EUROPEAN COMPANY LAW SERIES VOLUME 8

Public Companies and the Role of Shareholders

National Models towards Global Integration

Edited by
Sabrina Bruno
Eugenio Ruggiero

Foreword by Klaus J. Hopt

Wolters Kluwer
Law & Business

Public Companies and the Role of Shareholders

National Models towards Global Integration

Edited by

Sabrina Bruno

Eugenio Ruggiero

Wolters Kluwer
Law & Business

Published by:
Kluwer Law International
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.kluwerlaw.com

Sold and distributed in North, Central and South America by:
Aspen Publishers, Inc.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@aspenpublishers.com

Sold and distributed in all other countries by:
Turpin Distribution Services Ltd.
Stratton Business Park
Pegasus Drive, Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
Email: kluwerlaw@turpin-distribution.com

Printed on acid-free paper.

ISBN 978-90-411-3423-3

List of Authors

Sabrina Bruno	Associate Professor of Business and Company Law University of Calabria (Cosenza, Italy); Adjunct Professor LUISS Guido Carli University (Roma, Italy)
Alain Couret	Professor of Corporation and Financial Law at the Sorbonne School of Law (Paris, France). Director of the Financial Law Research Center. Attorney at Law CMS-BFL
Stefan Grundmann	Professor of German, European and International Private and Business Law, Humboldt Universität (Berlin, Germany)
Florian Möslein	Assistant Professor of Company Law, University of St. Gallen (Switzerland) and Schumpeter-Fellow, Humboldt Universität (Berlin, Germany)
Arthur R. Pinto	Professor of Law and Co-Director of the Center for the Dennis J. Block Study of International Business Law, Brooklyn Law School (New York, U.S.A.)
Daniel D. Prentice	Emeritus Fellow, Pembroke College, Oxford. Emeritus Allen & Overy Professor of Corporate Law, University of Oxford (Oxford, United Kingdom)
Federico Raffaele	PhD candidate in Law and Economics, LUISS Guido Carli University (Roma, Italy)
Eugenio Ruggiero	Adjunct Professor LUISS Guido Carli University (Roma, Italy) and University of Venice "Ca' Foscari" (Venice, Italy).
Gustavo Visentini	Full Professor of Business and Company Law, LUISS Guido Carli University (Roma, Italy)

List of Figures

Figure 2.1.	Ownership Structure of FTSE MIB Companies Year 2009 (Average Percentage of Share Capital).	59
Figure 2.2.	Ownerhisp Structure of FTSE MIB Companies Comparison 2005–2009 (Average Percentage of Share Capital)	61
Figure 2.3.	FTSE MIB: Average Capitalization of Five Least and Five Most Controlled Companies Year 2009 (in Billion of Euro)	63
Figure 2.4.	FTSE MIB: Models of Control Year 2009 (Percentages in Relation to Number of Companies)	64
Figure 2.5.	FTSE MIB: Identification of the Controlling Shareholder; Number of Companies Year 2009	64
Figure 2.6.	FTSE MIB: Voting Power in General Meetings for Each Class of Shareholders Comparison 2005–2009 (Average Percentage)	75
Figure 2.7.	FTSE MIB: Degree of Participation for Class of Shareholders Comparison 2005–2009 (Average Percentage)	76
Figure 2.8.	FTSE MID: Quorum for the Holding of General Meeting for Each Class of Shareholders Year 2009 (Average Percentage of the Share Capital)	79
Figure 3.1.	Detention by Foreign Investors of the Capital of French CAC 40 Companies	104
Figure 3.2.	Rate of Refusal Resolutions at General Meetings	109
Figure 3.3.	Participation Rate to General Meetings	112
Figure 3.4.	Practices Relative to the Notion of Independent Director	117

Figure 4.1.	Percentage of Companies with Share Stakes in Excess of 25% in 171 (1990) and 501 (1999) German Industrial and Commercial Companies	151
Figure 4.2.	Portfolio of members of the German Private Equity and Venture Capital Association (1991–2006)	152
Figure 5.1.	The UK Listed Firms	199
Figure 5.2.	Listed Firms Smaller as Percentage of Total Registered Firms	200
Figure 5.3.	Rising in Value	200
Figure 5.4.	Sector's Share of UK GDP	201
Figure 5.5.	Market Value of International Companies Listed on the London Stock Exchange 1970–2004	201
Figure 5.6.	The UK Nonfinancial Firms Source of Funds 1970–2001	202
Figure 5.7.	The UK Nonfinancial Firms Source of Funds 2005	202
Figure 5.8.	Number of AIM Companies and Total Market Value 199–2005	204
Figure 5.9.	2004: Ownership of Listed Firms	206
Figure 5.10.	Changing Owners of UK Plc	207
Figure 5.11.	Buyback Activity in United States versus Other Countries	208
Figure 5.12.	Pension Assets Relative to GDP for European Countries	210
Figure 5.13.	Equity Holdings by Pension Funds in 1999	211
Figure 5.14.	Growth in Authorized Funds under Management	211
Figure 5.15.	Top Ten Unit Trusts and OEICs Managers	212
Figure 5.16.	Market Capitalization and Total Assets of Investment Trust Industry	212
Figure 5.17.	The Growth of Life Insurance Assets 1989–1999	213
Figure 5.18.	Shareholdings Dispersed in UK Plc: Percentage of Shares Controlled by Top, Top Five and Top Ten Shareholders	215
Figure 5.19.	Total Number of M&A Deals	231
Figure 5.20.	M&A Value Relative to GDP	232
Figure 5.21.	UK M&A Half Year Trend Value	233

List of Tables

Table 2.1.	FTSE MIB: Comparison between 2005 and 2009 (Average/Maximum/Minimum Percentages of Share Capital)	60
Table 2.2.	FTSE MIB: Five Least and Five Most Controlled Companies (Core Shareholders' Holdings)	62
Table 2.3.	FTSE MIB: Five Least and Five Most Controlled Companies Holdings with reference to the Free Float Year 2009 (Average Percentage of Free Float)	62
Table 2.4.	FTSE MIB: Voting Power in General Meetings for Each Class of Shareholders Comparison 2005–2009 (Average/ Maximum/Minimum Percentages of the Share Capital Attending the Meeting)	74
Table 2.5.	FTSE MIB: Degree of Participation for Each Class of Shareholders Comparison 2005–2009 (Average/ Maximum/Minimum Percentages)	75
Table 2.6.	Quorums for Shareholders' Meetings	78
Table 2.7.	FTSE MIB: Quorum for Holding an Ordinary General Meeting Comparison 2005–2009 (Average/Maximum/ Minimum Percentage of the Share Capital)	78
Table 3.1.	2010 World Ranking of Capitalization	99
Table 3.2.	Number of Listed Companies	100
Table 3.3.	Structure of Investment (Type of Investors and Relevant Markets)	103
Table 3.4.	Distribution of the CAC 40 Companies According to the Part of the Capital Held by Foreign Investors	104
Table 3.5.	Evolution of the Value of the State-Owned Securities	106

Table 4.1.	Sample of 171 Large Industrial Companies in 1990	148
Table 5.1.	Domestic Equity Markets, 2005	203
Table 5.2.	Institutional Investment in AIM	205
Table 5.3.	The Institutionalization of the UK Equity Market	209
Table 5.4.	Larger UK Pension Funds 2004	210
Table 5.5.	Largest Investment Trusts	213
Table 5.6.	Major Life Insurance Companies 1999	214
Table 5.7.	Blockholders	215
Table 5.8.	Market Performers (IPO Value in First Three Quarters of 2006)	218
Table 5.9.	Takeover activity in 2004–2006	232

Foreword

*Klaus J. Hopt**

Comparative company law is a very timely area of research. This research differs from former studies in several ways. Older comparative research usually confined itself to comparing two countries, generally the home state and—since the first half of the 20th century—often the United States, and compiled a great deal of descriptive information on the law in the books of a plethora of foreign legislations in the manner used by many old doctoral dissertations. But in more recent times this has given way to an interest in various models of legal orders beyond just two countries or two types. Comparativists realized that mere dichotomies are as fallacious in comparative law as they are in other contexts, though it is still customary to confront case law countries and statutory law countries or Anglo-American and continental European law. Identifying models of legal orders implies going beyond mere norm description, and trying instead to compare the same or different legal rules in the various countries by setting them in their factual, historical, and cultural context. This is what functional comparative law research does. The context must not necessarily be studied by interdisciplinary cooperation (in contemporary company law this happens mostly between law and economics or social science research), though it is most challenging. But it can also be analyzed usefully in the traditional, intra-disciplinary way—i.e., by legal research and legal researchers alone, provided of course that the legal rules are put into the context of real life and the factual situation underlying the legal rules or the object of the regulation. For this analysis, it is useful to examine why and how the legal rules in question have been developed and reformed, how they are applied, and in particular how they are enforced.

* Max Planck Institute for Comparative and Private International Law, Hamburg, Germany.

Comparative company law is a vast and complicated area. While traditionally the interest was on specific legal rules, today the scope has been enlarged. The interest is rather in the role and relationship of the different players: to use a term from the arts—and law is also an art—the *dramatis personae*. If one focuses on the public—in particular the listed—companies, which are very different animals compared with private companies, the players include the board and the management; the shareholders and investors; the auditors and other gatekeepers; other stakeholders, in particular labor and other creditors, but these days also consumers; and the market authorities and the courts. It is obvious that covering all these players is difficult, if not impossible. Therefore, selecting one of them and looking into its role and function in more detail is a perfectly legitimate and sensible choice. Of course, there is always a danger in isolating a single player. Again, as in art, concentrating on the soloist in a concerto for a solo instrument, or on a single instrument in a chamber orchestra, risks neglecting the interplay with the orchestra or the other players. And even if the interplay is observed from the perspective of one of the players, the risk is that the overall impression of the work will be lost. However, this is the price to be paid for an in-depth analysis. Other studies containing an analysis of the other players can complement the study and our knowledge about the concert—or, returning to our topic, corporate governance.

Comparative company law is highly topical, today more than ever. Company law was always in touch with the spirit and the necessity of its time. This is so because trade has never stopped at the frontiers of countries, and the states, the companies and their players, and the legislators and rulemakers could not afford to neglect this reality. When globalization came—and it is disputed whether this is a phenomenon of the second half of the past century or already of its first half, or even of the second half of the nineteenth century—the necessity to look beyond the frontiers and to react to, learn from, and compete with other laws and rules—viz. legislators and rule makers—became even more obvious. The financial crisis has added momentum to this, since it was not confined to the United States and to the banks and other financial institutions, but spread more generally to Europe and to companies and the economy. Correspondingly, the absolutely appropriate reaction that we observe, in the European Union as well as in the United States, is that corporate governance of banks and financial institutions as well as corporate governance of other major enterprises is at the forefront of the agenda of research and regulation.

For these three reasons, this book, *Public Companies and the Role of the Shareholders: National Models towards Global Integration*, comes at the right moment. It looks at five countries—the United States, Italy, France, Germany, and the United Kingdom—and tries to identify the various national models. This selection is reasonable since it covers the major Western industrialized countries that are linked to each other by history, legal thought, company and market law development, and economic and political ties. It would have been tempting to confront this selection with the quickly rising Far Eastern economies such as Japan, as in *The Anatomy of Corporate Law*, now in its second edition (2009), or with China, the quickly emerging and fearfully observed challenger of all these countries, but this

would have presented its own huge difficulties and dangers. This book shows how much one can learn from classical comparative company law research. Though not interdisciplinary by methodology or contributing authors, it is by no means just descriptive or legalistic; instead, it combines detailed legal information on company law of the various jurisdictions, in particular on the general meeting and shareholder rights, with extensive factual information on the listed companies in general, the capital market data, and the ownership structure.

The book does not deal with corporate governance in general, but singles out one important actor—the shareholders—and tries to deepen our knowledge about their role in the modern public and primarily listed corporations of each of the five countries. This is particularly useful because there is already extensive literature on the board in both law and economics. According to one recent observer, there have been more than 200 working papers on corporate boards since 2003. But we do need to know more on the role of shareholders. After all, the shareholders are the real principals in the corporation and, in the terms of agency theory, the board is only their agent (this is not necessarily to be taken as a statement in the present-day dispute on shareholder and stakeholder primacy). But we know at least since Berle and Means that ownership and control are separated in many modern corporations. Yet at least in continental Europe, we also know (and have known for some time) that in the traditional companies which still prevail over here, the real agency conflict is not so much between the directors and the shareholders, but among the shareholders themselves, namely between the controlling shareholder—the family or the parent—and the minority shareholders. How the latter may be protected adequately is a persisting riddle, though minority protection has been on the agenda in particular of European company laws ever since the beginning of the modern company in the late first half of the 19th century. Ever since the Gladstonian reforms in England in 1844, one of the mechanisms used for this protection is disclosure, of course not alone, but in addition to many kinds of shareholder rights.

A key problem in the public company is that investors—the traditional small investor as well as modern institutional investors—are not so much interested in one or another shareholder right, but rather in the economic performance of the company. For the institutional investors, this means that they sell out if performance is not satisfactory, i.e., they follow the traditional Wall Street rule, while the mass of small investors follows the crowd for good or for bad, i.e., rational apathy or other not-so-rational modes of behavior that we have learned to observe from behavioral economics. It is an open question whether the institutional investors may change their attitude or be pushed to do so by regulation, including self-regulation (see the UK Stewardship Code of the Financial Reporting Council in July 2010 and the role of the Institutional Shareholders Committee, the "ISC"), and engage themselves more than they have up to now in internal corporate governance as well. Institutional investors is probably too broad a category; it encompasses national and international institutional investors, different kinds of institutional investors, and in particular hedge funds, all of which tend to behave differently and therefore need to be distinguished in research. Whether the

institutional investors act as they are expected and thereby promote shareholder activism in general will affect the more reserved or more optimistic evaluation of the role of the shareholders as a player in company law and corporate governance. The latter evaluation is understandably predominant in the book, and indeed may have been one of the motivations for the choice of its overall topic. This goes together with the degree of practical relevance of the EU shareholders' directive of 11 July 2007, which is disputed.

The book comes at a time of increased globalization and, hopefully, in the aftermath of the financial crisis. For right or wrong, the present mood is towards more regulation, including giving shareholders more rights, deepening and enlarging disclosure within the company to the shareholders and beyond the company to the market, stiffening the supervisory rights of the market authorities, and demanding of them more and/or better enforcement. Right now the discussion within the European Union and also between the European Union and the United States is on better cooperation of these authorities, across Europe as well as over the Atlantic Ocean, and possibly also on harmonization and to a certain degree even on centralization. Unfortunately, this development, which is seen by many as an economic and/or political necessity, has raised fears in the different nation states for their own cultural and legal tradition and sovereignty. It has even led to a legal backlash in the form of once again raising frontier barriers and protectionism. As to the latter, it is telling to observe the attitude of many EU member states in rejecting the anti-frustration rule as suggested by the 13th directive, or in later changing their takeover law and opting out of this rule, as Italy did in 2008 (though it reintroduced the anti-frustration rule again in 2009 as a default rule and allowed the companies to opt out of it in their by-laws). Another discussion to be observed is on the plans to merge the New York Stock Exchange and the German Stock Exchange in Frankfurt in the spring of 2011. While these plans can be evaluated very differently on economic terms and prognoses, there is a whole wave of sheer protectionism rising in the public and political discussion in Frankfurt, Paris, and even New York and Washington. This is not to say that a bill like the British Exchange and Clearing Houses Bill of 2006, which is meant to limit an excessive or disproportionate influence of foreign stock exchange law and foreign supervisory agencies on the London Stock Exchange, should necessarily be judged as protectionist. But even in the United Kingdom, the home country of the Takeover Panel's anti-frustration rule (sometimes less correctly referred to as the passivity or neutrality rule) and the model in many other European states for the ultimate say of the shareholders on a disputed takeover, the successful hostile takeover bid by the US company Kraft for the UK company Cadbury led to the June 1, 2010 consultation of the Takeover Panel and very worried questions. (For details, see the UK report, including the statistics quoted there. According to those, the total for financial and associated services in 2006 in the UK was already more than 12% of the GDP, as compared to manufacturing with 13.6%.)

The book is not only interesting for the three reasons just mentioned, but it also raises a host of other difficult and thought-provoking issues. After a short introduction, the five country reports are all treated in more or less the same sequence:

the listed companies; the ownership structure; the general meeting and the shareholders rights; the securities markets with their market authorities; and, though succinctly, the market of corporate control or takeovers that promise to discipline management and are considered to be the primary mechanism of external corporate governance. Only the last chapter escapes from this order and deals with directors' duties; this is not necessarily out of place, but it is understandable or at least tenable as a concession to the above-mentioned concerto analogy. Apart from this, the reader learns about general questions such as insider and outsider (financial) systems; the decline, and the reasons for it, of the German "Rhenanian Capitalism" system in the direction of a more capital market-oriented finance system; convergence and divergence of company laws and surprising differences between the US and the UK; and interesting similarities, e.g., between the UK and Germany, Germany and the US, or France and Italy. But there are many more specific issues treated or touched. Let me mention only an admittedly subjective selection: one share/one vote and the many exceptions to this principle (including the French double vote for longer term shareholders); fiduciary duties of the controlling shareholder, namely abuse of power/voting rights of the majority (but also of the minority, in particular the so-called rapacious shareholders who are prevalent in Germany); conflicts of interest and independent directors; proxy voting via banks (the traditional German type) and via company agents as in many other countries including the US; American-style proxy fights; different forms of boards and the shareholder choice between them; Italian-style minority representation within the board; gatekeepers; special investigation procedures; litigation and the role of the judge; and many others. In sum: this book is really worthwhile to read.

Summary of Contents

List of Authors v

List of Figures xvii

List of Tables xix

Foreword xxi

Introduction 1

Chapter 1
The United States 13
Arthur R. Pinto

Chapter 2
Italy 55
Sabrina Bruno and Eugenio Ruggiero

Chapter 3
France 97
Alain Couret

Chapter 4
Germany 139
Stefan Grundmann and Florian Möslein

Chapter 5
The United Kingdom **197**
Dan Prentice

Chapter 6
From Shareholders' Rights to Directors' Duties: Liability and Accountability of Directors **239**
Gustavo Visentini and Federico Raffaele

Table of Contents

List of Authors v

List of Figures xvii

List of Tables xix

Foreword xxi

Introduction 1

Chapter 1
The United States 13
Arthur R. Pinto

1. Listed Companies in the United States 13
   1.1. Legal Background 15
2. The Ownership Structure 19
   2.1. The Berle-Means Corporation-Separation of Ownership from Control 20
   2.2. Institutional Investors 21
   2.3. The Political Significance of Share Ownership to Household Savings 22
3. General Meeting of Shareholders 23
   3.1. Allocation of Power and Shareholder Voting 25
   3.2. Proxy Voting 28
      3.2.1. Proxy Fights 30
      3.2.2. Shareholder Democracy 32

4. Shareholder Rights, Duties, and Protection 33
4.1. Right to Information 33
4.2. Independent Directors 35
4.3. Gatekeepers 37
4.4. Fiduciary Duty 39
4.5. Controlling Shareholders 41
5. Shareholder Litigation 43
5.1. Federal Securities Law Litigation 45
6. The Role of Regulatory Authorities and Securities Markets 46
6.1. The SEC and Other Public Institutions 46
6.2. The Stock Markets 48
7. The Market for Corporate Control 49
7.1. Challenges to Management Control 49
7.1.1. Hostile Tender Offers 50
7.1.1.1. The Law 51
7.1.2. Proxy Fight to Change Management 53
8. Conclusion 54

Chapter 2
Italy **55**
Sabrina Bruno and Eugenio Ruggiero

1. Listed Companies in Italy 55
1.1. Requirements and Procedures for Listing 55
1.2. How Developed Is the Public Securities Market? 57
2. The Ownership Structure 58
3. The General Meeting of Shareholders 65
3.1. The Powers of the General Meeting of Shareholders 65
3.2. General Meeting of Shareholders and Managerial Powers: Historical Background and the New Regime 66
3.2.3. Procedural Rules for Convening General Meeting 70
3.2.4. Attendance to the General Meeting and Exercise of Voting Rights 71
3.2.5. Resolutions of the General Meeting 77
4. Shareholders' Rights, Duties and Protection 79
4.1. The Nature of the Shareholder 79
4.2. One Share: One Vote Principle 81
4.3. Rights of "Voice" for Minority Shareholders in Listed Companies 82
4.3.1. Initiative Powers for the Functioning of the General Meeting of Shareholders 82
4.3.2. The Board of Directors 83
4.3.3. Appointment of a Member of the Supervisory Board 84
4.3.4. Duties of Shareholders to Other Shareholders 85