ownership and control" persists. Factual managerial power is bolstered by pro-management legal institutions. The balance of power is tilted in favor of the board of directors (compared to shareholders) in a way that is unparalleled in other important corporate jurisdictions. The board of directors is entrusted with the task of directing the business and affairs of the corporation[34] with little influence from shareholders. The process of nominating and reappointing directors, including independent outside board members, is dominated by the incumbents, who have the advantage of using the firms' resources to run the proxy machinery to garner votes. The chances for an insurgent outsider to oust management are dim, and incentives are mitigated by the uncertainty of being reimbursed.[35] Securities law erects further

[31] DAVIS, *id.,* at 212-222; Markus Roth, *Employee Participation, Corporate Governance and the Firm: A Transatlantic View Focused on Occupational Pensions and Co-Determination,* 11 EUR. BUS. ORG. L. REV. 51, 58-59, 68-69 (2010); *see* EDWARD A. ZELINSKY, THE ORIGINS OF THE OWNERSHIP SOCIETY 101-105 (2007) (contrasting the prevalence of defined contribution plans in the US with their absence in other major industrial countries).
[32] KHURANA, *supra* 29, at 305-323.
[33] Kahan & Rock, *supra* note 25.
[34] DGCL 141(a).
[35] The leading case is Rosenfeld v. Fairchield Engine & Airplaine Corp., 128 N.E.2d 291 (N.Y. 1955) (establishing the "Froessel rule" named after Judge Charles Froessel). For a more thorough description and a deeper analysis *see* Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests,* 78 CAL. L. REV. 1073, 1106-1126 (1990); *see also* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise,* 93 VA. L. REV. 675, 682-683 (2007) (reporting that the number of contested proxy solicitations per year never exceeded 40 for the period between 1996 and 2004, during which time there were about 300 contested solicitations in total).

barriers to coordination that might tip the balance of power towards shareholders.[36]

The effects of market mechanisms that align the interests of managers with those of shareholders have long remained limited. While the US saw a famous wave of hostile takeovers in the 1980s, these subsequently became rarer as a consequence of Delaware case law. With the narrowing of the *Unocal*[37] standard in *Unitrin*[38], and the restriction of *Revlon*[39] duties under the two *Paramount*[40] cases, managers are essentially able to "just say no" to a hostile bid.[41] Studies have found that firms with both a poison pill and a staggered

[36] Under § 13(d) of the Securities Exchange Act, anyone directly or indirectly acquiring beneficial ownership of 5% of any class of equity security must submit a 13(d) filing with the SEC within 10 days. One important aspect is SEC Rule 13d-5(1), under which persons acting together "for the purpose of acquiring, holding, voting or disposing of equity securities" are deemed a group for purposes of § 13(d), and are thus required to submit a 13D filing if they jointly surpass the 5% threshold. *See* John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report,* 15 CARDOZO L. REV. 837, 842, 877-882 (1994), and Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States,* in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459, 461 (vol. 3, Peter Newman ed. 1998) (both discussing how this requirement inhibits, if not entirely prevents coordination among shareholders).
Furthermore, shareholders communicating among each other run the risk of having to file a proxy statement. Securities Act § 14 and SEC Rule 14a-1(l)(iii) require one if communication is "reasonably calculated to result in the procurement, withholding or revocation of a proxy." Rule 14a-8, which allows a proposal to be included in the company's proxy statement, is open only to limited subject matters requires submission six months before the shareholder meeting. *See* Black, *id*, at 459; *see also* Coffee, *id.,* at 884. Regarding impediments against institutional shareholder such as banks and insurers *see* ROE, *supra* note 10 (showing how banking regulation and other laws prevented institutional investors from taking a greater role in US corporate governance).
[37] Unocal Corp. v. Mesa Petroleum Co., 493 A. 3d 946 (Del. 1985).
[38] Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995).
[39] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (1986).
[40] Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (1989); Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 47 (Del. 1993).
[41] *E.g.* Jeffrey N. Gordon, *"Just Say Never": Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet,* 19 CARDOZO L. REV. 511, 516 (1997).

board that is entrenched in the corporate charter are essentially takeover-proof.[42] Executive compensation was intended to align financial managerial interest with shareholders'[43] and was sometimes even described as an adaptive response making up for the absence of pro-shareholder incentives resulting from takeover defenses.[44] However, there is mounting criticism that it primarily serves as a rent-creational device for management.[45]

2.2. The current trend towards shareholder empowerment

Finance theorists and scholars of corporate law have often lamented this state of affairs and sought to make management more attentive to the needs of shareholders. The debate has intensified in recent years due to the financial crisis, and to some extent the efforts of shareholder rights advocates are now coming to fruition. First, shareholder activism has led some firms to abandon certain practices that impede shareholder influence. Upon the insistence of institutional investors, an increasing number of firms have dismantled staggered boards, thus removing one barrier to hostile takeovers.[46] Bylaw provisions requiring majority approval for uncontested elections of direc-

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[42] Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy,* 54 STAN. L. REV. 887 (2002).

[43] Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives,* 98 J. POL. ECON. 225 (1990); Lucian A. Bebchuk & Jesse M. Fried, *How to Tie Executive Compensation to Long-Term Results*, 22 J. APPL. CORP. FIN. 99 (2010) (describing how executive compensation could be fixed to achieve long-term benefits).

[44] Kahan & Rock, *supra* note 25, at 896-899; *see also* Jeffrey N. Gordon, *An American Perspective on Anti-Takeover Laws in the E.U.: The German Example*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 541, 553–54 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004)

[45] Lucian Arye Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71 (2003); Lucian A. Bebchuk & Jesse M. Fried, *Pay without Performance: Overview of the Issues*, 30 J. CORP. L. 647 (2005).

[46] Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1007-1010 (2010); *see also* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power,* 118 HARV. L. REV. 835, 852-856 (2005) (providing data about precatory resolutions by activist shareholders to dismantle staggered boards)

tors have also become more widespread,[47] thus reducing managerial control over the process.[48] Second, modifications of securities law have somewhat expanded the shareholder franchise. A July 2009 amendment of NYSE Rule 452 and the Dodd-Frank Act of 2010 now prohibit brokers from voting shares held for clients in uncontested director elections without having received instructions.[49] This increases the influence of institutional investors by essentially eliminating votes that would otherwise have almost certainly been cast in the favor of the incumbents. Recent amendments facilitate the electronic dissemination of proxy statements, thus reducing the costs of a shareholder insurgency.[50]

Additional proposals are currently being debated. Most prominently, the SEC has repeatedly[51] issued proposals to amend its rules in order to expand "shareholder access" to the company's proxy statements, which would permit larger shareholders to place nominees for a limited number of seats on the company's proxy statement.[52] Bebchuk has suggested that shareholders should be permitted

[47] STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 213 (2008) (reporting that 31% of the Fortune 500 companies had adopted a majority voting bylaw by 2006); Kahan & Rock, *id.,* at 1010-1011. There was some debate whether Securities Law should require majority voting, but the Dodd-Frank Act was passed such a provision.

[48] Under plurality voting, which is the default rule (DGCL 216(3); RMBCA 7.28(a)), an unopposed candidate is elected if he gets a single vote (with all other shareholders abstaining). Both the DGCL and the RMBCA were amended in 2006 to prohibit directors from amending bylaws that require majority voting. *See* William K. Sjostrom & Young Sang Kim, *Majority Voting for the Election of Directors,* 40 CONN. L. REV. 459, 474-479 (2007).

[49] SEC Release No. 34-60215; File No. SR-NYSE-2006-92. Dodd-Frank Act § 957.

[50] *See* 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, 487-491 (2008); *see* Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914, Investment Company Act Release No. 28,075, 72 Fed. Reg. 70,450 (Dec. 11, 2007) (effective Jan. 11, 2008).

[51] The initial proposal was made by the SEC in 2003. *See* Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60,784, 60,785 (Oct. 23, 2003); Gordon, *supra* note 50, at 484.

[52] Kahan & Rock, *supra* note 46, at 1022. § 971 of the Dodd-Frank Act clarifies that the SEC has the power to pass such a regulation.

to "set the rules" by allowing them to initiate important decisions such as charter amendments or reincorporations,[53] which they currently cannot do without a proposal by the board of directors.[54] Dissatisfaction with managerial compensation practices has led to calls for "say on pay" in the form of an annual shareholder vote on compensation packages.[55] The Dodd-Frank Act now requires such a vote every three years.[56]

Advocates of such reforms argue that greater shareholder empowerment would induce management – either directly or indirectly – to act in the interest of shareholders, and reduce agency cost. The underlying concern is that directors and officers, if left unconstrained, will, on the one hand, squander the assets firm or shift them into their own pockets through self-dealing transactions, but on the other hand, frequently just not work hard enough to achieve the best possible result for shareholders. The normative conclusion is that shareholders are the group whose payoff managers should seek to maximize. Since they do not have explicit contractual rights, but are left with the firm's residual cash flows,[57] their position is most strongly at risk. They also have the best incentives to monitor managers and other constituencies in order to maximize the total value of the firm.[58] If managers maximize shareholder value, it follows logically that all other constituencies will also be fully satisfied. On the other hand, the more pragmatic reason for shareholder primacy is the relative ease of holding directors accountable to the clear objective of shareholder primacy, as opposed to a multi-faceted goal including stakeholders

[53] Bebchuk, *supra* note 46, at 865-875.
[54] In a dispersed ownership firm, directors will typically side with entrenched management and not make proposals favoring shareholder involvement.
[55] *Supra* note 17; *see e.g.* Jeffrey N. Gordon, "*Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-in,* 46 HARV. J. LEG. 323 (2008).
[56] Dodd-Frank Act § 951 (introducing a new § 14A of the Securities Exchange Act).
[57] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 11 (1991).
[58] Armen A. Alchian & Harold Demsetz, *Production, Information Cost, and Economic Organization,* 62 AM. ECON. REV. 777, 781-783 (1972).

and society as a whole.[59] Assuming that shareholder wealth maximization is the proper goal of corporate law, shareholder empowerment indeed appears as a solution to accountability problems, minimizing agency cost and optimizing incentives for directors and officers.

2.3. Objections to shareholder empowerment

If shareholder power is indeed so beneficial, why are large businesses typically run as corporations, where the board of directors enjoys such great authority and control by shareholders is tightly curtailed?[60] Some objections can be made within the shareholder primacy framework: Centralized management under the direction of a board of directors has a transaction cost advantage over shareholder decision-making, as it involves only a relatively small group of people who (in the best case) have the information, capabilities and incentives to run the firm well; direct control by the firms owners is usually only workable in small enterprises. Otherwise, DGCL 141(a), which grants broad authority to directors in spite of the obvious potential for agency cost, would be a losing proposition right from the beginning.[61] Some scholars argue that shareholders have good reasons to bind their own hands in favor of a group of experts with superior information and comparatively homogenous interests that will avoid mutual holdup of decision-makers. For example, shareholders may agree that corporations should maximize shareholder wealth, but disagree about how to best pursue this goal. Given the complexity of corporate decisions, it may be preferable to concentrate them at the level of the board of directors, which constitutes a relatively homoge-

[59] A. A. Berle, Jr., *For Whom are Managers Trustees: A Note,* 45 HARV. L. REV. 1365, 1368, 1372 (1931); *See* Bebchuk, *supra* note 35, at 731 (arguing that looser accountability also hurts stakeholders with managers' loss of accountability to shareholders).

[60] *See* DGCL 141(a).("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of the board of directors [...]").

[61] *E.g.* Lynn A. Stout, *The Mythical Benefits of Shareholder Control,* 93 VA. L. REV. 789, 792-793 (2006); John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?* in THE ANATOMY OF CORPORATE LAW 1, 13 (2nd ed., Reinier Kraakman et al. 2009)

neous group of people with good information and incentive, which will generally yield better results than bickering among potentially heterogeneous shareholders.[62] Relatedly, an argument against minority directors is that these might lead to a balkanization of the board.[63]

Some analysts point out that the interests of different groups of shareholders may diverge strongly, which is likely to create friction and inhibit decision-making in corporations.[64] Short-term and long-term shareholders often have strongly divergent goals, which is particularly relevant given the increasing role of activist short-term investors such as hedge funds. Since capital markets are not perfectly efficient and do not accurately reflect long-term value, some shareholders may be tempted to seek short-term profits by taking decisions that are contrary to the long-run interest of the firm, thus undermining an enduring productive development.[65] Diversified and undiversified shareholders are likely to have different risk preferences, and the interests of shareholders that have hedged their risks may be decoupled from the financial welfare of the corporation.[66] In fact, some shareholders may rather seek to advance their personal rent-seeking goals resulting from opportunities to obtain private benefits of control rather than to vote in favor of the greater good of the shareholder

[62] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governanc*e, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment,* 199 HARV. L. REV. 1735, 1744-1751 (2006); *see also* Martin Lipton & Steven A. Rosenblum, *Election Contests In the Company's Proxy: An Idea Whose Time Has Not Come,* 59 BUS. LAW. 67, 73 (2008); Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy,* 51 Wm. & My. L. Rev. 2071, 2088 (2008) (""In sum, many of the arguments used to support shareholder primacy theory … are based on shareholder homogeneity").
[63] Lipton & Rosenblum, *id.,* at 82-83.
[64] Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power,* 53 UCLA L. REV. 561, 577-593 (2006): *contra* George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism,* CASE RESEARCH PAPER SERIES IN LEGAL STUDIES, WORKING PAPER 09-22, 8-25 (2009), at http://ssrn.com/abstract=1435400.
[65] Anabtawi, *id* at 579-583; *see also* Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance,* 81 NOTRE DAME L. REV. 1431, 1467 (2006).
[66] Anabtawi, *id* at 583-585, 590-592.

class.[67] Generally, the emphasis on shareholder value has been criticized as creating a short-term focus for managers who will no longer be able to take the long-term development of the firm into account.[68]

Bratton and Wachter suggest that there is a tradeoff between reducing managerial agency cost resulting from unconstrained power, and the severe informational disadvantage of shareholders, even if shareholders were able and willing to vote for the greater good of the firm, and if the market price reflects historical information.[69] Related arguments focusing on misinformation of shareholders and the inability of capital markets to reflect future information has often been brought forward in hostile takeovers, among others by prominent practitioners such as Martin Lipton:[70] Managers and directors possess superior information over shareholders and should therefore be given the capability to defend against hostile bids. Otherwise, shareholders may mistakenly accept an offer at an inadequately low price, given that the markets are unable to given sufficient weight to management's vision for the firm, and to other factors that are hard to assess for an outsider. This view has been a core policy reason for the Delaware courts jurisprudence on takeover defenses[71], and some have argued that it has been vindicated by the rise of behavioral finance and the fall of the efficient capital markets hypothesis.[72]

The recent crisis has added more fuel to the debate about shareholder empowerment. While it may have pushed the trend towards more shareholder influence, we cannot rule out that the increased shareholder orientation of the past two decades is partly to blame for the events, given that pressure to produce more shareholder

[67] Stout, *supra* note 61, at 794-795.
[68] Lawrence E. Mitchell, *A Critical Look at Corporate Governance,* 45 VAND. L. REV. 1263, 1283 (1992).
[69] William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment,* 158 U. PA. L. REV. 653, 691-705 (2010).
[70] Martin Lipton, *Takeover Bids in the Target's Boardroom,* 35 BUS. LAW. 101 (1979) (arguing that shareholders benefit from takeover defenses).
[71] *See* the case law described *supra* in notes 37-40 and accompanying text.
[72] Lynn A. Stout, *Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right,* 60 BUS. LAW. 1435, 1440-1444 (2005).

value may have led to more risk-taking, particularly in financial institutions.[73]

As this overview shows, detractors of shareholder empowerment tend to focus on the absence of adequate information of shareholders and problems of their decision-making process. Another range of issues that are hard to explain under a pure contractual agency view also may play a role. As some scholars have pointed out, an important contribution of corporate law seems to have been the establishment of a stronger degree of stability in business life. One aspect is "entity shielding", i.e. the protection of the corporate pool of assets from shareholders' individual creditors:[74] If a shareholders defaults, her personal creditors do not have recourse to the company's assets. This prevents the breakup of firms for reasons that have nothing to do with how well they do and protects going concern value.[75] Members of a partnership therefore often waive their withdrawal rights for specified periods of time, while in corporations, a majority vote is required to initiate liquidation.[76] The reduction of the need to monitor the firm's owners therefore reduces capital accumulation.[77] Margaret Blair has taken this argument further by suggesting that the "lock-in" of capital in corporations was a historically important factor that facilitated the development of big business, as it made it much more difficult for partners or investors to withdraw (or threaten to withdraw)

[73] Bratton & Wachter, *supra* note 69, at 716-726; *see also* Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay,* 98 GEO. L. J. 247 (2010) (suggesting that compensation in financial institutions should be based on total firm value instead of shareholder value).

[74] *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm,* 119 HARV. L. REV. 1333, 1343-1356 (2006).

[75] Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law,* 110 YALE L. J. 387, 403-404 (2000).

[76] Hansmann et al., *supra* note 74, at 1348-1349. In Europe, the typical requirement is a supermajority. *See e.g.* AKTG (GERMANY) § 262 I 2 (requiring 75% of the capital represented in the shareholder meeting to initiate a voluntary dissolution); C. COM. L. 225-96 (FRANCE) (requiring a majority of two thirds for decisions of an extraordinary shareholder meeting, which is required for voluntary dissolution under L. 225-246).*See also* Edward Rock, Paul Davies, Hideki Kanda & Reinier Kraakman, *Fundamental Changes,* in THE ANATOMY OF CORPORATE LAW 183, 219 (Reinier Kraakman et al. 2009).

[77] Hansmann et al. *id.,* at 1350.

their contribution and thus put pressure on others relying on the continued existence of a large-scale institution.[78] She argues that the delegation of decision-making authority to the board – and hence, an absence of shareholder empowerment – helps to restrict the control any individual large investor had on the firm, which supported the development of large-scale, business-specific organizational capital.[79]

This relates to the contemporary stakeholder theory, informed by economics, which asserts that not only shareholders, but also other groups in the firm can be residual claimants: employees, for example, are often thought to invest in specific human capital with limited use outside of the particular firm, e.g. sets of skills that cannot easily be transported elsewhere without a transition cost (which may not only include further learning, but also moving expenses).[80] Since investment of this type is costly, it will be efficient to protect employees from "expropriation" by the group effectively controlling the firm (at least if this group is strongly mindful of the financial interests of shareholders). In this view, the attenuation of shareholder control over directors, and a divergence from shareholder primacy as a matter

[78] Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizations in the Nineteenth Century,* 51 UCLA L. REV. 387 (2003); *but see* Ribstein, *supra* note 65, at 1489 (suggesting that more sophisticated contracting methods have largely solved these problems today).

[79] Blair, *id.* at 433-434.

[80] *See e.g.* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 26 (1996); James M. Malcolmson, *Individual Employment Contracts,* in 3 HANDBOOK OF LABOR ECONOMICS 2291, 2311-2337 (Orley Aschenfelter & David Card eds. 1999) (reviewing the labor economics literature on contractual protection of specific investment); Larry Fauver & Michael E. Fuerst, *Does good corporate governance include employee representation? Evidence from German corporate boards,* 82 J. FIN. ECON. 673, 679 (2006); Edward P. Lazear, *Firm-Specific Human Capital: A Skill-Weights Approach*, IZA DISCUSSION PAPER NO. 813 (June 2003), at http://ssrn.com/abstract=422562 (discussing the nature of specific investment); John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web,* 85 MICH. L. REV. 1, 74 (1986) (discussing learning about social networks within an organization); ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128, 35 (1994) (describing the geographical aspect of specific investment by quoting an engineer contrasting the difficulty of getting another job in the same industry in Texas on one hand and the easiness in Silicon Valley on the other).

of the objective of directorial decision-making may be beneficial because it facilitates specific investment and the long-term development of the corporation to the benefit of all.[81] Blair and Stout's model describes the board of directors as a mediating hierarchy standing between shareholders and other corporate constituencies. Without being strongly accountable to any specific group, the board is in the position to assign the rents produced by the corporation to all groups, thus permitting specific investment and allowing long-term business development.[82] Excessive shareholder empowerment might result in an opportunistic "hold up" of other team members in order to maximize short-term shareholder value.[83] While the stakeholder position has traditionally been unpopular among those viewing corporate governance from an economic perspective, it has gained adherents in recent years. Even in finance, stakeholder concerns seem to be taken more seriously than they used to be. Even the latest edition of a leading finance textbook notes that "managers and employees of a firm are investors, too. … If you give financial capital too much power, the human capital doesn't show up – or if it does show up, it won't be properly motivated."[84] By going public, stockholders can commit "not to interfere if managers and employees capture private benefits when the firm is successful."[85]

Irrespective of which side one takes in this debate, it is hard to deny that both have a point: The benefits of reducing the agency cost produced by unaccountable management have to be weighed against the costs of shareholder involvement. Thus, there seems to be a trade-

[81] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law,* 85 VA. L. REV. 247 (1999); *see also* Kent Greenfield, *The Impact of "Going Private" on Corporate Stakeholders,* 3 BROOK. J. CORP. & FIN. L. 72, 86 (2008) ("If management is more autonomous, it is possible for managers to use their autonomy to allocate more of the corporate surplus to employees and other stakeholders.")

[82] Blair & Stout, *id.,* at 288-289; see also Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm,* 113 Q. J. ECON. 387 (1998); Bruno Frey & Margit Osterloh, *Yes, Managers Should Be Paid Like Bureaucrats,* 14 J. MGMT. INQ. 96, 99-100, 101-102 (2005); see also Gelter, *supra* note 6, at 136-143.

[83] Stout, *supra* note 61, at 795-797.

[84] RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 949 (8th ed. 2006).

[85] BREALEY ET AL., *id.,* at 949 n.36.

off between managerial discretion on one side and accountability to shareholders on the other.[86] For the comparative exercise of this paper, it suffices to say that the arguments on both sides are relevant and were therefore considered significant by participants in the historical debates. The crucial point I seek to make is that their relative importance historically was, and maybe still is different in the US on the one hand and in France and Germany on the other, given differences in structures of corporate control.

2.4. Vehicles of the debate: How do "legal" theories about the nature of the corporation matter?

Before looking at the national shareholder-stakeholder controversies, it is necessary to clarify what is meant by the debate about the legal nature of the corporation, given that the two were often linked. Historically, scholars and courts have construed corporations have been construed as "artificial entities", "aggregates", or "natural entities", with each theory being identified with different political currents.[87] While the "artificial entity" theory emphasizes the role of the state in creating the corporation,[88] the "aggregate theory" focuses on the underlying contractual relationship. The "natural entity" theory emphasizes the existence of the corporation outside the law, which merely reflects the social reality.

In the US, a great point of contention has often been whether corporations should enjoy constitutional protections against government like natural persons, most recently in the Supreme Court's *Citizens United* decision on corporate speech.[89] A natural entity theory

[86] Alessio M. Pacces, *Controlling the Corporate Controller's Misbehaviour,* RILE WORKING PAPER NO. 2009/01, 8-11 (2009), at http://ssrn.com/abstract=1327800.
[87] John C. Coates IV, *Note: State Takeover Statutes and Corporate Theory: The Revival of an Old Debate,* 64 NYU L. REV. 806, 809 (1989); Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility,* 30 DEL. J. CORP. L. 767, 772-793 (2005) (tracing the theories through Ancient Roman and medieval sources).
[88] A famous endorsement of the theory is Dartmouth College v. Woodward, 17 U.S. 518 (1819); *see* Avi-Yonah, *id.,* at 789.
[89] Citizens United v Federal Election Commission, 558 U.S. 50 (2010).

implies a stronger protection of the corporation against the government, which was an issue in several 19th century cases.[90] However, the meaning of corporate personhood under the Constitution is only peripherally related to the debates studied in this paper, which dealt with the governance of the relationship between firms and their managers, shareholders and other stakeholders. The aggregate or contractual theory is more often identified with the "shareholder" position in the debate about the purpose of corporate law, both with respect to shareholder empowerment, and an understanding of the corporation as serving the interest of shareholders. The two entity theories, particularly the natural entity one, are often identified with a broader objective, and a more independent position of management. In Germany, this "reification" of the corporation is often traced to the theory of the "association" of Otto von Gierke, who understood legal personality as the reflection of social reality.[91] On the basis of his historical study of German medieval law, he suggested that human beings were able to form fellowships that developed an autonomous existence that was necessary for social fulfillment.[92] Thus, he became internationally known as the forefather of natural entity theory.[93] His work was po-

[90] *See* Coates, *supra* note 87*,* at 809-825. The victory of the "natural entity" theory is usually identified with Santa Clara County v. Southern Pacific Railroad, 118 U.S. 394 (1886); *contra* Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory,* 88 W. VA. L. REV. 173 (1985) (arguing that the court's famous dictum was grounded in the contemporary "aggregate theory"). Similarly, Avi-Yonah argues that the trajectory of the two federal cases on the constitutionality of antitakeover statutes ended in a victory for the real entity theory. Avi-Yonah, *id.,* at 803-810. The two cases are Edgar v. MITE Corp., 457 U.S. 624 (1982), and CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987).

[91] OTTO GIERKE, DAS DEUTSCHE GENOSSENSCHAFTSRECHT (1868). This position was much later espoused in a graphic way by ADOLF A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 18-19 (1954) (describing how a corporation would continue to operate if its charter were canceled by the state).

[92] ROGER SCRUTON, THE PHILOSOPHER ON DOVER BEACH 59 (1990).

[93] *See e.g.* Horwitz, *supra* note 90, at 179; Ron Harris, *The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business,* 63 WASH. & LEE L. REV. 1421, 1431-1435 (2006) (both describing Gierke's theories and their reception in Britain and the US); Hasso Hofmann, *From Jhering to Radbruch: On the Logic of Traditional Legal Concepts to the Social Theories of Law to the Renewal of Legal*

pularized in English-speaking countries by Frederic Maitland in the early years of the 20th century, and a number of English political and legal theorists began to entertain a "natural entity" view.[94] Gierke's longstanding influence may have helped to spread an institutional understanding of corporate law in Continental Europe, at least in Germany. However, a "stakeholder debate" was not yet on the horizon during his lifetime. Gierke's core concerns were very fundamental ones, most of all the possibility of citizens to freely form associations, and the recognition of legal capacity and personality of the latter. Still, his natural entity theory later helped to underscore the legitimacy of managerial control[95] and influenced the German debate of the 1920s and 1930s.[96] Similarly, Merrick Dodd, who came to be seen as the forerunner of American stakeholder theory as a result of his

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Idealism, in A HISTORY OF THE PHILOSOPHY OF LAW IN THE CIVIL LAW WORLD, 1600-1900, 301, 335 (Damiano Canale, Paolo Grossi & Hasso Hofmann eds. 2009); *see also* Coates, *supra* note 87, at 818 (citing Gierke as one of the original proponents of the natural entity theory of the corporation). Gierke favored collectivism over the individualism embodied in Roman law (Mathias Reimann, *Nineteenth Century German Legal Science,* 31 B.C. L. REV. 837, 871 (1990); Hofmann, *id.,* at 331) and criticized the draft for the German Civil Code for the absence of social elements. OTTO GIERKE, DER ENTWURF EINES BÜRGERLICHEN GESETZBUCHES UND DAS DEUTSCHE RECHT (1889).

[94] *See* Frederic William Maitland, *Translator's Introduction,* in POLITICAL THEORY OF THE MIDDLE AGES vii, xviii-xliii (Otto Gierke, translated with an introduction by Frederic William Maitland, 1900); FREDERIC WILLIAM MAITLAND, 3 THE COLLECTED PAPERS OF FREDERIC WILLIAM MAITLAND 310-326 (1911); *see also* A.V. DICEY, LECTURES ON THE RELATION BETWEEN LAW AND PUBLIC OPINION IN ENGLAND DURING THE NINETEENTH CENTURY 154 (2nd ed. 1914); *see also* Harold Laski, *The Personality of Associations,* 29 HARV. L. REV. 404, 413 (1916) (describing the corporation as a "real entity, with a personality that is self-created"); John Dewey, *The Historic Background of Corporate Legal Personality,* 35 YALE L. J. 655, 665 n. 13 (1926).

[95] William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal,* 74 CORNELL L. REV. 407, 425 (1989).

[96] *See* ARNDT RIECHERS, DAS "UNTERNEHMEN AN SICH" 53-55 (1996) (describing the influence of Gierke on authors of the 1920s).

rebuttal to Berle[97], used a natural entity theory to suggest that managers should have wider responsibilities than merely to shareholders.[98]

The rise of economic analysis of corporate law has somewhat blurred these frontlines, although adherents of this school often speak of the corporation as a "nexus of contracts." In spite of the linguistic similarity, it would be wrong to identify this model the old contractual theory, as the corporate nexus is meant to include relationships with employees, creditors, suppliers and others, while the traditional contractual theory focuses only on the contract between shareholders as members of the corporation, thus interpreting it as an aggregate of shareholder interests. While economic analysis of corporate law tended to emphasize only shareholders in its earlier years,[99] stakeholder theories based on the idea of specific investment of other corporate constituencies merely differ in the assumption that regular contracts do not provide complete protection for these groups, but are still firmly grounded within the nexus framework.[100] Furthermore, proponents of a shareholder wealth maximization view of corporate law have shown how the corporation as an independent entity can provide long-term commitment to creditors, but to the ultimate benefit of shareholders.[101]

In the historical debates that are the primary subject of this article, however, the dividing lines are clear: Contractual theories ultimately view shareholders as owners of assets striking a deal among each other; thus, the corporation obviously must pursue shareholder interests. According to institutional theories, the corporation as distinct entity has emancipated itself from mere shareholder interests, which makes it rhetorically easier to justify limitations on shareholder power and an emphasis on stakeholder interest.

[97] *Infra* section 3.
[98] E. Merrick Dodd, Jr., *For Whom Are Managers Trustees?* 45 HARV. L. REV. 1145, 1160-1162 (1931); *see* David Millon, *Theories of the Corporation,* 1990 DUKE L. J. 201, 216-220.
[99] *E.g.* EASTERBROOK & FISCHEL, *supra* note 57, at 12.
[100] The most prominent one is the "team production" model. *See* Blair & Stout, *supra* note 81. The "nexus of contracts" thus morphs into a "nexus of specific investment." *Id.* at 275.
[101] *Supra* notes 74-77 and accompanying text.

3. Preeminent managerial power: contextualizing the historical US debate

The US debate is well known and is therefore kept short, but it needs to be contextualized for the comparative objective of this paper. Section 3.1 describes this debate and emphasizes the significance of dispersed ownership for it. This is the feature of corporate governance in most large US firms that distinguishes them internationally and has also created the model that captured the imagination of American corporate law scholars. A large degree of institutional independence was self-evident, as was managerial power and debates about the necessity of curbing it. Section 3.2 discusses the role of jurisprudence regarding the "shareholder primacy norm", and why it has little to add to the discussion. Section 3.3 explains how US corporate governance was differed from the German and French systems discussed in the subsequent chapters, and how this difference influenced the respective shareholder-stakeholder debates.

3.1. Berle, Dodd, and dispersed ownership

The cornerstones of the academic paradigm set by the Berle-Dodd debate of the 1930s. In the course of finalizing the seminal treatise with Gardiner Means[102], Adolf Berle published an article in the Harvard Law Review emphasizing the fiduciary position of directors and analogizing from trust law to corporate law. Having empirically studied the separation of ownership and control and identified what we would now call agency problems, he argued for great judicial discretion to police conduct by managers.[103] His original concern was not the relationship between a firm and non-shareholder constituencies, but chiefly the protection of shareholders against management and particularly their equal treatment in issues such as preemptive rights and dividend payments. Merrick Dodd, another luminary of corporate law at that time, argued against Berle's suggestion that

[102] BERLE & MEANS, *supra* note 7.
[103] Adolf A. Berle, *Corporate Powers as Powers in Trust,* 44 HARV. L. REV. 1049 (1931).

stockholders should be considered the *sole* beneficiaries of corporate activity, as large corporations had become the subject of public interest and developed a life and a responsibility of their own as a going concern.[104] As distant stockholders could hardly become subject to "a professional spirit of public service",[105] the board had discretion to act also in favor of other interests would be more socially desirable. Managers should not be seen as fiduciaries of shareholders, but rather of the corporation as an institution instead of its members.[106] Berle promptly rebutted Dodd's critique, arguing that private property was an essential element of American society, providing income streams in times of old age, childhood and sickness. If management were not strictly accountable to passive proprietors, management would further primarily its own welfare (to the detriment of everyone else).[107] However, in 1954 Berle conceded that Dodd's point of view had prevailed.[108]

From reading the last chapters of Berle and Means' book, one could infer that Berle modified his position as early as 1932. The two authors speculate that corporate law may be moving toward a new concept, in the course of which the owners of the firm would lose full control over the corporation, to the benefit of "the paramount interests of the community", allowing "corporate leaders" to "set forth a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profit from the owners."[109] Berle almost seemed to join Dodd. One could possibly conclude that Berle's position was inconsistent, or that the chapter only reflected Gardiner Means' views.[110]

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[104] Dodd, *supra* note 98, at 1145.
[105] Dodd, *id.,* at 1153.
[106] Dodd, *id.,* at 1162-1163.
[107] Berle, *supra* note 59, at 1365.
[108] BERLE, *supra* note 91, at 169; *see also* Adolf A. Berle, *Foreword,* in THE CORPORATION IN MODERN SOCIETY ix, xii (Edward S. Mason ed. 1959).
[109] BERLE & MEANS, *supra* note 7, at 355-356.
[110] *See* William W. Bratton, *Berle and Means Reconsidered* at *the Century's Turn,* 26 J. CORP. L. 737, 761-762 (2001); Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought,* 30 L. & SOC. INQ. 179, 205-209 (2005); *see also* Marc T. Moore & Antoine Rebérioux, *Corporate*

Bratton and Wachter recently suggested a persuasive interpretation of this exchange against the background of political struggles surrounding the New Deal. They explain that Berle and Dodd were adherents of different varieties of corporatism that were endorsed by different groups of pundits vying for the attention of the future president Franklin Roosevelt.[111] While reformers in both camps agreed that more centralized planning was needed to avoid the excesses of the capitalist system that had brought about the crisis, they differed on important details. The "business commonwealth" camp, some of whose representatives Dodd cites in his article, favored planning on the industry level, with powerful managers taking a prominent role. The Progressives, who went on to prevail in the early years of the Roosevelt administration, favored government planning and a significant role of unions. Berle was a partisan of this group and played a prominent role in the planning of the New Deal.[112] When his rebuttal to Dodd appeared in print, the book with Means was in the final stage of completion, and he had already transformed from his earlier incarnation as an analyst of corporate law doctrine into a New Deal Progressive. While he did not disclose these new goals in his rebuttal, his argument is, at its core, based on the idea that the elimination of the fiduciary obligation of management to shareholders would endow them with undesirable absolute power.[113] Seen in the light of Dodd's adherence to the pro-management camp in the political debate, Berle's opposition to a broader duty of managers within corporate law seems consistent with both his earlier articles and his work with Means. He believed that, absent regulation, a strict duty to shareholders was the best check on managerial power, and Berle and Means were not only concerned with the separation of ownership from control, but maybe even more with the concentration of economic power

Power in the Public Eye: Reassessing the Implications of Berle's Public Consensus Theory, 33 U. SEATTLE L. REV. 1109, 1113-1117 (2010) (describing the view of Berle as a forerunner of agency theory as a myth).

[111] William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation,* 34 J. CORP. L. 99, 122-124 (2008).

[112] Bratton & Wachter, *id.*

[113] Berle, *supra* note 59, at 1367.

in the hands of a few:[114] Acknowledging the suggestion of a corporation serving the community on its own accord to be utopian, they suggested that the implementation of a "communitarian" conception of the corporation would first require a "convincing system" to be worked out, in which the problem of too many principals (as we might say today) would be resolved.[115]

In his later work, Berle acknowledged that Dodd's position had been proven right in the end (even on normative grounds), arguing that the managerial class should accept the responsibility resulting from power; if they would not, America was likely to become more statist, as government would have to step in.[116] Bratton and Wachter suggest that for Berle, Dodd's position had not been right at the time of its publication in 1932, but had become the right answer only as a result of the New Deal regulatory state. Under the new system, a large part of the economy was subject to regulation in which public policy was able to shape managerial action.[117] In 1962, Berle affirmed his belief that managers could be more trusted to live up to the necessarily high standards in their powerful function in 1962 than they were in the late 1920s for this reason.[118]

For the objective of this paper, the most important point is that both Berle and Dodd were clearly taking their positions against the backdrop of powerful management and passive investors. The subsequent corporate law debate remained within the path prepared by the Berle-Dodd exchange. Participants differed whether managers were part of the problem and needed to be constrained, or whether they were part of the solution and deserved more discretion. By and large, analysts, including Berle, resigned to managerial power given the circumstances, but offered few alternatives. If they did, they were grounded rather in regulation than in corporate law.[119] Managerial

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[114] Tsuk, *supra* note 110 (pointing out this aspect of Berle and Means).
[115] BERLE & MEANS, *supra* note 7, at 356.
[116] BERLE, *supra* note 91, at 172-173.
[117] Bratton & Wachter, *supra* note 111, at 133-134.
[118] Adolf A. Berle, *Modern Functions of the Corporate System,* 62 COLUM. L. REV. 433, 437 (1962).
[119] A.A. BERLE, JR., POWER WITHOUT PROPERTY 107-110 (1959); *see also* Abram Chayes, *The Modern Corporation and the Rule of Law,* in THE CORPORATION IN

power came to be seen as an inevitable technological and organizational development, as shown by Alfred Chandler's famous historical account, which credited the rise of the managerial class for the development of the large firm and its success.[120] John Kenneth Galbraith argued that the firm's "technostructure", composed of managers and other leading groups in the corporation, resulted in a situation where it led a life on its own, distant from the shareholder.[121] Galbraith had no particular prescription for corporate governance and, maybe typical for this period, acknowledged that the goal of the firm was in practice no longer profit maximization (as neoclassical producer theory had assumed), but growth and market share. Shareholders seemingly were of little concern, and the stock price was of some minor psychological importance at best.[122] Some scholars even believed shareholder voting rights to be so unimportant that they considered their abolition.[123]

It seems that the typical view of this period to "abuses" of power would have been government intervention: Berle argued that the legitimacy of the power of self-perpetuating managers was the public consensus,[124] and Eugene Rostow suspected that excessive use of managerial power for political goals might trigger legislative reactions.[125] William Cary's critique of the purported "race to the bottom"[126] can be understood as part of the same trend, as can be Ralph Nader's proposal to "tame the giant corporations" by introducing fed-

MODERN SOCIETY 25, 40-41 (Edward S. Mason ed. 1959) (arguing that the voiceless position of shareholders is in fact deserved, as they are sufficiently protected by disclosure requirements).

[120] CHANDLER, *supra* note 23; *see also* Edward S. Mason, *Introduction,* in THE CORPORATION IN MODERN SOCIETY 1, 9-10 (Edward S. Mason ed. 1959).

[121] GALBRAITH, *supra* note 23.

[122] Berle, *supra* note 118, at 446.

[123] Chayes, *supra* note 119, at 151; Bayless Manning, *Review of Livingston: The American Stockholder,* 67 YALE L. J. 1477, 1490-1493 (1958).

[124] BERLE, *supra* note 119, at 109-110.

[125] Eugene V. Rostow, *To Whom and For What Ends is Corporate Management Responsible?* in THE CORPORATION IN MODERN SOCIETY 46, 68 (Edward S. Mason ed. 1959).

[126] William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974).

eral chartering.[127] Milton Friedman's famous 1970 essay against corporate social responsibility[128] seems to have represented a minority opinion during that period. In any case, the most important overall concern characterizing the debate of that time was not shareholders, but the absence of compelling legitimacy of managerial power that was thought to go beyond the economic sphere.[129] All of these scholars shared a concern about striking the right balance in the regulation of management activity primarily with a view to the shareholder-manager relationship. With the development of the law and economics movement in the 1960s and 1970s, markets (including capital markets, product markets, and the market for managerial labor) were recognized as an additional constraint on managerial decision-making.[130] This, however, did not change the fundamental nature of the conflict of interest between atomistic shareholders and strong managers with which analysts were preoccupied.

3.2. The irrelevance of corporate jurisprudence

This brief account of the debate shows one important pattern: as one would expect in light of the prevailing share ownership patterns, the issue at hand remained whether and how to constrain powerful managers. In the academic debate, shareholder primacy served to constrain managers, while the stakeholder argument did the opposite. Berle was a reformer fighting for investors, while Dodd was aligned with managerial interests.

Corporate case law addressing the "shareholder primacy norm" shows a different picture. Most Delaware cases plainly state that directors and officers hold a fiduciary duty to the corporation and

[127] NADER ET AL., *supra* note 19. *See* particularly *id.,* at 75 ("in nearly every large American business corporation, there exists a management autocracy").
[128] Friedman, *supra* note 4.
[129] *E.g.* Mason, *supra* note 120, at 5-9; Rostow, *supra* note 125, at 60.
[130] For an important early contribution *see* Henry Manne, *Mergers and the Market for Corporate Control,* 73 J. POL. ECON. 110 (1965).

its shareholders, and have to act in the best interests of both.[131] This seems to support an "entity" view and could even underscore a stakeholders view,[132] but analyzing linguistic details provides little benefit, given the scarcity of true shareholder-stakeholder conflicts outside of the takeover context. The most well-known cases discussing "shareholder primacy" are old and not from leading corporate law jurisdictions, the most cited ones being *Dodge v. Ford Motor Co.* and *Shlensky v. Wrigley*.

In *Dodge*[133], Henry Ford, the majority shareholder and director of Ford Motors, then a privately held firm, intended to retain earnings in order to expand the company and ultimately bring down the price of cars produced. The plaintiff Dodge brothers, who held a minority stake,[134] desired a dividend because they needed the money to set up a competing operation.[135] Ford argued that he was well within his rights to pursue his strategy, which he professed was motivated by "social and altruistic reasons."[136] The Michigan Supreme Court objected by enunciating the now famous "shareholder primacy norm":

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[131] *E.g.* Guth v. Loft, 5 A.2d 503, 510 (1939), Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); Smith v. van Gorkom, 488 A.2d 858, 872 (Del. 1985); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

[132] *See* Rutheford B. Campbell, Jr. & Christopher W. Frost, *Managers' Fiduciary Duties in Financially Distressed Corporations: Chaos in Delaware (and Elsewhere),* 2007 J. CORP. L. 491, 493-494 (speculating about the interpretation of the term). At the very least, the Delaware courts seem to assume that the "entity" stands for the wealth of all financial investors. *See* Credit Lyonnais Bank Netherlands, N.V. v. Pathe Communications Corporation, 1991 Del. Ch. LEXIS 215 at n. 55 (Dec. 30, 1991) (exploring the possibility of fiduciary duties to creditors in the vicinity of insolvency); N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 2007 Del. LEXIS 227 (finding that directors do not have direct fiduciary duties to creditors, but suggesting that creditors may bring derivative claims on behalf of the corporation if the firm is nearly insolvent and they are thus the residual claimants).

[133] Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

[134] For a list of Ford shareholders in 1908, *see* M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old is New Again,* in CORPORATE LAW STORIES 37, 49 (J. Mark Ramseyer ed. 2009).

[135] Henderson, *id.,* at 57. For a detailed account of the facts *see* D. Gordon Smith, *The Shareholder Primacy Norm,* 23 J. CORP. L. 277, 315-320 (1998).

[136] ROBERT CHARLES CLARK, CORPORATE LAW 603 (1986).

> "[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself […]."[137]

Ford later bought the Dodge brothers' share, continued to pay high wages and produce many cars, and as a result made the company even more profitable.[138]

In *Shlensky,* decided in Illinois in 1968,[139] the plaintiff sought to compel the directors of a baseball team to install lights at the stadium, thus allowing evening games, a higher spectator turnout and more profits. Wrigley, 80% shareholder and president of the corporation, objected "that baseball is a 'daytime sport' and that the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood."[140] The court did not object to the contestable argument that this would ultimately hurt the firm, thus resulting in a long-term decline of shareholder wealth. In doing so, it effectively deferred the decision to the directors' business judgment in the absence of any personal conflict of interest.

Two lessons are to be drawn. First, shareholder primacy is not enforceable – it all depends on how incumbents rationalize their decision. Dodd was among the first to note that the Dodge court cautiously avoided an "unqualified acceptance of the maximum-profit-for-stockholders formula."[141] Modern commentators generally share this view. Lynn Stout points out that the precedent is hardly ever cited by courts.[142] Robert Clark argues that Henry Ford's mistake was not his

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[137] 170 N.W., at 684.

[138] Henry G. Manne, *The Limits and Rationale of Corporate Altruism: An Individualistic Model,* 59 VA. L. REV. 708, 713 (1973).

[139] Shlensky v. Wrigley, 237 N.E. 2d. 776 (Ill. App. 1968).

[140] 237 N.E. 2d. 778.

[141] Dodd, *supra* note 98, at 1157-1158 n. 31.

[142] Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford,* 3 VA. L. & BUS. REV. 163, 168-172 (2008) (pointing out that the case hails from an unimportant jurisdiction for corporate law and that the shareholder primacy statement is essen-

decision as such but his purported social motivation,[143] while in fact he intended to expand the company and, most of all, suppress the Dodge brothers' nascent competitive venture by forcing them to sell him their shares at a low price.[144] Thus, Ford's professed philanthropic inclinations were a cover for actions that harmed other shareholders. By contrast, most managerial decisions with a potential shareholder-stakeholder conflict of interests are protected by the business judgment rule.[145] This is illustrated by *Shlensky*, given how the defendant was able to turn a "social" argument into a shareholder primacy one. Ford probably could have done the same.[146]

Second, both cases arose in privately-held firms with a clear majority shareholder and illustrate rather a majority-minority conflict than a shareholder-stakeholder one. Commentators often emphasize that the shareholder primacy norm is irrelevant in publicly traded corporations,[147] suggesting that modern courts would rather employ a duty of loyalty and minority oppression rhetoric in similar situations today, which had not yet been developed by the courts at that time.[148] The case law on the "shareholder primacy norm" has very little to do with the questions that animated the academic debate before hostile

tially a dictum that is rarely cited by courts); Henderson, *supra* note 134, at 34 ("[shareholder wealth maximization] was not and is not the law.").

[143] *Cf.* CLARK, *supra* note 136, at 138, 603; *see also* Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford,* 3 VA. L. & BUS. REV. 177, 182 (2008).

[144] *Cf.* CLARK, *id.,* at 604; *see also* Nathan Oman, *Corporations and Autonomy Theories of Contract: A Critique of the New Lex Mercatoria,* 83 DEN. U. L. Rev. 101, 135 (2005) (providing a similar account of Dodge v. Ford).

[145] Stephen M. Bainbridge, *Means and Ends, supra* note 62, at 582; *see also* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733, 775 (2005) ("So even Dodge, the high-water mark for the supposed duty to profit-maximize, indicates that no such enforceable duty exists."); Macey, *supra* note 143, at 181, 190.

[146] It is also possible that the courts looked favorably on Shlensky because there was no apparent self-dealing or self-interested behavior involved (other than in Dodge). Ribstein, *supra* note 65, at 1470.

[147] Smith, *supra* note 135, at 277.

[148] *E.g.* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928); Donahue v. Rodd Electrotype, 328 N.E.2d 505 (Mass. 1975). *See* Smith, *supra* note 135, at 320-322.

takeovers emerged: or concede that it is of little practical relevance,[149] particularly because of the business judgment rule. The controversy about Ford's dividend had nothing to do with the small investor whose interests are neglected by powerful managers where control was separated from ownership. Addressing issues of closely held corporations with controlling shareholders, the cases rather fall into the Continental European pattern discussed in sections 4 and 5, where the question is not whether and to what extent to align managers with shareholders, but whether and how to constrain blockholders.

3.3. How the US differs from Germany and France

Managerial power was the motivator of the historical US debate, and the best balance of powers between shareholders and directors is still debated. As we will see subsequently, institutional theories of corporate law have been historically prominent in Germany and France. In consequence of different ownership structures, institutional theories of the corporation had a function they did not have in the US. Here, a large degree of independence of management was always taken for granted, given the strong position of the board in those firms in which most scholars were interested. Arguments against shareholder empowerment are made in defense of the status quo. Their proponents suggest that US corporate law works if shareholders remain largely disenfranchised.

Models of corporate law explaining the benefits of managerial power only work well in a corporate system characterized by an "atomistic" share ownership structure,[150] where shareholders vote on few things, and when they do, they are a faceless mass of tiny financial investors. Where managers are de facto always subject to a risk of being replaced by a controlling shareholder, they will obviously be

[149] *E.g.* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy,* 31 J. CORP. L. 637, 651 (2006) ("no modern court has struck down an operational decision on the ground that it favors stakeholder interests over shareholder interests"); WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 298 (3nd ed. 2009).
[150] *Cf.* Bebchuk, *supra* note 46, at 909.

inclined to please him to avoid eviction.[151] When there is no single controlling shareholder, but a number of blockholders in controlling or changing coalitions that carry some influence, managers and directors have a reason to please the members of these coalitions. Controlling shareholders may abuse their position to obtain private benefits from the firm, to the detriment of minority shareholders and other stakeholders, who may be concerned that shareholders may use their power to harm them.[152]. Minority investors will be concerned that controlling shareholders will do with the firm as they please and take large private benefits.[153] And even if there is no single controlling shareholder, but there are blocks of share ownership that can *jointly* impose their will on the firm if enough of them cooperate, there is the additional problem of friction. Coalitions may change, and corporate policies may therefore lack stability.

In Germany and France during the periods of these historical debates, dispersed ownership structure was not widespread, which is why friction between shareholders must have been common. In the following two chapters, I suggest that institutional theories of corporate law had a great appeal in the debates in the early period of those two corporate law systems particularly because share ownership structures were not dispersed. Shielding corporations against shareholders was seen as an instrument to mitigate disruptive intra-shareholders conflicts, and to protect the firm and all of its stakeholders against shareholders opportunism.

There are of course also important political implications: Unlike the United States, where managerial bureaucrats had replaced large blockholders as a politically powerful elite,[154] "capitalist" shareholders persisted in France and Germany. To those concerned

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[151] *E.g.* Gérard Charreaux & Philippe Desbrières, *Corporate Governance: Stakeholder Value versus Shareholder Value*, 5 J. MGMT. & GOV. 107, 116 (2001).
[152] Gelter, *supra* note 6, at 154-168, 168-176.
[153] *E.g.* Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance,* 52 J. FIN. 737, 754-755 (1997); John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies,* in THE ANATOMY OF CORPORATE LAW 35, 36 (2nd. ed., Reinier Kraakman et al. 2009).
[154] Mark S. Mizruchi & Daniel Hirschman, *The Modern Corporation as Social Construction,* 33 U. SEATTLE L. REV. 1065, 1075-1076 (2010).

how corporations could help to pursue the public interest, danger to that purpose was emanating from those shareholders, and not primarily from management. One could summarize the difference to the US by saying that the debate was not about the optimal extent of constraints on management, but of constraints on shareholder power.

4. German block ownership and the theory of the "*Unternehmen an sich*"

The German corporate governance system is notorious for its focus on stakeholder interests.[155] The main reason is codetermination on German supervisory boards, which creates a limited, but significant influence of employees on corporate decision-making by granting them a number of mandatory seats.[156] While its roots can be traced back to the early years after World War I,[157] the current system took shape after World War II – partially in response to the large firms' cooperation with the Nazis,[158] and culminated in the 1976 Act, which requires equal representation in firms with more than 2000 employees.[159]

German corporate law has also long been dominated by an understanding of the corporation as an entity distinct from shareholders and the idea of an "interest of the firm" or "of the business." The

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155 Hansmann & Kraakman, *supra* note 3, at 444-446.
156 *See e.g.* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities,* in EMPLOYEES AND CORPORATE GOVERNANCE 163 (Margaret M. Blair & Mark J. Roe eds. 1999); Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies,* in THE ANATOMY OF CORPORATE LAW 89, 100-101 (2nd ed. Reinier Kraakman et al. 2009).
157 Employee participation was introduced shortly after World War I, but abolished by the Nazis. HERMAN KNUDSEN, EMPLOYEE PARTICIPATION IN EUROPE 32 (1995); Pistor, *id.,* at 166; Otto Kahn-Freund, *Industrial Democracy,* 6 INDUS. L. J. 65, 83-84 (1977) (describing it as a "half-hearted scheme"); Roth, *supra* note 31, at 62-63.
158 KNUDSEN, *id.,* at 33. There was concern that the Western allies might otherwise have dismantled the iron and steel industries. Pistor, *supra* note 156, at 167; Roth, *supra* note 31, at 73.
159 Pistor, *id.*, at 168-175. In the case of a tied vote, the vote of the chairman, who is invariably a shareholder representative, is decisive.

theoretical underpinnings go back to an academic debate of the 1920s and early 1930s. Section 4.1 describes the environment to which this debate reacted, namely a system with powerful (controlling) shareholders. Section 4.2 describes the development of German institutional theory of the "business in itself" during the 1920s and 1930s, and what influence it had on the 1937 corporate law reform. Section 4.3 looks at its post-war reception and its consequences for corporate law today, and section 4.4 looks at the Mannesmann decision as a prominent example. Section 4.5 concludes by linking it to ownership structure and the overarching thesis of this article.

4.1. In the realm of majority shareholders

One might feel tempted to trace the German proclivity to an institutional theory of the corporation and stakeholder orientation to 19th century legal theory. However, while Otto von Gierke's espousal of a natural entity theory of the firm near the end of the 19th century[160] is well known, the roots of a German "stakeholder theory" are more recent. Legal policy remained steeped in economic liberalism in the late 19th and the early 20th century, and the law continued to emphasize shareholders' ownership of the corporation, as a result of which shareholders retained complete control over corporate matters during that period.[161] For example, the *Reichsgericht* (the German Supreme Court at that time), opined in a 1904 decision that the purpose of the corporation is "to work for shareholders and to reassign its assets to them, during its existence in the form of profits, after its dissolution by means of distribution."[162] While the context of this statement is highly peculiar and the significance of the rhetoric should not be exaggerated,[163] subsequent decisions – primarily addressing majority-

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[160] OTTO GIERKE, DAS DEUTSCHE GENOSSENSCHAFTSRECHT (1868).

[161] Gerald Spindler, *Verfassung der Aktiengesellschaft: Vorbemerkung,* note 8, in MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, BAND 3 (3rd ed., Wulf Goette, Christian Habersack & Susanne Kalss eds, 2008).

[162] RGZ 59, 423, 425 [own translation].

[163] Like other "shareholder primacy v. stakeholder" cases, the decision arose from a conflict among shareholders. The core issue was whether the founding founding shareholders' oral commitment to proportionally reimburse the corporation for the

minority conflicts – continued to be based on a contractual understanding of the firm. Up to the 1920s, the "interest of the corporation" continued to be defined as what had been decided in the shareholder meeting,[164] e.g. in the *Hibernia* case, where the majority (several banks) had decided to issue preferred shares (without preemptive rights) in order to prevent the Prussian government from gaining control.[165]

4.2. The dark origins of German institutionalism

Subsequently, the Weimar Republic saw a debate about the concept of the "enterprise in itself" (*Unternehmen an sich*) during the Weimar Republic, which is usually cited as the origin of the movement towards what we might call stakeholder orientation today, but is more accurately described as the beginning of the emancipation of the corporation from its shareholders. The most important antecedent of the debate was Walther Rathenau, who published a booklet about the state of affairs of corporations in 1917 ("Vom Aktienwesen").[166] Rathenau was an industrialist, social theorist, and politician.[167] Describing how German corporations had been transformed from ventures of a small number of business partners into truly great enterprises during the past decades, and how family ownership was disappearing,[168] he addressed various corporate governance issues such as the role of the members of the supervisory board. Corporate law, he argued, had not been able to keep up with progress. His main concern, however, was apparently interference from shareholders. To some extent his treat-

administrative costs of incorporation qualfied as a gift, which would have required notarization to be enforceable.

[164] RGZ 68, 314, 317; RGZ 85, 170, 172; RGZ 107, 67, 71. *See* FRANK LAUX, DIE LEHRE VOM UNTERNEHMEN AN SICH 37-38 (1998) (surveying the case law).

[165] RGZ 68, 235, 246.

[166] WALTHER RATHENAU, VOM AKTIENWESEN. EINE GESCHÄFTLICHE BETRACHTUNG (1917). For good overviews *see e.g.* ADOLF GROSSMANN, UNTERNEHMENSZIELE IM AKTIENRECHT 141-143 (1980); RIECHERS, *supra* note 96, at 7-10.

[167] A member of the liberal *Deutsche Demokratische Partei* (German Democratic Party), he was assassinated by right-wing extremists while serving as foreign minister in 1922.

[168] RATHENAU, *id.,* at 7-13, 23-25.

ment of shareholder involvement seems odd to a modern reader schooled in thinking about corporate governance in terms of ownership structures and agency problems. He did not distinguish between blockholders and dispersed investors, but between long-term shareholders expecting an adequate yield on their investment and speculators seeking short-term capital gains.[169] Rathenau was preoccupied mainly with the latter group and denounced, for example, that corporate law no longer required a minimum time period of stock ownership before a shareholder was entitled to vote.[170] He also criticized that legal scholars, courts and newspapers frequently exhorted managers to follow the wishes of the shareholder meeting.[171] In spite of being an advocate of democracy in the political arena, he pointed out that even democratic states typically do not allow parliament to vote on each and every issue, but delegate day-to-day activities to a smaller group of people.[172] Hypothesizing that the shareholders of Deutsche Bank could vote to liquidate the firm, he argued that the government could not allow this to happen and would surely interfere by passing a special law.[173] He did not clarify why the firm's assets should be worth more than the stock price, so that it would pay for shareholders to vote for such a proposal and invest the proceeds in government bonds;[174] however, in this context he made his famous connection between corporate law and the public interest, suggesting that large firms were an important factor in the national economy, whose significance exceeded private interests by far.[175]

[169] RATHENAU, *id.,* at 26.
[170] RATHENAU, *id.,* at 29.
[171] RATHENAU, *id.,* at 34.
[172] RATHENAU, *id.,* at 59.
[173] RATHENAU, *id.,* at 39. Landsberger, writing in 1932, sees Rathenau's prediction as confirmed in view of government intervention in favor of banks during the global economic crisis. *See* Herbert Landsberger, *Der Rechtsgedanke des „Unternehmens an sich" und das neue Aktienrecht,* 7 ZENTRALBLATT FÜR HANDELSRECHT 79, 82 (1932).
[174] Theoretically, such a theory might have arisen if the government had pressured Deutsche Bank e.g. into extending unprofitable loans. Rathenau discusses this possibility in the context of the war economy, which may explain the particular concern for the public interest.
[175] RATHENAU, *id.,* at 38.

While this reference has often been interpreted as promoting a communitarian conception of the economy,[176] Rathenau's booklet rather gives the impression of a director complaining about annoying shareholders than that of one developing an economic or social theory. Haussmann, Rathenau's most frequently cited critic, explained that his classification of shareholders and his focus on speculative investors with his personal experience at AEG, the German equivalent to GE founded by Rathenau's father. In that company, management indeed faced "an unspecified multitude of shareholders without a particular majority group."[177] Haussmann criticized that Rathenau gave insufficient consideration to the role of large shareholders, while in reality firms with majority groups were more common.[178] In a longer book published in 1918 ("Von kommenden Dingen"), in which Rathenau summarized his social, political and economic visions, he described how large corporations were turning into "institutions resembling the state"[179] He suggested that the "joy of creation" was already overshadowing the desire for financial profit, and that the "official idealism identical with that prevailing in public service" dominated.[180] It may well have been this highly optimistic view of both management and public service that encouraged his hopes that autonomous corporations, standing between the private

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[176] *See* Oskar Netter, *Zur aktienrechtlichen Theorie des „Unternehmens an sich",* in FESTSCHRIFT HERRN RECHTSANWALT UND NOTAR JUSTIZRAT DR. JUR.H.C. ALBERT PINNER ZU SEINEM 75. GEBURTSTAG 507, 547-550 (Deutscher Anwaltsverein, Berliner Anwaltsverein & Firma Walter De Gruyter & Co. eds. 1932) (criticizing Haussmann for exaggerating Rathenau's communitarian ideas).

[177] FRITZ HAUSSMANN, VOM AKTIENWESEN UND VOM AKTIENRECHT 20 (1928). Haussmann uses the term "AEG type" to describe firms that we might call "Berle-Means" type firms today. It is possible that hyperinflation had led to increased ownership concentration in the early 1920s. *Infra* notes 195-197 and accompanying text. Against this backdrop, Netter's assessment that Rathenau wanted to protect the majority from the minority does not seem accurate. *See* Netter, *id.,* at 552.

[178] HAUSSMANN, *id.,* at 26.

[179] WALTHER RATHENAU, VON KOMMENDEN DINGEN 143 (1918). Other than his booklet on corporate law, this work was also translated into English and cited by Berle and Means. *See* WALTHER RATHENAU, IN DAYS TO COME 121 (transl. Eden & Cedar Paul 1921).

[180] RATHENAU, VON KOMMENDEN DINGEN, *id.,* at 144-145; RATHENAU, IN DAYS TO COME, *id.,* at 122-123.

sector and the state, could become a building block of the post-capitalist society he was expecting to develop.[181]

At first glance it might seem that Rathenau, the publication of whose 1917 booklet is often seen as a defining moment for the German debate (i.e. comparable to the role of the Berle-Dodd debate in the US), cannot easily be placed into the theory of this article, given the apparent assumption of a dispersed ownership structure. However, it is indeed typically Continental, as the dispersed ownership structure described by Rathenau is not entirely the atomistic version encountered by Berle and Means, where shareholders are purely passive, but a distinct German variety, where they are not. His concern was clearly not excessive managerial power, but the intervention of shareholders (both the majority and the demands of investors), for example by requesting dividends, thus depleting liquidity. Managers had to make concessions to these demands. While Americans were discussing the extent of managerial power and whether to constrain them, Rathenau's concern was how to protect the company and its business activity from shareholders. Within the framework of the US debate, one might be inclined to group him with scholars defending the powerful role of management.[182] However, given the focus on public policy in his second book, he should better be classified as close to social planners such as Berle after the New Deal. Nevertheless, it seems that this aspect of his work was not the one that primarily influenced the debate among *legal* commentators advancing an institutional theory of the corporation.

Among these, Haussmann was the first to address Rathenau's theories. He coined the term "*Unternehmen an sich*" and used it to describe how he understood Rathenau,[183] criticizing him and other economic theorists, including John Maynard Keynes, who had suggested that large corporations tended towards "self-socialization" in a

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[181] RATHENAU, VON KOMMENDEN DINGEN, *id.,* at 146-150; RATHENAU, IN DAYS TO COME, *id.,* at 124-128.
[182] *E.g.* Stephan M. Bainbridge, *The Case for Limited Shareholder Voting Rights,* 53 UCLA L. REV. 601 (2006); *contra* Bebchuk, *supra* note 46, at 833.
[183] RIECHERS, *supra* note 96, at 16.

lecture given in Berlin in 1926.[184] Haussmann studied the major conflicts of interest within firms and argues that, while the interests of the controlling shareholder typically coincide with that of the "business in itself", the main conflict being the one between large shareholders and transient investors.[185] His legal argument did not rest on the "business in itself", as he argued that the corporation was not an end in itself, but on the "collective interest of shareholders." He suggested that shareholders were tied to this interest, which should be used to provide the decisive balance in cases of conflicts.[186]

Other legal writers, however, viewed the concept of an independent interest of the corporation more favorably, such as Oskar Netter, who espoused the theory of the *Unternehmen an sich* as a legal theory rooted in the real life of corporations.[187] Shares held by the firm's management – a controversial issue during the Weimar Republic – should be deemed permissible unless they were not used to convey special advantages to the controllers to the detriment of the corporation.[188] The use of voting rights by shareholders should be limited by the duty of loyalty, he argued, which is tied to the interest of the corporation; the duty of loyalty thus implied recognition of the principle of the "business in itself".[189] This interest should also be the measure in majority-minority conflicts about the firm's business policies,[190] and in disputes about the extent to which the firm should be

[184] JOHN MAYNARD KEYNES, DAS ENDE DES LAISSEZ-FAIRE: IDEEN ZU VERBINDUNG VON PRIVAT- UND GEMEINWIRTSCHAFT 32-33 (1926); JOHN MAYNARD KEYNES, THE END OF LAISSEZ-FAIRE 42-43 (1926) (German and English publication of this lecture); *see* HAUSSMANN, *supra* note 177, at 30. Keynes was in fact describing the weak position of shareholders in large firms, in which case management was no longer promoting maximum profits for shareholders, but able to relegate them to receiving "adequate dividends."
[185] HAUSSMANN, *id.,* at 52-54.
[186] Fritz Haussmann, *Gesellschaftsinteresse und Interessenpolitik in der Aktiengesellschaft,* 30 BANK-ARCHIV 57, 64-65 (1930). For a description of the development of his views, *see* RIECHERS, *supra* note 96, at 21.
[187] Netter, *supra* note 176, at 583.
[188] Netter, *id.,* at 587.
[189] Netter, *id.,* at 592.
[190] Netter, *id.,* at 596-599.

permitted to withhold dividends from distribution.[191] Similarly, Landsberger argued that the corporation had developed into an independent organization, thereby establishing the *Unternehmen an sich* as a real-world fact to be reflected by the law.[192] The business organized as a corporation was to be considered a purpose in itself, and the underlying legal principle a factor needed to balance the interests of "providers of capital, owners, proprietors of influence", who "even where they possess a majority, are pitted against the interest of the totality of shareholders, which is recognized as a legal person by the law."[193] Landsberger, who cited Gierke's theory as a basis for his, argued that the point of the theory is simply to emphasize the importance of the entirety of shareholders, as opposed to their individual interests; stability of the corporation was the key, also in view of the public significance of the firm.[194]

The Weimar period saw an intense discussion about the term that extended beyond the handful of authors referred to here. While the idea of managerial independence had adherents in socialist circles, it served business interests as well. The hyperinflation period of following World War I had facilitated the acquisition of large ownership shares and changes in the prevailing majorities due to the redistributive effects of inflation, and possibly because the prices of stocks did not grow as fast as inflation.[195] This helped in particular foreign acquirers, whose actions caused concern about excessive foreign influence.[196] While the development of ownership structure during that

[191] Netter*, id.,* at 600-602.
[192] Landsberger, *supra* note 173, at 84, 88.
[193] Landsberger, *id.,* at 86.
[194] Landsberger, *id.,* at 87-88.
[195] Heinz-Dieter Assmann, in 1 GROSSKOMMENTAR AKTIENGESETZ, *Einleitung,* comment 131 (Klaus J. Hopt & Herbert Wiedemann eds. 1992); LAUX, *supra* note 164, at 127.
[196] Curt Eduard Fischer, *Rechtsschein und Wirklichkeit im Aktienrecht*, 154 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 85, 101 (1955); Assmann, *id.*; Gerald Spindler, *Kriegsfolgen, Konzernbildung und Machtfrage als zentrale Aspekte der aktienrechtlichen Diskussion in der Weimarer Republik,* in 1 AKTIENRECHT IM WANDEL 440, note 17 (Walter Bayer & Mathias Habersack eds. 2007).

period is not clear,[197] managers and controlling shareholders therefore began to entrench their positions through by multiple-vote shares or shares to a trustee of the corporation, typically banks, which increased the influence of these institutions on industrial firms.[198] Curt Fischer[199], viewing the debate on the *Unternehmen an sich* in retrospect after World War II, criticized the erosion of individual rights of shareholders and disclosure duties, while divergences from the one-share-one-vote principle increased, so that large shareholders' became more entrenched and powerful.[200] The opinions voiced in the course of the debate were highly diverse, and the same is true for its academic assessment in later decades. While some argued that its purpose was to legitimize the power of managers and the group of shareholders supporting it,[201] others suggested that the point was rather to empower directors, who had no particular interest in shareholder profits, to advance "general economic concerns".[202]

While all of these readings seem well-founded in some aspect of the complex debate, for the objective of this article it is necessary

[197] Caroline Fohlin, *The History of Ownership and Control in Germany,* in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 223, 229 (Randall K. Morck ed. 2005).

[198] *See e.g.* Assmann, *supra* note 195, at 133; Fohlin, *id.,* at 262-263; Spindler, *id.* notes 21-50.

[199] In the mid-1930s the young Curt Fischer had still criticized the proposals of the corporate law reform committee as not having absorbed Nazism to a sufficient degree. *E.g.* Curt Fischer, *Führerprinzip und Verantwortlichkeit im neuen deutschen Aktienrecht,* 1934 DER PRAKTISCHE BETRIEBSWIRT 29; Curt Fischer, *Resignation vor der Anonymität in der A.-G.,* 1934 DIE DEUTSCHE VOLKSWIRTSCHAFT 1004. On Fischer's biography *see* Werner Schubert, *Einleitung zu Band I,* in 1 AKADEMIE FÜR DEUTSCHES RECHT 1933-1945, PROTOKOLLE DER AUSSCHÜSSE: AUSSCHUSS FÜR AKTIENRECHT XX, XXX n. 70 (Werner Schubert, Werner Schmid & Jürgen Regge eds. 1986) [hereinafter: AKADEMIE FÜR DEUTSCHES RECHT].

[200] Fischer, *id.,* at 94-101; *see also* CLAUS OTT, RECHT UND REALITÄT DER UNTERNEHMENSKORPORATION 179 (1977).

[201] Fischer, *id.,* at 101-106; ERNST-JOACHIM MESTMÄCKER, VERWALTUNG, KONZERNGEWALT UND RECHTE DER AKTIONÄRE 13-16 (1958); RUDOLF WIETHÖLTER, INTERESSEN UND ORGANISATION IM AMERIKANISCHEN UND DEUTSCHEN RECHT 38 (1961).

[202] WOLFGANG ZÖLLNER, DIE SCHRANKEN MITGLIEDSCHAFTLICHER STIMMRECHTSMACHT BEI DEN PRIVATRECHTLICHEN PERSONENVERBÄNDEN 69 (1963); RIECHERS, *supra* note 96, at 177.

to focus on another one that seems not to have received a lot of attention, namely the role of ownership structure. To that end, it is necessary to distinguish Rathenau from the legal writers of the late 1920s and 1930s, who had different objectives. Rathenau did not believe he had much to say about corporate law and merely observed the separation of ownership and control, much as Berle and Means did in the US. As Haussmann pointed out, Rathenau's view was distorted by his personal experience at AEG, while concentrated ownership prevailed in most large German firms. His hope that autonomous large firms would contribute to the development of his utopian world of tomorrow was therefore of little significance. However, with his managerial background he was typical insofar as he voiced concern about *shareholder* decisions and requests, which set him sharply apart from the later American debate. The German legal writers a decade later had a similar concern that was unimportant in the Berle-Means world, namely conflicts of interest between shareholders that apparently were a lot more important in the German corporate world of that time than in the US. These authors followed a "sociological" method of the law, which viewed the law and the real world as mutually dependent.[203] Thus, legal authors such as Netter[204], Landsberger[205] and Geiler[206] argued that shareholders should be constrained in their decision-making by the interests of the business, understood as a separate entity from shareholders. The theory of the *Unternehmen an sich*, even though it was not always explicitly referred to, was intended to constrain shareholders. Even Haussmann, who denied the independent interest of the interest of the business (or of the firm) sought to limit shareholder influence by tying them to the interest of the "entirety of

[203] Karl Geiler, *Die wirtschaftsrechtliche Methode im Gesellschaftsrecht,* 68 BEITRÄGE ZUR ERLÄUTERUNG DES DEUTSCHEN RECHTS (GRUCHOTS BEITRÄGE) 592 (1927); KARL GEILER, BEITRÄGE ZUM MODERNEN RECHT 35 (1933) (both arguing that "is" and "ought" should not be seen as separate, and suggesting the application of legal sociology in corporate law). On the transient flirtation of early 20th century scholars with legal realism *see generally* Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism,* 31 HASTINGS INT'L & COMP. L. REV. 295 (2008).
[204] Netter, *supra* note 176, at 592.
[205] Landsberger, *supra* note 173, at 87-88.
[206] GEILER, *supra* note 203, at 82.

shareholders."[207] Given this difference in emphasis, Haussmann can probably be classified as a shareholder primacist. Rathenau had maybe misunderstood the preeminent problems under the most common type of ownership structure, and the goals of his initial sermon were those of a practitioner. However, both he and later authors sought to protect managerial power from shareholders, which stands in contrast to the concern about managerial power emphasized by Berle and Means.

The case law underwent a parallel development, in which the *Reichsgericht* (Supreme Court) moved away from the majority-focused understanding of power within the firm. In the 1927 "Hamburg-Süd" opinion, it gave its blessings to a shareholder decision to increase the firm's capital by issuing new multiple-vote shares to a consortium controlled by the management and supervisory board members, from which other shareholders were excluded.[208] The effect was effective entrenchment, given that only 25% of par value had to be paid up front, while the outstanding stock traded at 220%.[209] While most of the court's approval of the takeover defense (another bank was threatening to take over the firm) is relentlessly positivistic,[210] the opinion also declines that the structure could be contrary to public policy, since there were good reasons why the firm should be protected from shareholders:

> "It is obvious that the financial expansion and protection of the corporation in particular are of decisive significance to secure its autonomy and independence, and that a blocking majority in its common stock could endanger its viability and, in any case, the

[207] Haussmann, *supra* note 186, at 64. Netter criticized Hausmann's reliance on the "collective interest" of shareholders as inappropriate, since the collective interest could not be the sum of individual interests. Therefore, the only way would be to rely on majority decisions, which would be problematic because of private benefits of control. *See* Netter, *supra* note 176, at 577-578.
[208] RGZ 119, 248.
[209] RIECHERS, *supra* note 96, at 113.
[210] The court emphasizes that none of the individual elements of this early takeover protection was contrary to the law.

> beneficial continued development of the corporation…This is absolutely in line with other provisions of the defendant firm's articles, which obviously aim at preserving the enterprise in itself and its autochthonous character while repelling shareholders' interests."[211]

Generally, the case law was moving towards putting more limits on shareholders conduct in exercising their right to vote during the 1920s. After describing the case law, a 1930 article summarized the state of the law as follows:

> "Nothing prevents a shareholder from letting his own interests guide his vote. However, the ballot, and thus the shareholder resolution, is against public policy if the majority pursues selfish goals in a one-sided way at the cost of the company, or at the cost of the minority without this cost being necessitated by the good of the company."[212]

The intense Weimar Republic and early Nazi Germany debates about the reform of corporate law ultimately led to § 70 of the 1937 *Aktiengesetz*, which is often cited in the stakeholder debate. It stated that the management board was required

> "to manage the corporation as the good of the enterprise and its retinue and the common wealth of folk and realm demand."[213]

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[211] RGZ 119, 256 (own translation). The plaintiff was an association of shareholders. RIECHERS, *supra* note 96, at 112.

[212] Walter Horrwitz, *Über die Freiheit der Abstimmung im Aktienrecht,* 59 JURISTISCHE WOCHENSCHRIFT 2637, 2638 (1930).

[213] § 70 German AktG of 1937, translation following Detlev F. Vagts, *Reforming the "Modern" Corporation: Perspectives from the German,* 80 HARV. L. REV. 23, 40 (1966). "Folk and realm" is used here to translate "*Volk und Reich",* a wording that (at least today) would be clearly associated with Nazism that was duly purged

Most importantly,[214] the reform turned the relationship between management and shareholders on its head. The management board was charged by the law with the exclusive responsibility of managing the company[215], with unsolicited interference by the supervisory board or by shareholders not being legally binding.[216] While previously the meeting of shareholders had been the supreme controlling body,[217] its role now became a comparatively limited one.[218] Since 1937, the law requires the management board to be appointed and dismissed by the supervisory board. A premature revocation of a management board member requires cause (which could simply be a shareholder vote of no confidence if it is not obviously abusive).[219] Supervisory board members can only be dismissed prematurely by a

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from the law in the 1965 reform. Raiser‘s proposal to translate "Gefolgschaft" as "membership", is highly questionable.. *See* Thomas Raiser, *The Theory of Enterprise Law in the Federal Republic of Germany,* 36 AM. J. COMP. L. 111, 123 (1988).

[214] RIECHERS, *supra* note 96, at 167 (suggesting that the practical importance of § 70 was close to zero compared to other reforms).

[215] § 76(1) AktG.

[216] Hans Joachim Mertens, in KÖLNER KOMMENTAR ZUM AKTIENGESETZ, § 76, comment 42 (vol. 2, 2nd ed., Wolfang Zöllner ed. 1988/1996); Gerald Spindler, in MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, BAND 3, § 76, comment 22 (3rd ed., Wulf Goette, Matthias Habersack & Susanne Kalss eds., 2008); UWE HÜFFER, AKTIENGESETZ, § 76, comment 10 (9th ed. 2010) (pointing out that there is no fiduciary relationship between members of the management board and shareholders); *see also* BGH 30.3.1967, II ZR 245/63, 1967 NEUE JURISTISCHE WOCHENSCHRIFT 1462; Dieter Eckert, *Shareholder and Management: A Comparative View on Some Corporate Problems in the United States and Germany*, 46 IOWA L. REV. 12, 20 (1960).

[217] On the historic development s*ee e.g.* Hefermehl & Semler, *supra* note 161*,* comments 10-20.

[218] The provision is mandatory [HÜFFER, *supra* note 216, § 23, comment 36] , except for the case of a control agreements under § 291(1) AktG, according to which a controlling entity (an "enterprise" such as a parent company) has the right to control the firm, but is subject to certain special duties. *See generally* Peter Hommelhoff, *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: the Strengths and Weaknesses of German Corporate Group Law,* 2 EUR. BUS. ORG. L. REV. 61, 64-66 (2001); John Armour, Gerard Hertig & Hideki Kanda, *Transactions with Creditors,* in THE ANATOMY OF CORPORATE LAW 115, 127-128 (2nd ed., Reinier Kraakman et al. 2009); Luca Enriques, Gerard Hertig & Hideki Kanda, *Related Party Transactions,* in THE ANATOMY OF CORPORATE LAW 153, 176-178 (2nd ed., Reinier Kraakman et al. 2009).

[219] § 84(3) AktG.

supermajority of three quarters in the shareholder meeting.[220] Since the reform, the shareholder meeting can legally only get involved in management decisions when a decision is submitted for a vote by management.[221] Franz Schlegelberger, the leading official in the German Ministry of Justice at the time of the reform, famously described the shareholder meeting as the "dethroned king" of the corporation.[222]

The extent to which the previous debate had influenced these reforms has recently become a matter of dispute. According to the traditional narrative that emerged after World War II, the 1937 Act was the legislative conclusion of a broader current in a Weimar-era legal and economic thought that had begun with Rathenau,[223] although was also compatible with the Nazi *Führerprinzip* (leader principle), which exalted the role of the president of the management board over other members.[224] Even Fischer, who had opposed the *Unternehmen an sich* during the 1930s,[225] suggested that the idea of the "leader principle" did not bring about too many new develop-

[220] § 103(1) AktG.
[221] § 119(2) AktG. Previously, the shareholder has been entitled to give instructions to management under § 235 HGB.
[222] FRANZ SCHLEGELBERGER, DIE ERNEUERUNG DES DEUTSCHEN AKTIENRECHTS 28 (1935). Schlegelberger served as the Third Reich's minister of justice in 1941/42 and served some years in prison after the war. *See also* E. Geßler, *Vorstand und Aufsichtsrat im neuen Aktienrecht,* 66 JURISTISCHE WOCHENSCHRIFT 497, 497 (1937) (pointing out that previously large shareholders and banks had ensured that the shareholder meetings had the desired content).
[223] *E.g.* BRUNO KROPFF, AKTIENGESETZ 13 (1965) (official report on the 1965 reform); Vagts, *supra* note 213, at 48; Knut Wolfgang Nörr, *Zur Entwicklung des Aktien- und Konzernrechts während der Weimarer Republik,* 150 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 155, 161 (1986); RIECHERS, *supra* note 96, at 166; DIRK BAHRENFUSS, DIE ENTSTEHUNG DES AKTIENGESETZES VON 1965, 45 (2001); SUSANNE KALSS, CHRISTINA BURGER & GEORG ECKERT, DIE ENTWICKLUNG DES ÖSTERREICHISCHEN AKTIENRECHTS 320 (2003).
[224] *See* Jan von Hein, *Vom Vorstandvorsitzenden zum CEO?* 166 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 464, 475 (2002).
[225] Fischer, *Führerprinzip, supra* note 199, at 29.

ments, but rather in a codification of the corporate practice of several decades.[226]

Interestingly, American law was one of the sources of inspiration for German policymakers after the Nazi takeover: Johannes Zahn, who had completed an S.J.D. degree at Harvard Law School,[227] criticized the theory of the "*Unternehmen an sich*" for carrying Marxist thought into private law,[228] but nevertheless proposed the powerful position of the board in the US as the basis for German reform in his 1934 book in order to restructure the relationship between shareholders and directors in Germany. Like their American counterparts, German directors should become leaders of a business organism independent from changing majorities among shareholders.[229] Zahn, who spoke before the corporate law reform committee's work in 1934,[230] agreed with the plan to strengthen the role of management, as he was personally close to banking and business circles.[231]

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[226] Fischer, *supra* note 196, at 109.

[227] According to the title page of the book. In the preface he reports having worked as "scientific assistant at the Seminar for Comparative Private Law of Harvard University."

[228] JOHANNES C. D. ZAHN, WIRTSCHAFTSFÜHRERTUM UND VERTRAGSETHIK IM NEUEN AKTIENRECHT. ANREGUNGEN ZUM NEUBAU DES DEUTSCHEN AKTIENRECHTS AUF GRUND EINER VERGLEICHENDEN DARSTELLUNG DES DEUTSCHEN UND NORDAMERIKANISCHEN AKTIENRECHTS 39 (1934).

[229] ZAHN, *id.,* at 94. While Zahn emphasized that American law, not having been influenced by Roman law, was based on "Teutonic" legal principles, he suggested that the strong position of directors in the US stems from the idea of liberty of the individual (as businessman), a precept that entirely differed from what was considered "German" at that time. ZAHN, *id.,* at 13, 201 passim. However, Zahn also discussed Dodge v. Ford in great detail and concluded that managers should act to the benefit of shareholders (*id.,* at 41-48). The Berle-Dodd exchange apparently came too late to be included in his book.

[230] Schubert, *supra* note 199, at XLVII (thanking Ernst Geßler, one of the leading drafters of both the 1937 and 1965 acts, for bringing this to his attention); von Hein, *supra* note 224, at 476; *contra* Bernd Mertens, *Das Aktiengesetz von 1937 – unpolitischer Schlussstein oder ideologischer Neuanfang?* 29 ZEITSCHRIFT FÜR NEUERE RECHTSGESCHICHTE 88, 98 n.54 (2007). Mertens argues that the pre-1945 sources do not support the claim of Zahn's influence, and that German law moved even further away from the US board system by inhibiting the supervisory board's involvement in management. It is true that Zahn recognized that the ideological basis of managerial leadership was different in the US. However, von Hein (*id.,* at 476)

In a recent article, Bernd Mertens doubts the received wisdom and argues that the reforms were not the logical continuation of a previous development, but rather an ideological new beginning.[232] He suggests that the reason for the preponderant view (according to which Nazi ideology was merely reflected by some of the language of the law) was that scholars and policymakers sought to distance themselves from that period.[233] He is of course right in pointing out that the 1930 draft for a new corporate law did not include the provisions discussed here,[234] and that the discussion about the *Unternehmen an sich* doctrine remained controversial.[235] However, even Hjalmar Schacht, the Minister of Industry, opposed the most extreme proposals that might have implemented a completely authoritarian *Führerprinzip*, which would have eliminated any residual shareholder control. Schacht conceded that large firms needed to obtain capital, which would not be possible without at least limited shareholder influence.[236]

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correctly points out that ZAHN (*id.,* at 17) considered the "leader principle" to be a fixture of American corporate law and that his participation in committee meetings is proven by the minutes. He presented his case before the corporate law committee of the Academy of German law on February 9, 1934. While he did not explicitly refer to American law, he proposed to make management independent from shareholders in order to allow the "average investor" to see management as "the entrepreneur", and to establish a clearer duty of loyalty between shareholders. *See* AKADEMIE FÜR DEUTSCHES RECHT, *supra* note 199, at 60-65 (transcript of the meeting).

[231] RIECHERS, *supra* note 96, at 159.

[232] Mertens, *supra* note 230, at 91-108.

[233] Mertens, *id.,* at 115.

[234] Reichsjustizministrerium, *Entwurf eines Gesetzes über Aktiengesellschaften und Kommanditgesellschaften auf Aktien,* reprinted in 2 QUELLEN ZUR AKTIENRECHTSREFORM DER WEIMARER REPUBLIK (1926-1931) 847 (Werner Schubert ed. 1999).

[235] An overview is provided by RIECHERS, *supra* note 96, at 154-169.

[236] Walter Bayer & Sylvia Engelke, *Die Revision des Aktienrechts durch das Aktiengesetz von 1937,* in 1 AKTIENRECHT IM WANDEL 619, notes 49-52 (Walter Bayer & Mathias Habersack eds. 2007) (citing Schacht's speech held before the Academy for German Law on November 30, 1935); *but* see Peter Doralt, *Die Unabhängigkeit des Vorstands nach österreichischem und deutschen Aktienrecht – Schein und Wirklichkeit,* in DIE GESTALTUNG DER ORGANISATIONSDYNAMIK. FESTSCHRIFT FÜR OSKAR GRÜN 31, 37 (Werner H. Hoffmann ed. 2003) (suggesting that the draftsmen only paid lip service to the *Führerprinzip* and implemented a program skeptical of capitalism, particularly anonymously held capital).

The 1937 reform also addressed dividends, which had been the subject of the famous controversy between the Dodge brothers and Henry Ford in the US and was also widely debated in Germany. The reform transferred the authority to approve the annual accounts from shareholders to the management and supervisory boards by allowing the two bodies to jointly decide to create retained earnings in the balance sheet, and thus to curb shareholders' "hunger for dividends."[237] In the US, Henry Ford's predicament of being forced to pay dividends was and is unusual, given that the decision by default lies with the board of directors.[238] As such, it is normally protected by the business judgment rule and not usually liable to attack as self-dealing, given that all shareholders participate pro rata.[239] True, retention of profits within the firm is only beneficial if it has good projects to invest in. However, participants in the German debate displayed strong concerns about the risk of management being forced to make a distribution at an inconvenient time, which sometimes disrupts for business planning.[240]

The overall emerging picture of the debate is that German analysts of the interwar period were strongly concerned with the presence of different shareholder groups, changing majorities, and controlling shareholders, which was not much of a concern in American "Berle-Means" type corporations. The *Unternehmen an sich* debate reacted partly to this. Stakeholder concerns and employee interests seem to have entered the German debate primarily as a result of the enactment of § 70. In an influential treatise, Schlegelberger and other senior officials of the Ministry of Justice suggest that the "retinue" of

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[237] Hefermehl, *Die Rechnungslegung im neuen Aktiengesetz,* 66 JURISTISCHE WOCHENSCHRIFT 503, 503 (1937) ("In other firms, the shareholder meeting confirmed financial statements that stood in blatant contrast to the proposals of the administration. This did not happen because shareholders considered different financial statements to be correct because they had better expertise, but exclusively because they desired a personal advantage, while remaining indifferent towards the fate of the firm"); *see* Fischer, *supra* note 196, at 99; KALSS ET AL., *supra* note 223, at 318. On the debate before the 1965 act, when the concern was the lack of capital of German firms, *see* Kropff, *supra* note 244, note 65.

[238] § 170(1) DGCL (providing that directors *may* declare dividends).

[239] *See e.g.* Kamin v. American Express Co., 54 A.D.2d 654 (N.Y. 1976).

[240] *Supra* note 237.

the enterprise is intended to refer to employees, whose wellbeing the members of the management board must take care of.[241] But of course, keeping the common good of folk and realm in mind was the preponderant objective among all, thereby integrating the firm into the policy framework of the national economy.[242]

4.3. Post-War reception

The Aktiengesetz 1937 remained in place in Western Germany after the end of World War II without any significant changes.[243] With the exception of the default provision that the chairman of the management board could decide alone in the case of disagreements,[244] the reforms were retained after the war. As Bruno Kropff (one of the leading drafters of the subsequent 1965 reform) points out, by that time the distribution of competences between shareholders and the two boards had by and large come to be considered appropriate.[245] Thus, it seems safe to say that in spite of its ideological component, much of the substance of the act must have seemed defensible on policy grounds. While it was debated whether shareholders should again be granted the power to get involved in business decisions, the distribution of competences according to the 1937 reform was still considered adequate.[246] A 2003 article echoes this view by explaining why the limited role of the shareholder meeting and the legal entrenchment of the board of directors are considered mandatory law:

> "[T]he corporate constitution set out in the *Aktiengesetz* is seen as an optimal guarantee, on the one hand, for serving the public economic interest in a well-functioning enterprise, and, on the other hand, for

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[241] FRANZ SCHLEGELBERGER, LEO QUASSOWSKI, GUSTAV HERBIG, ERNST GESSLER & WOLFGANG HEFERMEHL, AKTIENGESETZ, § 70, comments 6, 7 (3rd ed. 1939).
[242] SCHLEGELBERGER ET AL., *id.,* comment 8.
[243] *E.g.* Mertens, *supra* note 230, at 110.
[244] *See* Bruno Kropff, *Reformbestrebungen im Nachkriegsdeutschland und die Aktienrechtsreform von 1965,* in 1 AKTIENRECHT IM WANDEL 670, note 57 (Walter Bayer & Mathias Habersack eds. 2007).
[245] Kropff, *id.*, note 60
[246] Kropff, *id.*

> protecting the interests of current and future shareholders (against management, and, if they exist, large shareholders) and of creditors (against management and shareholders)."[247]

Notably, the German reform of 1965 partly reversed the 1937 decision regarding dividends and required 50% of profits to be distributed if the financial statements were approved by the supervisory board (and thus not submitted to a shareholder vote).[248]

While employee interests had not been the focus of the debate of the 1920s, this gradually changed in the post-War Federal Republic. Scholars tended to distance themselves from the concept of *Unternehmen an sich*, but instead focused on the *Unternehmensinteresse* (the interest of the enterprise) concept of § 70. While no uniform interpretation of the term has ever emerged, post-war scholarship continued to understand the enterprise or the corporation to be distinct from shareholder interests.[249] The first post-War edition of a leading treatise of German corporate law emphasized how the reform led to an insulation of management from shareholders and argued that the independent responsibility of the management board

> "is not an alien contaminant in corporate law resulting from faulty national socialist economic thought. This provision rather takes into account a development of the structure of business, particularly the big enterprise in its macroeconomic and social importance, which is by no means restricted to the domain of corporate law in Germany. Even though one might deplore that particularly corporate law and the practice of large firms – even before the reform of 1937 – is moving more towards the "business in itself" […], this development cannot be stopped and will lead to a cer-

[247] Doralt, *supra* note 236, at 40.
[248] § 58 AktG.
[249] *But see* Fischer, *supra* note 196, at 101-106; *see also* RIECHERS, *supra* note 96, at 1 (noting in the introduction to his 1996 book that the term "*Unternehmen an sich*" is still popular).

tain reduction of shareholders' role as formal owners."[250]

The general idea of the "good of the enterprise" survived the enactment of a new Aktiengesetz in 1965 at least in some form, when the old § 70 was replaced by a new § 76 that merely reiterated the board's independence (much like DGCL § 141(a)), but was devoid of an explicit goal. However, the legislative report made it clear that no change in the law was intended;[251] in fact, it pointed out that it was self-evident that managers would have to take capital, employee and public interests into account.[252] In its decision declaring the 1976 codetermination act to be constitutional, the German constitutional court gave support to this view by stating that ownership of stocks was subject to "social restrictions."[253]

The new, expansive codetermination law of 1976[254] may have further fueled arguments in favor of what we today call a stakeholder-oriented interpretation of the law, but corresponding academic writing

[250] Walter Schmidt & Joachim Meyer-Landrut, § 70, comment 1, in 1 AKTIENGESETZ GROSSKOMMENTAR (Carl Hans Barz, Robert Fischer, Ulrich Klug, Konrad Mellerowicz, Joachim Meyer-Landrut, Wolfgang Schilling & Walter Schmidt 2nd. ed. 1961) (own translation).

[251] *See e.g.* Joachim Meyer-Landrut, § 76, comment 9, in 1 AKTIENGESETZ GROSSKOMMENTAR (Carl Hans Barz, Herbert Bröner, Ulrich Klug, Konrad Mellerowicz, Joachim Meyer-Landrut, Wolfgang Schilling, Herbert Wiedemann & Hans Würdinger, 3rd. ed. 1973).

[252] *See* the official reasoning for the proposal in KROPFF, *supra* note 223, at 97. For an overview of the development of the rule *see* Vagts, *supra* note 213, at 40-41; *cf.* Mertens, *supra* note 216, § 76, comment 16 (stating that the language of the 1937 act was still relevant; Klaus J. Hopt, *Aktionärskreis und Vorstandsneutralität,* 22 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 534, 536 (1993). However, some authors did not agree with this interpretation. *See e.g.* Wolfgang Hefermehl, in 2 AKTIENGESETZ, § 76, comment 20 (Ernst Geßler, Wolfgang Hefermehl, Ulrich Eckardt & Bruno Kropff eds. 1973, 1974) (suggesting that no such requirement exists). The German law's Austrian offshoot to this day explicitly requires the management board to pursue the good of the enterprise while having regard to the interests of stockholders, employees and the public interest (§ 70 Austrian AktG of 1965).

[253] BVerfGE 50, 290, 315 f "Mitbestimmung".

[254] MITBESTIMMUNGSGESETZ, BGBl. I 1976, S. 1153.

began to develop earlier. Legal scholars writing in the 1960s and 1970s increasingly adopted a sociological theory of corporate law, in which the *Unternehmensinteresse* was traced to the idea that the enterprise constitutes a social collective.[255] The corporation was seen as an amalgamation of the interests of owners, workers and managers,[256] the proper goal of which was to maintain the existence of the firm, taking the interests of various groups into account[257], and to maintain its long-term earning power.[258] In that view, it is in the discretion of the management board to pursue other goals, such as fulfilling consumer demand, providing adequate wages and working conditions,

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[255] THOMAS RAISER, DAS UNTERNEHMEN ALS ORGANISATION 133-157 (1969); Thomas Raiser, *Das Unternehmensinteresse,* in FESTSCHRIFT FÜR REIMER SCHMIDT 101, 117 (Fritz Reichert-Facilides, Fritz Rittner, Jürgen Sasse eds. 1976); *see also* Wolfgang Schilling, *Das Aktienunternehmen,* 144 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 136 (1980); *contra* Fritz Rittner, *Aktiengesellschaft oder Aktienunternehmen?* 144 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 330, 330-334 (1980); WERNER FLUME, UM EIN NEUES UNTERNEHMENSRECHT (1980).

[256] Wolfgang Zöllner, *Einleitung,* in KÖLNER KOMMENTAR ZUM AKTIENGESETZ, EINLEITUNGS-BAND, comment 130 (1st ed., Wolfgang Zöllner ed. 1984) (pointing out that the continued existence of old, unproductive firms serves no one); Michael Kort, in 19 GROSSKOMMENTAR AKTG § 76, comment 53 (Klaus J. Hopt & Herbert Wiedemann eds. 2003); Wulf Goette, *Leitung, Aufsicht, Haftung – zur Rolle der Rechtsprechung bei der Sicherung einer modernen Unternehmensführung,* IN FESTSCHRIFT AUS ANLASS DES FÜNFZIGJÄHRIGEN BESTEHENS VON BUNDESGERICHTSHOF, BUNDESANWALTSCHAFT UND RECHTSANWALTSCHAFT BEIM BUNDESGERICHTSHOF 123, 127 (Karlmann Geiß, Kay Nehm, Hans Erich Brandner & Horst Hagen eds. 2000).

[257] Zöllner, *id.,* note 256, comment 136; Hopt, *supra* note 252, at 536-537; Klaus J. Hopt, *Übernahmen, Geheimhaltung und Interessenkonflikte: Problem für Vorstände, Aufsichtsräte und Banken,* 31 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 333, 359-360 (2002).

[258] FRITZ RITTNER, WIRTSCHAFTSRECHT § 9, note 15 (2nd ed. 1987); Mertens, *supra* note 216, § 76, comments 10, 22-23; Kort, *supra* note 256, § 76, comment 51; Spindler, *supra* note 216, § 76, comment 61; Goette, *supra* note 256, at 127; THOMAS RAISER & RÜDIGER VEIL, DAS RECHT DER KAPITALGESELLSCHAFTEN § 14, comment 13 (4th ed. 2006) (mentioning the management board's duty to "increase" shareholder value as one of several tasks); HÜFFER, *supra* note 216, § 76, comment 13. It is interesting to note that this interpretation of the law seems to correspond to John Kenneth Galbraith's descriptions of what managers in large firms do in fact. *See* GALBRAITH, *supra* note 23, at 153 passim.

the relationship to the firm's social and cultural environment, the maintenance of a livable environment, and macroeconomic concerns.[259] Profits must be made in an amount that suffices to maintain the firm.[260] During this period, confidence in the German corporate governance system was as its peak, and Germany even strove to export some of its core elements to the European level, e.g. by means of the proposed 5th EEC Company Law Directive, which would have required the introduction of worker representation across the continent.[261] The project failed, not the least due to resistance from UK after the introduction of employee representation had failed within the domestic debate in Britain.[262] A contrarian movement developed only during the 1990s, apparently under the influence of US scholarship and an increasing significance of capital markets and institutional investors. As a result, the idea of "shareholder value" became part of the debate.[263] Unsurprisingly, the growing attractiveness of a share-

[259] Mertens, *supra* note 216, § 76, comment 11.

[260] Mertens, *id.*, § 76, comment 22-23; JOHANNES SEMLER, LEITUNG UND ÜBERWACHUNG DER AKTIENGESELLSCHAFT, comments 38, 48 (2nd ed. 1996); *contra* Peter Raisch, *Zum Begriff und zur Bedeutung des Unternehmensinteresses als Verhaltensmaxime von Vorstands- und Aufsichtsratsmitgliedern*, in STRUKTUREN UND ENTWICKLUNGEN IM HANDELS-, GESELLSCHAFTS- UND WIRTSCHAFTSRECHT, FESTSCHRIFT FÜR WOLFGANG HEFERMEHL 348, 352, 363 (Robert Fischer, Ernst Geßler, Wolfgang Schilling, Rolf Serick & Peter Ulmer eds. 1976) (suggesting that maintaining the firm's legal capital suffices).

[261] *See e.g.* J. Temple Lang, *The Fifth EEC Directive on the Harmonization of Company Law, Part 2,* 12 COMMON MKT. L. REV. 345, 346-349 (1975).

[262] VANESSA EDWARDS, EC COMPANY LAW 388 (1999). The government-commissioned "Bullock Report" recommended the introduction of a mandatory employee participation system similar to the German one, but the project had only limited support even within the Labour movement and was ultimately abandoned when Margaret Thatcher came to power in 1980. *See* LORD BULLOCK (CHAIRMAN), REPORT OF THE COMMITTEE OF INQUIRY ON INDUSTRIAL DEMOCRACY (1977) (official report recommending employee participation): David Marsh & Gareth Locksley, *Capital in Britain: Its Structural Power and Influence over Policy,* WEST EUR. POL., March 1983, at 36, 49-50 (discussing the failure of the proposal).

[263] Manfred Groh, *Shareholder Value und Aktienrecht,* 42 DER BETRIEB 2153 (2000); Spindler, *supra* note 216, § 76, comments 66-68; Peter O. Mülbert, *Shareholder Value aus rechtlicher Sicht,* 26 ZEITSCHRIFT FÜR GESELLSCHAFTS- UND UNTERNEHMENSRECHT 129 (1997); Friedrich Kübler, Shareholder Value: Eine Herausforderung für das Deutsche Recht? in FESTSCHRIFT FÜR WOLFGANG ZÖLLNER 321

holder primacy goal[264] coincided with mounting criticism of codetermination.[265]

4.4. An unusual practical application: The Mannesmann case

In spite of its long pedigree, the reception of the *Unternehmensinteresse* ("interest of the business") doctrine by the courts can at best be called ambiguous. The courts use the concept or equivalent ones frequently, but typically without defining it or striking a balance between shareholder and stakeholder interests, e.g. when discussing whether the exclusion of a preemptive right is justified "in the interest of the firm", [266] or when defining the duties of board members.[267] Un-

(Manfred Lieb, Ulrich Noack & H.P. Westermann eds. 1998); Axel von Werder, *Shareholder Value-Ansatz als (einzige) Richtschnur des Vorstandshandelns?* 27 ZEITSCHRIFT FÜR GESELLSCHAFTS- UND UNTERNEHMENSRECHT 69 (1998); *contra* HÜFFER, *supra* note 216, § 76, comment 12a-12b (rejecting shareholder value and espousing a stakeholder conception).

[264] Kübler, *id.*; Groh, *id.,* at 2158; Klaus J. Hopt & Markus Roth, in GROSSKOMMENTAR AKTIENGESETZ, § 111, comment 104 (4th ed. 24th installment, Klaus J. Hopt & Herbert Wiedemann ed. 2005); Holger Fleischer, in 1 KOMMENTAR ZUM AKTIENGESETZ, § 76, comment 34 (Gerald Spindler & Eberhard Stiltz 2007).

[265] *E.g.* Axel von Werder, *Modernisierung der Mitbestimmung,* 64 DIE BETRIEBSWIRTSCHAFT 229 (2004); Eberhard Schwark, *Globalisierung, Europarecht und Unternehmensmitbestimmung im Konflikt*, 2004 DIE AKTIENGESELLSCHAFT 173; Michael Adams, *Das Ende der Mitbestimmung,* 2006 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1561.

[266] Under German case law, a substantive reason that is potentially subject to judicial review is required to deprive shareholder of their statutory preemptive right. *See* BGH March 13, 1978, II ZR 142/76, BGHZ 71, 40 ("Kali+Salz"); BGH April 19, 1982, II ZR 55/81, BGHZ 83, 319; BGH June 23, 1997, II ZR 132/93, BGHZ 136, 133 ("Siemens/Nold"); *see also* OLG Stuttgart 12.8.1998, 20 U 111/97, DB 1998, 1757; OLG Braunschweig July 29, 1998, 3 U 75/98, ZIP 1998, 1585; BGH November 21, 2005, 2006 WERTPAPIER-MITTEILUNGEN 432; BGH March 7, 1994, II ZR 52/93, BGHZ 125, 239 (discussing whether a company should seek a foreign stock exchange listing); *see also* BGH February 8, 1988, II ZR 159/87, BGHZ 103, 213, 217 (using the interest of the association as an argument why the company should be represented by the supervisory board instead of management board in a court procedure about the removal of members of the management board).

der the Takeover Law implementing the 2004 EU directive, takeover defenses are permitted when they were approved by shareholders and permitted in the company's charter,[268] and the supervisory and management must act in the "interest of the target company,"[269] i.e. the *Unternehmensinteresse.*[270]

The one recent case where the doctrine was at least of superficial significance was *Mannesmann*, resulting from the first openly hostile takeover bid for a German firm,[271] launched by Vodafone Airtouch of the UK in 2000. Mannesmann's management abandoned its defenses, the cost of which had gone into the hundreds of millions of Deutschmarks,[272] after Vodafone had raised its bid price from € 240 to € 360.[273] The supervisory board then decided to grant "appreciation awards" to the members of the management board, most of all an amount of € 16 Million to CEO Klaus Esser, who had been in this position for less than a year, in addition to his contractual severance payment of € 15 Million.[274] Other management board members, some of whom had been members for only a few days and left the firm a few months after the decision, also received substantial sums. These awards "in recognition for their contribution to the firm's success" had in fact been suggested by Mannesmann's 10% shareholder, Hut-

[267] BGH June 5, 1975, BGHZ 64, 325, 331, NJW 1975, 1412 (duty of confidentiality); *see also* BGH February 25, 1982, BGHZ 83, 144 (briefly mentioning that the board should remain operational in the interest of the business); *see also* BVerfG March 1, 1979, 1 BvR 532, 533/72, 419 and 41 BvR 21/71, BVerfGE 50, 290, 374 (Constitutional Court approving the 1976 codetermination regime and mentioning the obligation of board members to pursue the interest of the enterprise in passing).

[268] § 33a WpÜG.

[269] § 3(3) WpÜG.

[270] *E.g.* Kai Haakon Liekefett, *Bietergleichbehandlung bei öffentlichen Übernahmeangeboten,* 50 DIE AKTIENGESELLSCHAFT 802, 806-810 (2005) (discussing what the concept could imply in the takeover context).

[271] *E.g.* Cheffins, *supra* note 6, at 502.

[272] *Cf.* Mark Binz & Martin Sorg, *Esser und Ackermann müssen Pyrrhussiege fürchten,* FRANKFURTER ALLGEMEINE ZEITUNG, May 6, 2004, at 12 (reporting costs of € 432 Million).

[273] *See* Franklin A. Gevurtz, *Disney in a Comparative Light,* 55 AM. J. COMP. L. 453, 460 (2007).

[274] Stefan Maier, *A Close Look* at *the Mannesmann Trial,* 7 GERMAN L. J. 603, 604 (2006).

chinson Whampoa of Hong Kong, which benefited from the sale financially[275] and had previously offered to make such a payment.[276]

Since the bonus gave the appearance of a bribe to many observers,[277] it sparked outrage in the press and among employees.[278] In 2003, Mr. Esser and members of Mannesmann's supervisory board were indicted for *Untreue* (disloyalty), a criminal offense punishing the abuse of the power to depose over someone else's property or to legally bind someone else.[279] Defendants, including the former president of the board, Deutsche Bank CEO Josef Ackermann, claimed that such payments were in accordance with international practices. The employee representatives on the supervisory board, who had acquiesced to the payments without giving their assent, were also indicted.[280] Law professors commented in the business press, most prominently Marcus Lutter and Wolfgang Zöllner, who pointed out that "the management board must secure the corporation's position in the market and increase profits." Shareholders had benefited from the higher bid price in consequence of the board's defensive efforts, but the firm (which ceased to exist) itself had not. In this view, their actions violated their duty to advance the interest of the firm.[281] Others explained that the gains in stock price were only a temporary result of

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[275] Peter Kolla, *The Mannesmann Trial and the Role of the Courts,* 5 GERMAN L. J. 829, 833 (2004); CURTIS MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM 70 (2008).
[276] Mark K. Binz & Martin Sorg, *Ackermann & Co.: Gutsherren oder Gutsverwalter?* BETRIEBS-BERATER, February 6, 2006, at I; MILHAUPT & PISTOR, *id.,* at 70.
[277] Kolla, *supra* note 275, at 833.
[278] Gevurtz, *supra* note 273, at 461; MILHAUPT & PISTOR *id.,* at 70-71.
[279] § 266 StGB (GERMANY). A typical case of *Untreue* would be a property manager who uses rent payments to gamble instead of passing them on to the owner, but the offense is also relevant in the corporate context. *See* Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy,* 4 EUR. COMPANY & FIN. L. REV. 491, 520 (2007).
[280] MILHAUPT & PISTOR, *supra* note 275, at 70-71.
[281] Marcus Lutter & Wolfgang Zöllner, *"Die Mannesmann-Prämien durften nicht gezahlt werden"*, FRANKFURTER ALLGEMEINE ZEITUNG, February 10, 2004, at 12; *see also* FRANKFURTER ALLGEMEINE ZEITUNG, March 19, 2004, at 14 (citing criminal law scholar Bernd Schünemann as saying that the board's actions were punishable under criminal law).

the takeover offer: The main beneficiary of the defenses was Hutchinson, whereas Vodafone subsequently wrote off the purchase price (to the detriment of German taxpayers), and thousands of jobs were lost.[282]

The initial trial resulted in an acquittal, but on appeal, the German Federal Supreme Court (BGH) sided with the prosecution. In its opinion, the BGH only paid lip service to the concept of *Unternehmensinteresse*, but applied a more specific statute that requires management compensation to be reasonable.[283] In the eyes of the court, this was not the case here, since the bonus was neither based on a prior contractual stipulation, nor could it be understood to generate future benefits such as an incentive effect for managers given the impending breakup of the firm. Thus, the court found that the decision to make the payment violated the duty of loyalty. The defendants ultimately reached a settlement with prosecutors, in the course of which they agreed to pay substantial fines without having to admit guilt.[284]

In spite of the court's rhetorical embrace of an institutional understanding of the corporation, in which it reiterated that the interests of the totality of shareholders, of creditors and the public are relevant for concept of the welfare of the "business", the reference to the *Unternehmensinteresse* was superfluous. The court could easily have reached the same result by referring to any definition of the best "interests of the company", including one taking only shareholder wealth into account. The best analogy in US corporate would be the waste doctrine.[285] It is telling that even employee representatives on

[282] Binz & Sorg, *supra* note 276, at I.
[283] BGH December 21, 2005, BGHST 50, 331. The statute referred to is § 87(1), sentence 1 AktG.
[284] Bernard Black, Brian Cheffins, Martin Gelter, Hwa-Jin Kim, Richard Nolan, Mathias Siems & Linia Prava Law Firm, *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency),* 2008 COLUM. BUS. L. REV. 1, 145-146.
[285] *See also* Gevurtz, *supra* note 273, at 464 ("Essentially, this is the same as a waste claim in the United States"). Gevurtz' suggestion conclusion that this shows that German courts are less deferential to business decisions therefore seems premature. Fleischer, *id.,* at 543. *See also* Maier, *supra* note 274 ("Contrary to popular opinion, the BGH's verdict in the Mannesmann trial makes no statement as to the

the board did not object to the payment: At the time of the decision, the breakup of the company (and layoffs) had already become inevitable.[286] Furthermore, contradicting its professed adherence to an understanding of the corporation transcending shareholder interests, the court stated that the board's actions would not have led to a criminal conviction if all shareholders had approved them, and not only Vodafone, which held 9.8% when the decision was made, and 98.6% at the time of the payment.[287]

4.5. Conclusion: Institutionalism as an attempt to constrain shareholder power

In spite of recent criticism,[288] we can still discern the imprint of an institutional understanding of the corporation in German law. Commentators typically see the *Unternehmensinteresse* as a proxy for the interests of various groups that must be reconciled.[289] Its practical significance is rather doubtful, given that courts are usually able to skirt clear definitions. Historically, the debate around 1930 was primarily concerned with the institutional construction of the firm. The legal theory of the *Unternehmen an sich* was partly intended as a constraint on the conduct of shareholders, who were thought to be able to often exert a detrimental influence on the firm. Other than in the US, managerial power could not simply be taken for granted given the complications in the corporate governance system created by non-atomistic share ownership patterns. Thus, participants in the German

appropriateness of executive remuneration.") and *id.,* at 606 (rejecting the argument that non-contractual appreciation awards could be justified by the extra effort of defending against hostile takeovers to achieve a high price).

[286] MILHAUPT & PISTOR, *supra* note 275, at 80.

[287] MILHAUPT & PISTOR, *supra* note 275, at 73; *see* Gevurtz, *supra* note 273, at 484

[288] *E.g.* Fleischer, *supra* note 264, § 76, comments 30-31; *see also* Philipp Klages, *The Contractual Turn: How Legal Academics Shaped Corporate Law Reforms in Germany,* at http://www.mpifg.de/people/kg/downloads/Contractual%20Turn.pdf, at 11-16; Roth, *supra* note 31, at 64 (both identifying a shift towards a contractual understanding of the corporation and a shareholder primacy objective in legal scholarship).

[289] HÜFFER, *supra* note 216, § 76, comment 15.

debate struggled with intra-shareholder conflicts, for the resolution of which an institutional understanding of the firm was intended to provide benchmarks. As far as the concept was intended to serve the public interest (e.g. in the context of the 1937 statute), the intention was clearly to shift the balance of powers between shareholders and management in favor of the latter in order to reduce the scope of financially motivated decision-making. Nevertheless, the practical effects of the theory contemporary German corporate law seem to be limited.

5. French institutionalism and the "*intérêt social*"

France shares two traits with Germany that are interesting for this article's thesis: First, France is also often said to have a corporate governance system not primarily intended to serve shareholder interests, but also those of employees and others, and the public interest in general. France does not have codetermination, the reason probably being that the tradition of *dirigisme*, meaning that the government often intervenes in the economy, partly through direct ownership of large businesses.[290] Like Germany, France developed a strong "institutional school" of corporate law, which focused on the doctrine of the *intérêt social* or *intérêt de la société* (interest of the association or corporation), which is usually understood to take the interests of other non-shareholder constituencies into account.[291] The second feature France shares with Germany is concentrated ownership, and I argue that the impact it had on shareholder-stakeholder debates was similar, while the tradition of state ownership appears not to feature prominently.

Section 5.1 describes the academic debates from which the French institutional school developed. Section 5.2 looks at the role specific legal rules and cases. Section 5.3 looks at rules relating to the

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[290] *E.g.* James A. Fanto, *The Role of Corporate Law in the Adaptation of French Enterprises,* 1998 COLUM. BUS. L. REV. 97, 100-103.

[291] *E.g.* PHILIPPE MERLE & ANNE FAUCHON, DROIT COMMERCIAL. SOCIETES COMMERCIALES, para. 52-1 (13th ed. 2009); Christiane Alcouffe, *Judges and CEOs : French Aspects of Corporate Governance,* 9 EUR. J. L. & ECON. 127, 133 (2000).

removal of directors, which counteract a strong independent position of the firm. Section 5.4 concludes.

5.1. The origins of the French institutional school

The contemporary institutional school can trace its roots to the 1930s and developed vigorously during the 1960s. The first to develop an "institutional theory" of the corporation was Gaillard in his 1932 dissertation. He observed the growing number of small investors, but at the same time the possibility that financial groups could easily obtain the majority of shares. Small shareholders would remain passive, while a financial group, if not restrained by the law, could use the power of the shareholder meeting to dominate the company.[292] In his view, a contractual theory could not adequately address abuses, as it presumed that minority shareholders had voluntarily submitted to majority control, which is why courts would normally not interfere with majority decisions (except maybe under a theory of good faith).[293] As a legal solution, he proposed an institutional theory, in which the corporation was to be understood as the subject of its own interest, the *intérêt social*; corporate decisions by managers, but also shareholder votes, should be subject to judicial review under this standard.[294]

The emergence of the institutional theory in the early 1930s may have been influenced by contemporary economic developments, as a result of which the significance of controlling shareholders had grown. As in Germany, multiple-vote shares had been increasingly used in French publicly traded companies during the 1920s. Following a period of high inflation around 1926, French companies sought means to protect themselves against takeovers, particularly by foreign

[292] EMILE GAILLARD, LA THEORIE INSTITUTIONNELLE ET LE FONCTIONNEMENT DE LA SOCIETE ANONYME 10-13 (1932).
[293] GAILLARD, *id.,* at 14-20.
[294] GAILLARD, *id.,* at 36-43. Gaillard's theory was not only normative, but to a large degree descriptive, as he attempt to explain the existing French case law on its basis. *See* GAILLARD, *id.,* at 33-36.

investors.[295] Volatile majorities that created difficulties for management were increasingly seen as a problem,[296] and it was increasingly thought that anti-takeover protections were needed to keep French firms viable in international competition.[297]

Georges Ripert, a leading French business law scholar of the mid-20th century, endorsed an institutional theory of the firm in his 1946 book, arguing that shareholders were abandoning their status as an owner, taking a position similar to that of a creditor. His book paints a picture of corporations resembling American firms with strong management and apathetic shareholders, whose passivity no corporate law reform has managed to overcome.[298] Like American scholars of his period, he recognized the "enterprise" as a de facto entity, despite the law's emphasis on shareholder democracy.[299] While Ripert did not ignore the concerns of workers, he also did not consider them to be an issue of concern of corporate law and objected to codetermination.[300] Employment law, on the other hand, ensured that labor was no longer put to the service of capital and was, according to Ripert, already on the way towards effectively giving employees property right in their jobs by virtue of legal limits on dismissals.[301]

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[295] Muriel Petit-Konczyk, *Big changes in ownership structures – Multiple votes in interwar France,* WORKING PAPER 11, at http://ssrn.com/abstract=944808.
[296] ROQUEFORT-VILLENEUVE, LES ACTIONS A VOTE PLURAL AU POINT DE VUE ECONOMIQUE 33-58, 59-77 (1932).
[297] *Id.,* at 78-92. Nevertheless, multiple-vote shares had been prohibited and were no longer allowed to be issued according to a 1931 law. Existing ones had to be transformed into regular shares in 1934. Petit-Konczyk, *supra* note 295, at 4.
[298] GEORGES RIPERT, ASPECTS JURIDIQUES DU CAPITALISME MODERNE 87-104 (1st ed. 1946). In particular, *see* RIPERT, *id.,* at 102 ("pendent toute la vie sociale, l'actionnaire se présente comme créancier de la société"). Interestingly, in spite of occasional references to German law, Ripert does not refer to American or German writers with similar ideas. For a summary of Ripert's theory *see* Thierry Kirat, *The firm between law and economics,* in THE FIRM AS AN ENTITY 131, 138-141 (Yuri Biondi, Arnaldo Canziani & Thierry Kirat eds. 2007). Kirat, however, does not discuss Ripert's ideas about employment.
[299] *See* Kirat, *id.,* at 141.
[300] RIPERT, *id.,* at 270.
[301] RIPERT, *id.,* at 296-300

An increasing number of scholars emphasized the "institutional character" of the company during subsequent decades, and, in doing so, focused on majority-minority conflicts.[302] Despax argued in 1957 that the "enterprise" had a separate interest from that of the entrepreneur,[303] and that it was developing more and more autonomy in the law. Effectively, it was on the way to having legal capacity on its own;[304] he also suggested that it was necessary to balance the interests of capital, labor, and costumers within the enterprise.[305] As in Germany, the discussion of this period was partly linked to an increasingly sociological understanding of the nature of the "enterprise" that was more than just a form of business organization.

The heyday of the institutional school came during the 1960s. Members of the "School of Rennes" argued that the "enterprise" served as a focal point for economic activity, economic assets, and entrepreneurial decision-making, for which the corporation provided the organizational structure.[306] The School of Rennes was later described by one of its main representatives, Claude Champaud, as a "realist" movement.[307] His 1962 book explored the concentration of

[302] *E.g.* Jean Portemer, *Du contrat à l'institution,* 1947 SEMAINE JURIDIQUE JCP, doctrine, para. 586 (suggesting that an understanding of managers as agents of shareholders may no longer by adequate); Jean Leblond, *Les pouvoirs respectifs de l'assemblée générale, du conseil d'administration et du directeur général adjoint dans la doctrine institutionnelle,* 1957 GAZETTE DU PALAIS, I, doctrine, 29-32 (emphasizing the mandatory role of different company organs); *see* Jean Paillusseau, *La nouvelle société par actions simplifiée. Le big-bang du droit des sociétés,* 1999 RECUEIL DALLOZ, chronique, 333, at 344-345.

[303] MICHEL DESPAX, L'ENTREPRISE ET LE DROIT, para. 178-198 (1957).

[304] DESPAX, *id.* para. 351-391.

[305] DESPAX, *id.* para. 290.

[306] JEAN PAILLUSSEAU, LA SOCIETE ANONYME, TECHNIQUE D'ORGANISATION DE L'ENTREPRISE 5 (1967); *see* Jean Paillusseau, *Le droit des activités économiques à l'aube du XXIe siècle (suite et fin),* 2003 RECUEIL LE DALLOZ 322, 322-324; *see also* Alain Couret, *Le gouvernement d'entreprise. La corporate governance*, 1995 RECUEIL DALLOZ SIREY, chronique, 163, 165; Géraldine Goffaux-Callebaut, *La définition de l'intérêt social,* 2004 REVUE TRIMESTRIELLE DE DROIT COMMERCIAL ET DE DROIT ECONOMIQUE 35, 36.

[307] *See* Claude Champaud, *Les fondements sociétaux de la « doctrine de l'entreprise »,* in ASPECTS ORGANISATIONNELS DU DROIT DES AFFAIRES. MELANGES EN L'HONNEUR DE JEAN PAILLUSSEAU 117, 149 passim (2003).

corporations, focusing on legal instruments used to achieve concentration and to create corporate groups, and on the legal consequences. Other than American scholars such as Berle, to whom he sometimes referred in his work, he did not focus on the managerial power of large corporations, but developed a distinction between shareholders purely contributing funds and those taking a larger share, intending to exercise control over the firm.[308] Quite obviously, this raised much less concern about the protection of shareholders against management, but rather the protection of non-controlling shareholder and creditors.[309] "Business activity", he argued, "in large corporations is profoundly marked by the dominance of controlling shareholders,"[310] which of course raises the problem of abuse.[311]

Champaud seems not to have been particularly concerned with stakeholders or an institutional understanding of the firm. However, the emphasis on the two types of shareholders was picked up a few years later by Jean Paillusseau, who developed the legal theory of the *intérêt social.* He argued that the traditional contractual understanding of the corporation was not capable of explaining the increasing power of managers in large firms and the decline of the practical importance of shareholder meetings.[312] His descriptive account is similar to that of the American authors of this period. Again, the crucial difference to the US that characterized his theory related to concentrated ownership.[313] The reason for the decline of the shareholder meeting was therefore, in his view, not merely the absenteeism of contributors of capital, but the existence of controlling shareholders who were able to impose their will on the firm.[314] The theory thus seems torn between the apparent necessity of centralized corporate decision-making and the role of large blockholders. Apparently assuming that controlling

[308] CLAUDE CHAMPAUD, LE POUVOIR DE CONCENTRATION DE LA SOCIETE PAR ACTIONS 29-44 (1962); PAILLUSSEAU, *supra* note 306, at 49-52.
[309] *E.g.* CHAMPAUD, *id.,* at 45.
[310] CHAMPAUD, *id.,* at 140.
[311] CHAMPAUD, *id.,* at 145-146.
[312] PAILLUSSEAU, *supra* note 306, at 239-245.
[313] *See* PAILLUSSEAU, *id.*, at 49-52 (referring to the distinction between two types of shareholders emphasized by Champaud).
[314] PAILLUSSEAU, *id.,* at 239.

shareholders were typically represented on the board of directors, he observed that members of the board of directors were typically in the position to impose their will on other shareholders; the shareholder meeting must therefore not be allowed to authorize or approve acts contrary to the *intérêt social*.[315] For the definition of the concept, while not explicitly emphasizing stakeholder issues, he picked up Despax' theory of the institutional nature of the firm and argued that the firm's interest cannot be identified with the interest of shareholders, but that it includes all of the interests converging in the enterprise, the goal essentially residing in the life and growth of the economic organism.[316] The interest of the firm was thus intended as a limit to shareholder power.

5.2. Institutionalism, the law, and the courts

Institutional theories of the corporation apparently did have some background in the development of legislation. On the legal level, the concept of *intérêt social* can be traced to the 1930s, when France was suffering from the effects of the Great Depression and political instability. The Laval government had been given the power to take emergency measures in June 1935 in order to "ensure the defense of the currency and to fight speculation."[317] Among other things, the government used this power to pass a decree-law in August 1935 without parliamentary approval or debate.[318] This law introduced a number of business crimes, including *abus de biens sociaux* (abuse of corporate assets), which remains in the law[319] and

[315] PAILLUSSEAU, *id.,* at 194.
[316] PAILLUSSEAU, *id.,* at 196-200.
[317] PAUL PIC, ÉVOLUTION RECENTE DU DROIT DES SOCIETES 1930-1943, 8 (2nd ed. 1943).
[318] Décret-loi du 8 août 1935. *See* HENRY SOLUS, LA REFORME DU DROIT DES SOCIETES PAR LES DECRETS-LOIS DE 1935 ET 1937, 2 (1938).
[319] In the [former] Code des Sociétés of 1966, the criminal provision was in art. 425(4) and 437(3). The current provision is C. COM. art L. 242-6. *See* PAILLUSSEAU, *supra* note 306, at 189-191; Alcouffe, *supra* note 291, at 133; EVA JOLY & CAROLINE JOLY-BAUMGARTNER, L'ABUS DE BIENS SOCIAUX A L'EPREUVE DE LA PRATIQUE 8 (2002); Nicole Stolowy, *Company-Related Offenses in French Legislation,* 2007 J. BUS. L. 1, 3 (2007).

continues to be important in practice.[320] It penalizes directors' misuse of the company's property and credit in bad faith, "when directors knew that it was contrary to its interest."[321] While the provision did not explicitly use the wording *intérêt social*,[322] the concept was used to refer to the offense.[323] Even early commentators pointed out that the interest of the company was not identical to that of shareholders, but that, for example, an actual damage to the corporate patrimony was required and that a decrease in the stock price did not suffice.[324]

Attempts to strengthen management vis-à-vis shareholders may have played a role as well. In fall 1940, only months after the German invasion, the Vichy government hastily passed a reform of the structure of the firm's leadership without a debate or a clarification of its motives,[325] which had to be amended in early 1943 due to

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[320] Conac et al., *supra* note 279, at 518-519 (citing statistics reporting several hundreds of convictions between 2000 and 2006).

[321] *See* SOLUS, *supra* note 318, at 88; PIERRE BAUDOUIN-BUGNET & GILLES GOZARD, LA DIRECTION DES SOCIETES PAR ACTIONS EN FRANCE ET EN ALLEMAGNE 35 (1941); PIC, *supra* note 317, at 73. In fact, Baudouin-Bugnet and Gozard report that the provision merely codified an already existing development in the case law deriving from the more general crime of *abus de confiance* (breach of trust). According to Solus, this statute was not sufficiently specific to combat the tendency of directors to treat the corporation as if it were their own. *Abus de confiance* continues to be relevant e.g. for transfers of property to the benefit of managers and employees and in partnerships. The *intérêt social* is also relevant here.

[322] To be precise, the law penalizes "managers who, in bad faith, have made use of the company's property or credit in a way which they knew was contrary to the interest of it, for personal purposes or to favor another association in which they had a direct or indirect interest" ("les gérants qui, de mauvaise foi, ont fait des biens ou du crédit de la société un usage qu'ils savaient contraire à l'intérêt de celle-ci, dans un but personnel ou pour favoriser une autre société dans laquelle ils étaient intéressés directement ou indirectement").

[323] *E.g.* JOSEPH HAMEL & GASTON LAGARDE, 1 TRAITE DE DROIT COMMERCIAL, para. 660 (1954).

[324] SOLUS, *supra* note 318, at 92-93.

[325] Loi du 16 novembre 1940. This law replaced the prior loi du 18 septembre 1940 before it could come into force, which was suffering from even greater legislative problems. *See* Paul Cordonnier, *Loi du 16 novembre 1940*, 1941 DALLOZ CRITIQUE, legislation, 1, 1-2; MICHEL GERMAIN, 1/2 TRAITE DE DROIT COMMERCIAL para. 1367 (G. Ripert & R. Roblot, 18th ed. 2001).

shortcomings in legislative craftsmanship.[326] However, there was also a substantive aspect to this reform, which further increased the concentration of power: In 1940, the president of the board was by default the CEO at the same time, but he was still permitted to designate another person to take that position. The 1943 reform made the identity of the two functions mandatory,[327] introducing the *Président Directeur-General* (PDG) – CEO and president of the board – as the dominating figure in French corporations.

Until the "nouvelles régulations économiques" reforms of 2001,[328] the two functions of president of the board (*président*) and CEO (*Directeur-General*) had to be held by the same person.[329] Some contemporary writers attributed this development to a "transposition of the German theory of the *Führerprinzip*" in France.[330] After the end of the German occupation, a growing number of scholars objected to this interpretation of invents and argued out that these enactments had been intended to identify a clear responsibility within

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326 Loi du 4 mars 1943. *See* RIPERT, *supra* note 298, at 116-117; HAMEL & LAGARDE, *supra* note 323, para. 652 (both citing low legislative quality as a reason for the amendment); *see also* Paul Esmein, *L'Administration des Sociétés anonymes d'après la loi du 16 novembre 1940,* 1940 GAZETTE DU PALAIS, II, doctrine, 90, 93-94 (describing that the president legally responsible for the actions of the *directeur*).

327 *See* PIC, *supra* note 317, at 79; Joseph Hamel, *Les pouvoirs du président et du directeur général des sociétés anonymes d'après la loi du 4 mars 1943,* 1943 GAZETTE DU PALAIS, II, doctrine, 59, 60.

328 Loi no 2001-420 du 15 Mai 2001 relative aux nouvelles régulations économiques (JO 16 mai 2001, p. 7776) [hereinafter: NRE law].

329 After 1967, firms were able to opt out by implementing a two-tier board structure inspired by German law. However, the latter never took root in France. *See* Alcouffe, *supra* note 291, at 129 (reporting that less than 3% had opted for a two-tier structure).

330 BAUDOUIN-BUGNET & GOZARD, *supra* note 321, at 53 ("one could not achieve a more complete application of the *Führerprinzip*…" [own translation]); LOUIS CZULOWSKI, LA NOTION DE DIRECTION DANS LES SOCIETES ANONYMES ET LA LEGISLATION DE 1940, 133-134 (1943) (agreeing with this assessment); PAUL PIC & JEAN KREHER, 2 DES SOCIETES COMMERCIALES, para. 2018 (3rd ed. 1948) ("the reform of the Vichy government seems like a rather servile imitation of the 'führer prinzip' [sic!] of the German law of 1937"); *See* DESPAX, *supra* note 303, para. 249; *see also* the references provided by PAILLUSSEAU (*supra* note 306, at 154-155), who seems to give a mixed assessment; Esmein, *supra* note 326, at 90-91 (stating that the draftsmen's intention was to ensure that the company had a "veritable boss").

the firm and were a reaction to prevailing monitoring problems, as the members of the board (particularly the president) did not take a sufficient interest in what the firm's mangers did.[331] Yves Bouthillier, the finance minister of the Vichy government, later explained that the motivation was to appease the working class by showing that the government took action by linking responsibility to personal liability of the PDG, while at the same time avoiding the populist option of state ownership.[332] By contrast, a book comparing French and German law published in 1941 (by a former and a future center-left member of parliament) identified strong German influence on the enactment and concluded that "understanding German law sheds light on French legislation and facilitates its comprehension."[333] While all of these reasons may have jointly motivated the reform, some post-war writers may have felt compelled to distance French legal developments from German influence.[334] Given that French law, other than German law, concentrated power in the hand of one person – the PDG – one could even argue that the principle was implemented in purer form west of the Rhine.[335]

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[331] HAMEL & LAGARDE, *supra* note 323, para. 652; CLAUDE BERR, L'EXERCICE DU POUVOIR DANS LES SOCIETES COMMERCIALES, para. 109-110 (1961); GEORGES RIPERT & RENE ROBLOT, TRAITE ELEMENTAIRE DE DROIT COMMERCIAL, para. 1268 (5th ed. 1963); *see also* RIPERT & ROBLOT, *id.,* at para. 981 (pointing out that politicians subsequently remained opposed to large firms, which resulted in nationalizations). This possible rationale is described in more detail by PIC, *supra* note 317, at 74.

[332] YVES BOUTHILLIER, LE DRAME DE VICHY II: FINANCE SOUS LA CONTRAINTE 298-303 (1951); *see also* JEAN PEYRELEVADE, LE GOUVERNEMENT D'ENTRPRISE 30-34 (1999) (summarizing Bouthillier's justification).

[333] BAUDOUIN-BUGNET & GOZARD, *supra* note 330, at 144 (own translation).

[334] The two motivations are not necessarily a contradiction, as the German *Führerprinzip* was also defined as a combination of personal authority and responsibility. *See e.g.* Wilhelm Kißkalt, *Reform des Aktienrechts,* 1 ZEITSCHRIFT DER AKADEMIE FÜR DEUTSCHES RECHT 20, 26 (1934).

[335] *See* CZULOWSKI (*supra* note 330*,* at 124, 134 n4) (correctly pointing out that the German law does not fully implement the principle, as it left the possibility of having several management board members of equal rank (other than French law); FRANÇOIS BLOCH-LAINE, POUR UNE REFORME DE L'ENTREPRISE 66 (1963) ("Believing to imitate the Germans during an embarrassing period, one made us adopt, un-

The law did not revert after World War II. As one author from that period notes, the reason may have been post-war state involvement in the economy.[336] A 1963 textbook points out that the political authorities took a hostile stance towards large corporations, a many of which were nationalized during that period. Reforms were characterized by a "spirit of struggle against financial capitalism."[337] The "hierarchical" view of the firm was subsequently espoused also by the French Supreme Court (*Cour de Cassation*) that prohibited the shareholder meeting from interfering with the board's competences.[338] Contemporary observers suggested that the law of 1940 had effectively turned the relationship between the shareholder meeting, directors, and the PDG on its head.[339]

As described in the previous subsection, the 1960s are often thought to be the period when the institutional view of the corporation finally defeated the contractual view not only in legal theory, but also in the law. The 1966 reform has been described as endorsing it by creating a largely mandatory corporate law (the "institution") that would protect minorities, creditors, and employees.[340] More importantly, the core role of the *intérêt social* in the case law took root during the 1960s. Besides its role in corporate criminal law already described, there are various contexts in which it comes up. Among other things, it is used as the standard to which managerial decisions are held in liability suits, and it is also a component of the *abus to majorité* (abuse of majority powers) and *abus de minorité* (abuse of minority rights) doctrines, which are used to assess the validity of shareholder

der the name of the 'führer prinzip' [sic!], that formula of the 'président-directeur général' that the Germans have never known").

[336] *See* Leblond, *supra* note 302, at 29 (attributing the maintenance of the reform to a "post-war statist tendency").

[337] RIPERT & ROBLOT, *supra* note 331, at 474-475.

[338] Cass. civ., 4 juin 1946, 1947 LA SEMAINE JURIDIQUE (JCP), II, para. 3518 ("arrêt Motte").

[339] *E.g.* D. Bastian, *Case note,* 1947 LA SEMAINE JURIDIQUE (JCP) II, 3518 (describing how different observers, in their interpretation of the law, either sought to expand or to limit its consequences).

[340] Jean Paillusseau, *La modernisation du droit des sociétés commerciales,* 1996 RECUEIL DALLOZ SIREY, chronique, 287, 289.

resolutions (i.e. resolutions found to violate the *intérêt social* can be voided).[341]

Interestingly, the question of dividends, which had been controversial both in *Dodge v. Ford* in the US and in the German debates of the 1920s and 1930s, is sometimes addressed by the *abus de majorité* doctrine under French law, namely when the majority shareholder votes to retain earnings. While the power to decide about this issue has always remained with the shareholder meeting in France, the courts tend to find against the plaintiff minority, as judges usually consider the retention of earnings to be in the interest of the firm.[342] The *intérêt social* serves as the standard to which the majority shareholders' decision is held.

Nevertheless, the leading case that connects the notion of *intérêt social* to a purported shareholder-stakeholder conflict, *Fruehauf*[343], was decided in 1965 and is as unusual as the sparse US cases on the shareholder primacy norm. Fruehauf-France had entered into a contract to deliver sixty trucks to a customer who would ultimately have exported them to the People's Republic of China, which apparently caused some difficulty for its American majority shareholder at home. The majority voted to cancel the deal, but the minori-

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[341] MAURICE COZIAN, ALAIN VIANDIER & FLORENCE DEBOISSY, DROIT DES SOCIETES 167 (17th ed. 2004).,For an abuse to found, the courts generally require two conditions to be met cumulatively, namely (1) that a decision was taken with the exclusive purpose to favor the majority (and harm the minority), and (2) that this decision does not respect the *intérêt social*. *See* C. cass. 18 avril 1961, 1961 SEMAINE JURIDIQUE (JCP), ED. G., II, para. 12164; Cass. com. 22 avr. 1976, 1976 REVUES DES SOCIETES 479; Cass. com. 30 mai 1980, 1981 REVUE DES SOCIETES 311 (note by Dominique Schmidt); *cf.* Dominique Schmidt, *De l'intérêt commun des associés*, 1994 SEMAINE JURIDIQUE (JCP), EDITION GENERALE, I, 440, 441; Antoine Pirovano, *La "boussole" de la société. Intérêt commun, intérêt social, intérêt d'entreprise ?* 1997 RECUEIL DALLOZ 190, 194; COZIAN ET AL., *id*, at n. 354; *see also* Conac et al., *supra* note 279, at 501. In other words, when a resolution is found to conform to the *intérêt social*, but favors the majority, it is shielded from nullification, which has led to some criticism in recent years. *See particularly* SCHMIDT, *id.,* at 318, 330-331, 339-340.

[342] *See* MERLE & FAUCHON, *supra* note 291, para. 580; COZIAN ET AL., *id.*, para. 362.

[343] CA Paris, 22 mai 1965, JCP 1965, II, para. 14274bis; D. 1968, Jur. p. 147 (note by Raphaël Contin).

ty of board members (representing French minority shareholders) objected and asked the competent local court to appoint a preliminary administrator for the company. The Paris Court of Appeal confirmed the lower courts' decision to that end, stating that the cancellation would have resulted in the ruin of the company because of the alienation of a major customer, and ultimately in the loss of 650 (French) jobs. Thus, the decision was found to violate the *intérêt social*. Even though the case became well-known[344] and is still cited for introducing a new criterion into the evaluation of management decisions, no others followed.[345] Like the American cases, it is easy to argue that the case represented rather a majority-minority conflict than a shareholder-stakeholder one.[346]

Despite the significance of the criminal provisions drawing upon the idea of *intérêt social,* which are said to be of some relevance to the protection of creditors, commentators assert that it has not been all that important with respect to potential conflicts of interest between shareholders and other constituencies. Most of all, the *Fruehauf* case, in which the court explicitly referred to the dangers to employees, remained largely without further jurisprudential consequences, as it did e.g. not allow unions to challenge management decisions on behalf of employees.[347] The concept has been criticized as embodying outdated managerial ideas of the 1970s, when the *intérêt social* was used as "a curtain of fume behind which managers had ultimately considered the enterprise their own," with legal mechanisms being built around the protection of the position of the dominant stockholder.[348] In any case, the function of the standard seems to be mainly to restrain actions that deliberately harm the corporation, without being much of a check on business decisions, such as how to

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[344] *Cf.* Raphaël Contin, *Note,* 1968 RECUEIL DALLOZ SIREY 148, 150.

[345] Claude Ducouloux-Favard, *Actionnariat et pouvoir,* 1995 RECUEIL DALLOZ SIREY, chronique, 177, 180; Philippe Bissara, *L'intérêt social,* 117 REVUE DES SOCIETES 5, 15 (1999) (both pointing out that the case remained isolated).

[346] *See* PAILLUSSEAU, *supra* note 306, at 199 (describing the case); *see also* Pirovano, *supra* note 341, at 190 (pointing out the political ramifications of the case).

[347] Pirovano, *id.*, at 190.

[348] Pirovano, *id.*, at 195.

best finance the company, which supplier to use, or how to organize the firm.[349]

The nationalization of many large French firms seems not to have played a significant role in the institutionalist movement in French thought about the corporation,[350] as authors developing the theory rarely discuss it.[351] Nationalized firms such as Renault were often directly run as an economic unit of the government and not as corporations. In other cases, the state was the only shareholder.[352] Where minority shareholders remained, their relationship with the state majority may not have been all too different from that of a minority in a family-owned firm if the government used the firm to advance goals at odds with purely financial shareholder interests. However, managers in public-sector firms are usually thought to have comparatively large powers to act independently, even from the gov-

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[349] Bissara, *supra* note 345, at 16.

[350] While the Third Republic (up to World War II) was described as anti-labor up to the rise of the left-wing Popular Front in 1935 (ROE, *supra* note 9, at 70), the state began to play a major role in the French economy after World War II. Nationalizations began in 1936/37 with industries crucial for the military and transportation. *See* HAMEL & LAGARDE, *supra* note 323, para. 893. After the war, all firms "with the character of a public national service or of a natural monopoly" followed, as did some firms such as Renault whose owner was (possibly falsely) being accused of collaboration. *See* HAMEL & LAGARDE, *id.* para. 894; JEAN-FRANÇOIS ECK, HISTOIRE DE L'ECONOMIE FRANÇAISE DEPUIS 1945, 13 (4th ed. 1994). Some firms were nationalized to aid the government's planned reconstruction efforts, which succeeded and resulted in "Les Trente Glorieuses", 30 years of economic growth after the war. *See* James A. Fanto, *The Transformation of French Corporate Governance and Institutional Investors,* 21 BROOK. J. INT'L L. 1, 32 (1995). Much later, the socialist government under President Mitterrand took a number of large firms under the wing of state ownership in 1981/82. Fanto, *id.,* at 33; Michel Berne & Gérard Pogorel, *Privatization Experiences in France,* CESIFO WORKING PAPER NO. 1195, 1, at http://ssrn.com/abstract=553952 (2003). On nationalization and privatization during the 1980s *see also* ECK, *id.,* at 50-51.

[351] DESPAX (*supra* note 303, at 164-169) discusses nationalizations, but focuses on the legal aspect of nationalizations laws leaving the structure of the "enterprise" intact.

[352] HAMEL & LAGARDE, *supra* note 323, para. 902, 914. In the *économie mixte* the government merely took a majority share, but it was usually made sure that directors were appointed by the state. HAMEL & LAGARDE, *id.*, para. 932; Fanto, *supra* note 350, at 34.

ernment,[353] which would have put them in the position to advance an agenda centering on the "interests of the firm", however defined.

5.3. Dismissal *ad nutum*

There is another aspect of French law that may explain why the "interests of the firm" as a guiding legal standard is less important than it might seem at first glance. Despite the establishment of the institutional theory in French corporate law in the 1960s, shareholders were always in the position to remove directors by a simple majority vote before their stipulated term of office. Ducouloux-Favard, writing in 1996, describes this revocation *ad nutum* as a characteristic of the contract of agency and a pillar of corporate law that remains indestructible.[354] True, the 2001 NRE law[355] resulted in some changes to the relationship between shareholders and managers. Previously, shareholders could directly remove the *Président Directeur-General* (PDG, i.e. CEO) by revoking the appointment to the board of directors, given that he had to be its president.[356] Now, shareholders can now only remove board members,[357] while the managing directors are appointed, and can be removed by the board at any time.[358] While the PDG may traditionally have enjoyed a particularly authoritative position during the day-to-day management of the firm,[359] this powerful position was undermined the majority's removal power that French

[353] JEAN KERNINON, LES CADRES JURIDIQUES DE L'ECONOMIE MIXTE 88-90 (2nd ed. 1994); Fanto, *id.,* at 34-37.
[354] Claude Ducouloux-Favard, *Les déviances de la gestion dans nos grandes entreprises,* 1996 RECUEIL DALLOZ SIREY, chronique, 190, 191. In fact, several early proponents of the French institutional theory had recognized that the revocation ad nutum principle was untenable under the contrary position and called for legislative reform. *See* GAILLARD, *supra* note 292, at 120-123; RIPERT, *supra* note 298, at 119.
[355] S*upra* note 328.
[356] GERMAIN, *supra* note 325, para. 1685.
[357] Art. L. 225-18 al. 2 C. com.
[358] Art. L. 225-55 C. com. These rules are considered mandatory law. *See* MERLE & FAUCHON, *supra* note 291, para. 386; GERMAIN, *supra* note 325, para. 1653.
[359] *E.g.* Alcouffe, *supra* note 291*,* at 129 (2000). On the transplantation of the Nazi *Führerprinzip* to France, *see supra* note 328-335 and accompanying text.

law always retained.[360] The reform may in fact have slightly strengthened the position of managers by providing that premature removal from office may give rise to damages under certain circumstances.

5.4. Conclusion: Another attempt to constrain shareholders through institutionalism

French corporate law shares an influential institutionalist current with German law. The development began in the 1930s and came to full fruition in the 1960s. French law shared many aspects of its historical development with German law, such as a period of volatility of ownership structures between the wars, and an ensuing debate focusing on the institutional nature of the firm. As in Germany, it was intended as a legal standard that would serve to defend the firm against individual interests of shareholders, an issue that was of little significance in the US. Again, the historical overview illustrates how the economic background variable of ownership structure influenced the debate.

6. Emerging comparative patterns

On the basis of these country-specific histories, we can identify some cross-country patterns. Section 6.1 summarizes the results of the US, German and French debates and puts them into comparative perspective. Section 6.2 further develops the main theory of this article, namely how pro-shareholder and pro-stakeholder (or institutional) arguments were employed to reach different ends in dispersed and concentrated ownership systems. Section 6.3 asks whether the historical debates had an influence on more recent developments. I suggest that there has been a change since the 1980s, to which a growing disillusionment with the actual effects of institutional theories may have contributed.

[360] *See* GERMAIN, *supra* note 325, at 453; Ducouloux-Favard, *supra* note 354, at 191 (describing the possibility of removal *at nutum* as being at odds with the prevailing institutional theory of the firm); Enriques et al., *supra* note 156, at 61 (noting the non-waivable right in French law to remove directors midterm).

6.1. A transnational history of the debate

The ultimate trigger of the debate was the development of the "great corporation", characterized by a large capital basis, specialized management, and an increased detachment from its owners. Rathenau was among the first to recognize this when he spoke of the "substitution of the reason" (*Substitution des Grundes*) for the existence and role of corporations in 1917.[361] He argued that the "enterprise" was essentially turning into an institution resembling the state,[362] a passage that was later cited by Berle and Means.[363] With his involvement in the New Deal, Berle similarly began to sympathize at least to some degree with a "public" function of corporations and directors, although he thought that the shareholder primacy norm was necessary to curb managerial power. Rathenau pointed out that the development of large firms was already more advanced in the US and in Germany than in other countries including the UK and France, which may explain why these countries were the first to develop a debate.[364]

The rise of the large firm was a phenomenon common to the US and Germany, but apart from that point, the debates diverged between the two countries. Rathenau's position seems to have been characterized by his personal experience on the board of what we would today call a Berle-Means firm, while most German firms had controlling shareholders, an issue that was picked up by subsequent legal commentators. Concentrated ownership may in fact have increased after World War I due to inflation (as it did in France in the late 1920s). Berle and Means, on the other hand, identified a prevailing pattern of powerful management and dispersed shareholders that had already solidified. The distinction characterized the respective national debates: In the US, scholars were concerned by the quasi-political,

[361] *See* RATHENAU, *supra* note 166, at 8.
[362] RATHENAU, *supra* note 179, VON KOMMENDEN DINGEN, at 143; RATHENAU, *supra* note 179, IN DAYS TO COME, at 121.
[363] BERLE & MEANS, *supra* note 7, at 352.
[364] RATHENAU, *supra* note 166, at 10. In the UK, the debate arose primarily during the 1970s, when the introduction of a mandatory employee participation system similar to the German model was discussed. *See* BULLOCK, *supra* note 262: Marsh & Locksley, *supra* note 262, at 49-50 (discussing the failure of the proposal).

agency-cost driving power of managers, while in Germany, legal scholars picking up Rathenau's ideas were concerned with the position of large shareholders in corporations, and with their interference with the proper functioning of management.

Mark Roe persuasively argued that American politics was historically often turned against the power of large financial institutions, which kept them small and unable to become major shareholders like their European peers. Economic crises and corporate governance scandals led to the New Deal reforms, which helped to further enshrine dispersed ownership.[365] By the time of the economic crisis of the 1930s, this structure was firmly entrenched (at least in the mind of the public debate shaped by Berle and Means). The political response was the New Deal, specifically the 1933 Securities Act and the 1934 Securities Exchange Act, which partly addressed the concern about excessive power of managers by providing extensive disclosure. Most stakeholder concerns that might have arisen were overshadowed by the fact that the enshrinement of managerial power ensured the protection of legal capacity from shareholder influence and thus protected stakeholders' expectations, while it exacerbated agency problems in the shareholder-manager relationship. In the following decades, scholars observed the power of managers and debated whether and how to constrain it, and whether political and regulatory intervention was necessary to ensure that firms directed their minds towards the public policy concerns that their powerful position entailed.

In Germany, managers were not seen as sufficiently insulated from the possibilities of blockholders to interfere. The 1937 corporate law reform, in spite of many ideological overtones, was ultimately pragmatic, as even hardened ideologues had to realize that large firms could not operate without tapping capital markets. The reform intended to shield managers from shareholder influence and enshrined a corporate objective norm that went well beyond shareholder interests. Still, in spirit it was skeptical towards capital, and it was intended to foster managerial power. Concerns were raised not by the power of managers, but primarily by the power of capital, both to the proper

[365] ROE, *supra* note 10, at 51-123.

functioning of firms and the public interest.[366] The attempt to contain it may have been a logical reaction. Blockholders persisted and continued to exert a strong influence on large German firms, which prohibited the rise of a truly strong management.

True, as in the US, there often was popular sentiment against big business in these countries; however, it was never directed directly against large blockholders, whose role was already entrenched.[367] With structures of corporate control firmly in place, the reforms helped to solidify an institutional view of the firm that intended centralize power within the firm and to reduce the role of shareholders – quite the opposite from what was debated in the US. Codetermination, in particular its enhancement in 1976, was another reaction to capital against the background of raising political power of labor.[368] At the same time, it strengthened the institutional view of the firm, which, however, remained overshadowed by concentrated ownership. Until the 1990s, when the importance of capital markets began to rise again, this view remained mostly unopposed.

The French debate resembled the German one. French populism in the 1930s was directed against powerful families.[369] Like their Eastern neighbors, French firms saw entrenchment through shares carrying a disproportional number of votes (which were prohibited in France in 1931/1934 and in Germany in 1937). However, only after World War II and a period of nationalization, French institutionalist theory solidified in the 1960s, with the *intérêt social* intended as a

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[366] *See* FRIEDRICH KLAUSING, GESETZ ÜBER DIE AKTIENGESELLSCHAFTEN UND KOMMANDITGESELLSCHAFTEN AUF AKTIEN 56 (1937) (official report accompanying the 1937 act stating that "fundamental decisions regarding the fate of the corporation are made by the majority of the providers of funds, who are personally not responsible, who usually lack precise and competent insight into business and the firm's operations, and who typically emphasize the concerns of capital.")

[367] *See* ROE, *supra* note 10, at 212-216 (describing German "populism" and the role of banks).

[368] Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States,* in 102 YALE L. J. 1927, 1970 (1993).

[369] Antoin E. Murphy, *Corporate Ownership in France,* in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 185, 188 (Randall K. Morck ed. 2005) (referring to prime minister Edouard Daladier's famous criticism of the alleged two hundred "grandes familles" in 1930).

benchmark to resolve conflicts among shareholders. The debate was initially hardly characterized by shareholder-stakeholder conflicts; by contrast, adherents of the institutional school of corporate law were preoccupied with the protection of the firm from influence by shareholders, which were seen as a danger to a prosperous development. As in Germany, the increased need to tap capital markets made the pendulum swing back in the other direction in the 1990s.

6.2. Defending the firm against its shareholders

Why was institutionalism brought forward as an answer to interference of shareholders with management or from strife between shareholders groups? As explained above in section 2.3, economic analysis has brought forward reasons why it may be beneficial to set limits to shareholder control. Many of the arguments resonate with the historical debate: Tight monitoring may stifle managerial initiative.[370] Discord among shareholders, particularly when they are heterogeneous, may hamper decision-making,[371] which is a more significant issue in a firm with various blockholders than in an "atomistic" structure where each shareholder will most likely be primarily interest in making a return on his or her investment. Controlling shareholders or coalitions of large shareholders may abuse their strong position in the firm to obtain private benefits, to the detriment of the minority and other stakeholders.[372] Last but not least, to those who sought to make corporations subservient to public policy goals, financially motivated decision-making by shareholders was obviously an anathema.

Table 1 summarizes the argument: Shareholder influence may increase the agency cost of debt, as managers are more likely to engage in risk enhancement:[373] The going-concern value of the firm is

[370] Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholders, Monitoring, and the Value of the Firm,* 112 Q. J. ECON. 693 (1997).
[371] Bainbridge, *Shareholder Disempowerment, supra* note 62, at 1744-1751; Anabtawi, *supra* note 64, at 577-593.
[372] *E.g.* Shleifer & Vishny, *supra* note 153, at 754-755; Armour et al., *supra* note 153, at 36.
[373] *See* Hollis Ashbaugh-Skaife, Daniel W. Collins & Ryan B. LaFond, *The effects of corporate governance on firms' credit ratings,* 42 J. ACCT. & ECON. 203 (2006)

more strongly protected if it is harder for shareholders to force the disgorgement of funds.[374] Shielding corporations from shareholders allows long-term commitment of capital to the firm, which in turn may allow stakeholders to commit to their relationship due to lower risks for their specific investment.[375]

Ownership structure	**Effective controller of the firm**	**Main problem(s)**	**"Reformist" response in historical debates**	**Defense of the status quo**
Dispersed ownership	Directors and officers	• Managerial agency cost	shareholder primacy	institutional theory of the firm / stake-holders
Concentrated ownership	Controlling shareholder or coalition	• Controller's private benefits • disruptive conflict between shareholders • holdup of stakeholders	institutional theory of the firm / stake-holders	shareholder primacy

Table 1

In a dispersed ownership setting, managerial agency problems and the strong position of management in general were considered to be the main problem. The "reformist" position was therefore to constrain managers tightly, for which a shareholder primacy position seemed to offer the best option. An institutional or stakeholder theory focusing on the board of directors was typically a defense for incum-

(finding a correlation between block ownership and higher cost of debt, and a negative one for takeover defenses); on the debate in finance *see also* Roman Inderst & Holger Müller, *Ownership Concentration, Monitoring, and the Agency Cost of Debt*, WORKING PAPER (1999), at http://ssrn.com/abstract=190497; Michael Bradley, Dong Chen, George Dallas & Elisabeth Snyderwine, *The Relation between Corporate Governance and Credit Risk, Bond Yields and Firm Valuation,* WORKING PAPER (2007), at http://ssrn.com/abstract=1078463.

[374] *See* Hansmann et al., *supra* note 74, at 1348-1350 (discussing the protection of the going concern value from liquidation).

[375] Blair, *supra* note 78.

bent managers. In a concentrated ownership system, disruptive influence of shareholders on the firm becomes a major problem, either because of a controlling shareholder, or because of disputes between shareholders. Thus, an institutional theory that reduced shareholder control seemed appealing as a way of shutting out the power of capital and as a guideline for the resolution of conflicts. For several decades, the "reformist" position was therefore the one asserting the independence of the firm. The point of my argument is not that the managerial agency problem is unimportant in general, or in concentrated ownership systems specifically. I rather emphasize that the problems of shareholder decision-making power brought forward in the contemporary debate increase when a firm's ownership structure does not resemble an atomistic Berle-Means structure, where everybody has merely a small financial interest, but when there are larger blocks, where the interests of blockholders, controlling or not, are heterogeneous. Against the backdrop of concentrated ownership structures, institutional theories were therefore more appealing.

6.3. Does the theory predict more recent developments

Do these patterns persist, and do they help us to explain contemporary developments in corporate governance? Is there still a controversy between supporters of strong management and those of shareholders in the US, while in Europe advocates of institutional theories seek to expand the "independent" position of shareholders to the disadvantage of blockholders?

For the US, the question is easily answered affirmatively. Since the takeover wave of the 1980s, the debate has most often emerged in the context of hostile takeovers. Such an event results in the replacement of the typical Berle-Means ownership structure by one dominated by a core shareholder determined to reshape business activities or even to break up the firm. The takeover wave of the 1980s led to a backlash of law that is (at least superficially) pro-stakeholder. In 1985, the Delaware Supreme Court famously established a two-prong test for antitakeover measures in *Unocal*.[376] First,

[376] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

the board has to identify a threat, and second, its response must be reasonable in relation to the threat posed. Regarding the evaluation of the existence of a threat by the target board, the court explained that a number of elements were to be considered when evaluating a possible threat, such as

> "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "*constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally*), the risk of nonconsummation, and the quality of securities being offered in the exchange" (emphasis added).[377]

When it further specified the standard in subsequent opinions, at least during the 1980s, the Delaware Supreme Court maintained its view that the interests of other constituencies are to be considered as objects of a threat which the board may resist.[378] The *Unitrin* decision of 1995[379] further increased the latitude of the board by finding that defensive measures will only be prohibited if the court finds them to be draconian, i.e. "coercive" or "preclusive". Similarly, in more than half of all states,[380] a statute explicitly allows or requires directors to take the interests of other constituencies into account, with Delaware and California being the most prominent absentees. Groups mentioned apart from shareholders are employees, creditors, bondholders,

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[377] 493 A.2d 955.

[378] Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 , 1342 (1987); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 68 (1989); Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (1989)

[379] Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995).

[380] Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and High Fears,* 1999 ANN. SURV. AM. L. 85, 125-128 (listing a total of 32 statutes, among those 30 constituency statutes and 2 statutes explicitly allowing to consider the directors to consider the corporation's continued independence as optimally serving the corporation's and shareholder interest). However, Nebraska's statute was repealed in 1995. Springer, *id.,* at 95.

suppliers and communities; some statutes mention broader societal interest[381] or even officers of the corporation.[382]

The rhetoric employed by the Delaware courts, as well as some of these statutes, is often built on an institutional understanding of the corporation. Before enumerating the relevant constituencies in the quoted passage above, the court requires directors to identify the "threat posed" by the takeover bid to the "corporate enterprise."[383] In doing so, the argument is that the court may reasonably consider the interests of shareholders, including "short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor."[384] This language seems to indicate that the Unocal court considered the entity aspect to be worth of protection, and that it views it as an amalgamate of the interests of various groups. Very much in line with a typically American understanding of corporate law, the board of directors is given a broad latitude in defining how exactly these interests are to be weighed. It is particularly revealing that, according to the Delaware Supreme Court, *Revlon* duties apply when a corporation initiates a bidding process "to sell itself".[385] It would be hard to find such language in Continental European parlance, since logically only the corporation's owners would be in the position to sell it.

The *Unocal* court was also concerned about conflicts of interest between long-term and short-term shareholders,[386] as were Continental European proponents of institutional theories of corporate law.[387] While Delaware leaves it to directors to resolve these conflicts by identifying a threat to the "corporate enterprise", the European scholars looked to the "institutional interest" as a judicial guideline,

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[381] JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS 172 (2nd ed., 2003).
[382] Springer, *supra* note 380, at 125-128.
[383] 493 A.2d 955.
[384] 493 A.2d 956.
[385] Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (1989); Paramount Communications v. QVC Network, 637 A.2d 34, 43 (Del. 1994); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 929 (Del. 2003).
[386] 493 A.2d 956.
[387] *Supra* sections 4.2 and 5.2.

which again underscores the different functions of the "institutional" argument.

In the two European countries, it appears that institutionalism seems to be losing the important role it once had. A growing number of legal writers now argue in favor of shareholder primacy.[388] One explanatory factor could be the internationalization of the debate in the wake of ECJ case law[389] permitting regulatory competition,[390] and other forces of convergence. Policy debates are now often dominated by the goal of attracting international investment. Consequently, agency cost analysis has gained significance. A parallel development was the propagation of UK-inspired "codes of good corporate governance", which addressed the grievances of institutional investors and swept the Continent in the late 1990s and early 2000s.[391]

Despite changes in some Continental corporate governance practices (such as the cautious withdrawal of German banks from extensive share ownership in industrial firms[392]), concentrated ownership structures have largely remained in place so far. Nevertheless,

[388] For Germany, *see supra* notes 263-265 and accompanying text. For France, *see* Dominique Schmidt, *De l'intérêt commun des associés*, 1994 SEMAINE JURIDIQUE (JCP), EDITION GENERALE, I, 440-441; DOMINIQUE SCHMIDT, LES CONFLITS D'INTERETS DANS LA SOCIETE ANONYME 11-12 (2nd. ed. 2004) (both criticizing the prevailing interpretation of *intérêt social* as being too friendly to controlling shareholders).

[389] Centros Ltd v. Erhvervs- og Selskabsstyrelsen, Case C-212/97, [1999] E.C.R. I-1459; Überseering BV v. Nordic Construction Company, Case C-208/00, [2002] E.C.R. I-9919; Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, Case C-167/01, [2003] E.C.R. I-10155.

[390] *E.g.* STEFANO LOMBARDO, REGULATORY COMPETITION IN COMPANY LAW IN THE EUROPEAN COMMUNITY (2002); Jens C. Dammann, *Freedom of Choice in European Corporate Law,* 29 YALE J. INT'L L. 477 (2004); Luca Enriques, *EC Company Law and the Fears of a European Delaware,* 15 EUR. BUS. L. REV. 1259 (2004); John Armour, *Who Should Make Corporate Law? EU Legislation versus Regulatory Competition*, 58 CURRENT LEGAL PROBS. 369 (2005); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law: Perspectives on European Corporate Governance,* 6 EUR. BUS. ORG. L. REV. 3, 43-48 (2005); Martin Gelter, The Structure of Regulatory Competition in European Corporate Law*,* 5 J. CORP. L. STUD. 247, 253-264 (2005).

[391] *See e.g.* Ruth V. Aguilera & Alvaro Cuervo-Cazurra, *Codes of Good Governance,* 17 CORP. GOV 376 (2009).

[392] Cheffins, *supra* note 6, at 502-503.

some observers have identified a shift from "institutional" theories of the corporation to contractarianism in Germany.[393] In France, criticism against institutional theories of the corporation began to mount in the 1990s as well.[394] Protection of individual shareholders increased in the past twenty years in several important jurisdictions, including Germany and France.[395] The UK model of requiring a mandatory bid when a single shareholder acquires a controlling stake, which is arguably intended to protect small shareholders against large ones, was implemented throughout Europe through the Takeover Directive.[396]

What are the reasons for this shift? Is it merely a change against controlling shareholders, resulting in a departure from institutional theories to minority shareholders' rights? The growing appeal of the American model may have played a role. Another factor could have been a growing disillusionment with institutional theories. German and French commentators have both increasingly criticized institutional objectives to be too malleable, too unclear be workable for courts in practice, who are likely to accept a definition of the corporate interest suiting insiders.[397] While there is no clear pattern in the outcomes of the court decisions discussed in this paper, legal standards such as shareholder primacy, *Unternehmensinteresse* or *intérêt social* leave a lot of space for interpretation and argument. Since both managers and controlling shareholders are in a good position to make

[393] Klages, *supra* note 288 (suggesting that "corporatist" arguments have been outcompeted by "contractarian" arguments since about 1990). *See also* Roth, *supra* note 31, at 64 (2010) (suggesting a trend towards "enlightened shareholder value").
[394] *Supra* note 388.
[395] John Armour, Simon Deakin, Priya Lele & Mathias Siems, *How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection,* 57 AM. J. COMP. L. 579, 609-612 (2009)
[396] *But see* Marco Ventoruzzo, Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe, 11 U. PENN. J. BUS. L. 125, (2008) (arguing that the mandatory bid actual helps to entrench controlling shareholders).
[397] For Germany, *see* Spindler, *supra* note 216, comment 70 (diagnosing a disillusionment about the usefulness of the concept of *Unternehmensinteresse* among legal scholars); for France, *see* Schmidt, *supra* note 388; SCHMIDT, *supra* note 388 (both criticizing the *intérêt social* as allowing too much discretion to controlling shareholders).

a good case to the court, the actual constraints for these groups is very small, if there is any.

In shareholder-employee conflicts of interests, there were certainly more important regulatory incursions that limited shareholder power, most of all codetermination in Germany, and stronger employment protection laws in Western Europe compared to the US.[398] These differences may also help to explain why shareholder primacy typically had the greater appeal in the US, whereas institutional theories have more often appealed to Continental European scholars. Institutional theories of corporate law seem to precipitate rather than follow the full development of pro-labor laws.[399] It remains to be seen whether the current American trend towards shareholder empowerment, which seems to be the consequence of increased significance of institutional shareholders, will lead to a backlash of stakeholder-oriented thought. It is conceivable that the debate lost its vigor since there was less at stake with pro-stakeholder laws in place that gave them specific rights and were therefore actually enforceable. As Christopher Bruner points out in the context of the UK, the growth the welfare state may also have reduced employees' need for protection.[400] Today employees – the stakeholder group probably least capable of contractual self-protection – certainly have less need for protection than at the time when institutional theories arose. Fewer distributive gains may be available between employees and shareholders than in the past. It may therefore become easier to argue in favor of the protection of minority shareholders without interfering with stakeholder issues too much.

[398] *See* Gelter, *supra* note 6, at 168-173.
[399] In Germany, contemporary employment protection law has its roots in the years after World War II. The *Kündigungsschutzgesetz* (KSchG) was passed in 1951 to reunify laws in the Western zones. *See* Stefan Fiebig, *Einleitung*, comments 108-113, *in* KÜNDIGUNGSSCHUTZGESETZ HANDKOMMENTAR (Stefan Fiebig et al. eds., 2nd ed. 2004); *see also* 4 RECHT DER ARBEIT 61–63 (1951) (the official proposal), regarding codetermination, *see supra* note 156-158 and accompanying text. French employment protection law solidified in the 1970. *See* Gelter, *id.*, at 171-172, while the institutional school in corporate law developed in the 1960s.
[400] Bruner, *supra* note 6, at 621-631.

7. Conclusion

This article took a "grand tour" through the history of the debates about the goal of corporate law and objective of directors in the US, Germany and France. We have traced shareholder-stakeholder debates through history and the particular political circumstances in which corporate law developed. The roots of the debates in all three countries go back to the interwar period, with the German one beginning the earliest, followed closely by the US. The French debate has its roots in the 1930s as well, but reached its peak only during the 1960s.

While political and cultural factors have certainly played a role for the attractiveness of institutional and stakeholder theories in the two Continental European countries, I have attempted to show that differences in the underlying economic structure have at least contributed to divergences in their reception. Both shareholder primacy and stakeholder arguments were intended to serve different goals in the debates of these countries, depending on prevailing (or perceived) corporate ownership structures and distribution of power between management and shareholders.

In the dispersed ownership system of the US, the main concern was and is the unconstrained power of managers. In debates revolving around large American firms they largely served the managerial status quo. Shareholder primacy arguments tended to be brought forward in order to keep corporations and managers in check, while stakeholder arguments served as a managerial defense. By contrast, in France and Germany there was less need to tame Continental "giant corporations" and their managers, but rather a concern that firms needed protection from their shareholders, whose influence was considered detrimental by some early analysts of corporate governance. Institutional theories – coupled with stakeholder arguments or not – were intended to assert an independent position of the firm, and thus as an instrument to protect the most important economic vehicles of economic activity against capital. In practice, this project seems to have largely failed. Growing disillusionment with stakeholder theories – at least on the level of directors' duties – and the increasing

attractiveness of the American model during the 1990s began to undermine the role of stakeholder theories and became a force of convergence in corporate governance. The future will show whether the current financial crisis will turn the tide.

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