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Corporate Law and Economic Stagnation: How Shareholder value and Short-termism Contribute to the Decline of the Western Economics

Masouros, P.E.

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Author: Masouros, Pavlos

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Chapter Three

Corporate Law's Contribution to the Great Reversal in Corporate Governance

As outlined in the Introduction (*see* Section 3.3.), Chapter Three seeks to buttress this study's Second Hypothesis, i.e. that corporate law is one of the determinants of the reorientation of corporate governance towards shareholder value. In fact, what the Second Hypothesis seeks to do is to expand the causality chain depicted in Figure 2 by adding corporate law as a contributing factor at least for the Great Reversal in Corporate Governance (*see* Figure 29).

Nevertheless, the Second Hypothesis does not aspire to put forward an exclusive explanation for the rise to dominance of shareholder value. Just like the First Hypothesis (developed in Chapter One) does not claim to provide a complete account of how the world's developed countries reached the point of reduced rates of capital accumulation and economic growth, but merely seeks to highlight one of the relevant reasons (*see* for alternative explanations in Section 7.7. of Chapter One), so does the Second Hypothesis aspire to put forward just one of the reasons why the Great Reversal in Corporate Governance occurred. After all, given that this study fully accedes to the idea of institutional complementarity with regard to the production of outcomes at the sphere of Political Economy, Chapter One has already pointed to an abundance of legal and extra-legal institutions that have brought about the reorientation of corporate affairs towards shareholder value.

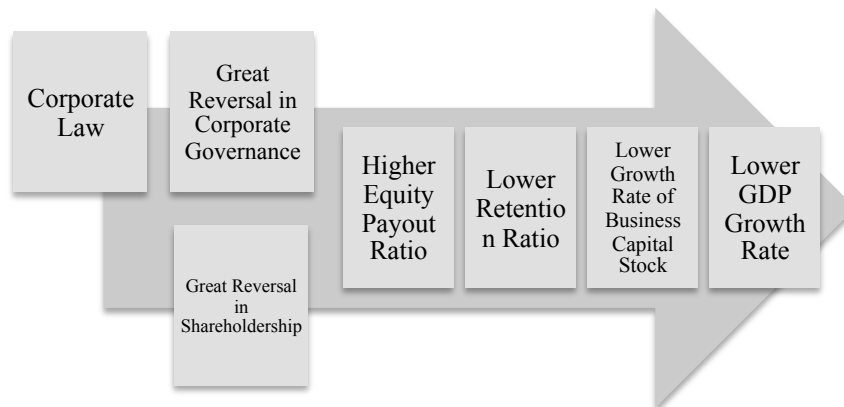


Figure 28 - The Causality Chain of the Second Hypothesis

The Second Hypothesis seeks, apart from complementing the First Hypothesis, to rebut an assumption that is found in the functional convergence

claim: that the rise of shareholder value has been largely unaccompanied by changes in the corporate law. It has been claimed that ‘the recrudescence of shareholder influence appears to have occurred against the backdrop of a remarkable stability over the post-war period in the relevant company law provisions’⁶³². Others in summarizing the reasons for convergence in corporate governance have stated that corporate law has displayed ‘a certain inertia’⁶³³. Although, these claims empower the perception that there have been forces in play other than corporate law that brought about the Great Reversal in Corporate Governance, a perception, with which this study does not take issue, at the same time they weaken the Second Hypothesis. Therefore, the pitfalls of this perception need to be shown in this Chapter, in order to marshal the argument that the causality flow that leads to low GDP growth rates in the post-Bretton Woods era starts *inter alia* from corporate law.

Chapter Three responds to these challenges by introducing the post-Bretton Woods shareholder value index (‘PBWSV’); an index that shows the progress that the corporate laws of the five jurisdictions, whose capital accumulation rates were presented in Chapter One (France, Germany, The Netherlands, UK, US), have made at the shareholder value level during the post-Bretton Woods era. Such a post-Bretton Woods shareholder value index would show how each jurisdiction’s corporate law scored from a shareholder value perspective at the time of the collapse of the Bretton Woods arrangements in 1973 and then how this score changed over the years until 2007, the year before the ongoing crisis officially started. This index is ‘dynamic’, in the sense that it identifies what the relevant scores were for each jurisdiction every single year from 1973 to 2007.

Eventually, out of the index a trend line will emerge illustrating the incremental move of each jurisdiction’s corporate law towards shareholder value or away from shareholder value. If in the end of the Chapter the trend line is found to have an upwards direction for these five jurisdictions (i.e. a direction *towards* shareholder value), then there is an indication that the Second Hypothesis holds true and that the foundations of the ‘inertia’ or the ‘indifference’ claim regarding corporate law’s role in the Great Reversal in Corporate Governance will be shaken.

As it will be shown, the PBWSV builds on the wisdom of previous numerical comparative corporate law studies, but is the first to evaluate the development of these five corporate laws on the specific issue of shareholder value (and not shareholder protection broadly).

Apart from backing the Second Hypothesis the PBWSV provides evidence that there is some degree of formal convergence between the insider and outsider systems of corporate governance (*see* Section 4.2.2. of the Introduction). Therefore, Chapter Three is to be added to the cohort of papers that bear on the functional vs. formal convergence debate, but also to the group

⁶³² Paul Davies, *Shareholder Value, Company Law and Securities Markets Law – A British View*, in CAPITAL MARKETS AND COMPANY LAW (K. HOPT & E. WYMEERSCH, EDS.) (2003), 261, 262

⁶³³ AGLIETTA & REBERIOUX, *supra* note 502, 71

of papers that adopt numerical methods to measure the convergence and divergence of legal rules between different countries in general⁶³⁴.

1. The art of quantifying corporate law

1.1. The LLSV index

The ‘law and finance’ line of thought (*see* Section 4.2.4. of the Introduction) initiated the trend to quantify the law in relation to shareholder protection⁶³⁵ and more generally to use a numerical method when conducting comparative research in law. What ‘law and finance’ scholars actually did was to ‘cherry pick’ some types of arrangements that exist in the various legal systems, identify them as important for shareholder protection and make them the variables of a ‘shareholder rights index’ (**‘LLSV index’**)⁶³⁶, according to which each jurisdiction would be assessed as to the degree of protection it offers to its shareholders. If a country’s legal system had in place the selected arrangement, then it scored one point on the index; if the arrangement didn’t exist it scored zero. On the condition that the arrangements chosen as variables of the LLSV index are adequate proxies for shareholder protection, then this index can classify jurisdictions from the most shareholder-protective to the least shareholder-protective on the basis of the jurisdictions’ scores. This is a result that can be difficult to obtain through traditional descriptive comparative studies.

To understand the mechanics of the quantification of corporate law and pave the way for understanding the principles that are followed here in the construction of the PBWSV, it is worth looking briefly at the technicalities of the LLSV index.

As far as the variables are concerned, firstly, the index looks at whether jurisdictions have in place the one-share/one-vote (**‘1S/1V’**) principle. Secondly the index points to the existence or non-existence in a country’s legal system of six shareholder rights that together comprise the so-called ‘anti-director rights index’ (**‘ADRI’**)⁶³⁷. Finally, it looks at whether jurisdictions have the institution of mandatory dividends or not. All in all, the LLSV index is composed of eight variables that are used as proxies for shareholder protection.

Regarding the 1S/1V principle a jurisdiction receives one point on the LLSV index if it has institutionalized the principle in its corporate law and zero

⁶³⁴ See William Carney, *The Production of Corporate Law*, 71 SOUTHERN CALIFORNIA LAW REVIEW 715; Mark West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, 149 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 528

⁶³⁵ The seminal paper is La Porta et al., *supra* note 48, 1126ff.

⁶³⁶ The abbreviation ‘LLSV index’ derives from the first letter of the last name of the authors that introduced that index in their well-known paper: La Porta, Lopez-de-Silanes, Shleifer, Vishny.

⁶³⁷ The six ADRI variables are: (i) the right of shareholders to mail their vote; (ii) the prohibition of share blocking; (iii) the derivative suit and the appraisal remedy; (iv) the existence of institutions that allow proportional representation on the board; (v) the pre-emptive right; and (vi) the right of shareholders to call an extraordinary meeting.

if not. Regarding the ADRI, for each of the six rights of this constituent index that are provided for in national corporate law a jurisdiction receives one point, but no point at all if there is no relevant provision. Thus, the maximum a jurisdiction can theoretically get on the ADRI is six points, the minimum zero. No points are given to a country if it has in place the institution of mandatory dividends, as this is viewed upon as a legal substitute for the overall weakness of shareholder protection in a country⁶³⁸. The higher a jurisdiction scores on the overall LLSV index (ADRI index + 1S/1V), the shareholder-friendlier its corporate law is perceived to be.

The goal of the LLSV index is to identify the corporate law determinants that lead to strong capital markets. Obviously, the provisions in corporate law that matter the most from this viewpoint are those related to the protection of minority shareholders; minority protection makes an equity investment safer, so the argument goes. It is natural then that the LLSV index comprises mainly of those rights that are traditionally in the corporate legal doctrine associated with the protection of minority shareholders. Consequently, while the mechanics of the LLSV index should be taken under account in constructing the post-Bretton Woods shareholder value index, the latter cannot borrow the LLSV variables, as the two indexes have different objectives and aspire to measure different aspects of a corporate legal system.

1.2. Alternative shareholder protection indices: the Lele/Siems index

The LLSV index has become a widely used way of evaluating the level of shareholder protection that a national corporate legal system offers, as the hundreds of citations to the paper introducing it show⁶³⁹. Nevertheless, it is also criticized, as having a limited scope and not including all arrangements that matter for shareholder protection⁶⁴⁰ or as being US-biased⁶⁴¹, given the fact that some of the rights included in the index were chosen because of their existence in the US, which means that in essence the object of comparison is how close a national corporate law is to the US system of shareholder protection (*hidden benchmarking*). Others assert that the scores of some countries on the index are not accurate and that jurisdictions that get zero points for a certain variable have another institution in place that fulfills the same function as the rule, which the law and finance scholars are looking for in formal law.

⁶³⁸ La Porta et al., *supra* note 48, 1128

⁶³⁹ See Craig Doidge et al., *Private Benefits of Control, Ownership, and the Cross-listing Decision*, 64 THE JOURNAL OF FINANCE 425; Nicholas Georgakopoulos, *Statistics of Legal Infrastructures: A Review of the Law and Finance Literature*, 8 AMERICAN LAW & ECONOMICS REVIEW 62; Marco Pagano & Paolo Volpin, *The Political Economy of Corporate Governance*, 95 AMERICAN ECONOMIC REVIEW 1005; Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 JOURNAL OF FINANCE 537

⁶⁴⁰ See John Coffee, *The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control*, 111 YALE LAW JOURNAL

⁶⁴¹ See Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries*, WDI Working Paper 1999. Available at SSRN: <http://ssrn.com/abstract=183708>

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The criticisms led certain authors to recode or to expand the LLSV index. Some attempted to make it more accurate⁶⁴², others to adjust it to the exigencies of comparative legal research that includes the study of corporate laws of transition economies, which cannot be judged yet on the basis of Western standards⁶⁴³.

Of the various indexes that have quantified shareholder protection since the LLSV index the most comprehensive is the one prepared by Lele and Siems in 2006⁶⁴⁴. To be sure, most recently authors have begun to build their comparative research in corporate law and governance on the Lele/Siems index rather than on the LLSV⁶⁴⁵. This is because the Lele/Siems index comprises of 60 variables/proxies for shareholder protection and thus escapes the criticism of narrowness that burdens the LLSV index, but also because it is constructed on the basis of solid methodological foundations. These methodological foundations are derived from an earlier paper of Mathias Siems, where he had designed a concrete framework for all numerical comparative studies⁶⁴⁶ and from a paper by Holger Spamann, where he recoded the LLSV index⁶⁴⁷.

The recent recognition of the qualities of the Lele/Siems index indicates that its methodological foundations should serve as the basis for any further effort to conduct a numerical comparative study in corporate law. In light of this, the PBWSV, despite the fact that it comprises of different variables than the Lele/Siems index, is constructed after the mechanics of the Lele/Siems index, so as not to be accused of not respecting the principles of comparative law, of containing measurement errors or of comparing otherwise incomparable rules. The next section serves exactly the purpose of adjusting the Lele/Siems methodology to the exigencies of the study to be conducted by the PBWSV.

1.3. Constructing the post-Bretton Woods shareholder value index

1.3.1. The compatibility of the post-Bretton Woods shareholder value index with the principles of comparative law

Any effort to do comparative law by using numerical methods, such as an index, is unavoidably subject to criticisms; it can be accused as a reductivist approach, as being governed by arbitrariness or as suffering from home bias, to name but a few. The challenge then is to construct the index in a way that is in

⁶⁴² See Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' under Consistent Coding*, ECGI – Law Working Paper No. 67/2006

⁶⁴³ Katharina Pistor, *Patterns of Legal Change: Shareholder Protection and Creditor Rights in Transition Economies*, 1 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 59

⁶⁴⁴ Priya Lele & Mathias Siems, *Shareholder Protection: A Leximetric Approach*, 17 JOURNAL OF CORPORATE LAW STUDIES 17

⁶⁴⁵ See Christopher Van der Elst, *Law and Economics of Shareholder Rights and Ownership Structures: How Trivial are Shareholder Rights for Shareholders?*, Tilburg Law School Legal Studies Research Paper No. 008/2010, Feb. 15, 2010. Available at SSRN: <http://ssrn.com/abstract=1553094>

⁶⁴⁶ Mathias Siems, *Numerical Comparative Law – Do We Need Statistical Evidence in Order to Reduce Complexity?*, 13 CARDOZO JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 521, 539ff.

⁶⁴⁷ Spamann, *supra* note 642, 4ff.

accordance with the general principles of comparative legal research, so that the ‘micro-comparison’⁶⁴⁸ of the legal rules that it entails can lead to results that won’t be easily disputed by many.

1.3.1.1. Designing a legal trend line

The necessity of using a numerical method, such as the PBWSV, instead of a more mainstream descriptive method of comparison must be established⁶⁴⁹. In connection to this the purpose of the discourse in this Chapter has to be reiterated, since it is commonly acknowledged that it is the purpose of the comparative research that will determine the method of comparison that ought to be used⁶⁵⁰.

The purpose of Chapter Three is to back the Second Hypothesis, which suggests that the *rise* of shareholder value, which contributed to the *reduction* of growth rates in the post-Bretton Woods era, is attributed to reforms in the field of corporate law during the same period. In essence, the goal is to show the corporate law-propelled rising *trend* of a specific set of corporate governance institutional logics that contributed to a declining *trend* in a macroeconomic indicator. Trends can be better illustrated by the design of (linear regression) trend lines and the latter can only be drawn on the basis of numerical data. Therefore, just like this study used numerical data to illustrate through a trend line the incremental *fall* of capital accumulation rates in the post-Bretton Woods era, it must use a trend line based on numerical data to illustrate the incremental *rise* in the promotion of shareholder value by corporate law during the same period. This is why a numerical approach is preferred over a descriptive one.

1.3.1.2. A complement to the political economy analysis

It is claimed that a comparative legal study must include a study of the history, the politics, the economics, the cultural background in literature and the arts, the religions, beliefs and practices and the philosophies of the countries, whose legal order is put under scrutiny⁶⁵¹. Many of these issues have already been touched upon in this study with regard to the five jurisdictions, whose legal route at the shareholder value level the index investigates (*see* Sections 3-6 of Chapter One). Therefore, the presentation of the historical evolution of the legal rules pertaining to shareholder value is not done out of context here. In fact, in many cases the time that a reform in the corporate rules presented here was undertaken is found to coincide with the years that the jurisdiction at hand decided to enter more aggressively the international battlefield for the siphoning of funds into its national capital markets (*see* Section 4.3. of Chapter One).

⁶⁴⁸ The term ‘micro-comparison’ refers to the comparative study of specific topics and aspects of two or more legal systems and is to be distinguished from ‘macro-comparison’, which refers to the comparative study of entire legal systems. The two terms have been coined in comparative law by MAX RHEINSTEIN, *GESAMMELTE SCHRIFTEN* (1979), 245

⁶⁴⁹ Siems, *supra* note 646, 539

⁶⁵⁰ PETER DE CRUZ, *COMPARATIVE LAW IN A CHANGING WORLD* (1999), 227

⁶⁵¹ Ferdinand Stone, *The End to be Served by Comparative Law*, 25 *TULANE LAW REVIEW* 325, 351

1.3.1.3. Concrete criteria for the selection of the points of comparison: corporate rules that minimize residual loss and corporate rules used by shareholder activists

A comparative study must be conducted in such a way, so as to avoid imposing the author's own legal conceptions upon the foreign legal cultures it puts under scrutiny⁶⁵². This principle amounts to a more general *desideratum* of the methodology of social sciences that calls for elimination of subjective judgment to the extent possible⁶⁵³. A study that aspires to make a contribution to the comparative corporate governance and to modern political economy cannot afford to be accused of arbitrariness in the choice of its variables/points of comparison.

In light of this challenge, the question to be asked is: how should the variables of the PBWSV be chosen, so as not to have an arbitrary or biased selection of the norms that are put under scrutiny?

The first point that should be made here is that a shareholder value index is not the same with a shareholder protection index; the former is more specialized, while the latter more general. Not every legal arrangement that protects shareholders vis-à-vis the management or vis-à-vis other (dominant) shareholders promotes at the same time the institutional logics of shareholder value in corporate governance. Shareholder protection rules may help reduce monitoring and bonding costs and thus eventually lead to better book-to-market ratio, share price, Tobin's Q, greater dividend yield and stock return, but they do not necessarily cause the managers to think in a way more favorable to shareholders⁶⁵⁴. In my view, shareholder value-promoting legal institutions are those that help minimize what agency theory calls 'residual loss' (see Section 6.2.2. of Chapter One). Residual loss is the money equivalent of the reduction in welfare experienced by the shareholders because of the divergence that exists between the management's decisions and those decisions, which would maximize the shareholders' welfare⁶⁵⁵. Corporate law rules that 'nudge' managers to think more in shareholder-welfare terms, i.e. that align the management's incentives with those of the shareholders, are the rules that reduce the said money equivalent and maximize what is called 'shareholder value'. Therefore, it is only these rules that will be inserted as variables in the PBWSV.

Nevertheless, while the residual loss-minimizing effect may be obvious for some rules (e.g. rules facilitating the use of stock options), for other provisions it may not be so evident. Therefore, so as not to miss out legal arrangements that are significant for this study's purposes we treat the significance that shareholder activists assign to certain corporate rules as a proxy

⁶⁵² DE CRUZ, *supra* note 650, 223

⁶⁵³ GARY KING, ROBERT GEOHANE & SIDNEY VERBA, *DESIGNING SOCIAL INQUIRY* (1994), 25

⁶⁵⁴ In fact many empirical studies using indexes show the correlation of these firm characteristics to stronger shareholder protection; see Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 *QUARTERLY JOURNAL OF ECONOMICS* 107; Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 *JOURNAL OF FINANCE* 1147

⁶⁵⁵ Jensen & Meckling, *supra* note 491, 308

for these rules' positive effect on shareholder value. Rules for the introduction of which shareholder activists have lobbied or whose content they have sought to impose upon the firm through private ordering arrangements belong to the PBWSV. In addition to this, existing legal devices that have been frequently used by shareholder activists to promote their goals are also considered here to be shareholder value-maximizing and are thus featured in the index at hand.

Apart from the residual loss-minimizing rules and the legal arrangements that shareholder activists treat as 'holy grails', the PBWSV features an additional innovation in the issue of selection of variables/points of comparison. In the calculation of the overall score of a jurisdiction the PBWSV takes under account corporate or securities rules that have a documented counterbalancing effect on specific shareholder value-promoting rules. This point will be elaborated further under Section 1.3.2.3 below, when explaining the methodology of rating.

From the explanation of the criteria that shape the structure of the PBWSV it becomes evident, why the latter could not simply constitute a recoding of the LLSV or a reduced version of the Lele/Siems index. The PBWSV is a *suis generis* index that can avoid criticisms about arbitrariness by drawing firmly on agency theory and on empirical data for the selection of its variables and that respects comparative law's principle of functionality by exposing inconsistencies within the same legal system, which may deprive some formal rules of their intended effect.

1.3.2. The mechanics of the post-Bretton Woods shareholder value index

One of the sources of criticism for previous indexes in the field of corporate law was the lack of transparency regarding the variables and the coding. In the previous sub-section the effort to make the PBWSV more transparent compared to previous indexes began by laying down the criteria, by which the variables on the index are chosen. In this sub-section the sources, where the variables are sought for, are identified, the issue of whether both mandatory and default rules are considered is tackled and the technicalities of rating are touched upon.

1.3.2.1. Sources of corporate law

The sources of law, where the rules constituting the variables of the PBWSV are sought for, must be identified. This issue is linked to the more foundational question of what are the sources of corporate law.

In Section 3.3 of the Introduction I acknowledged that among the *legal* institutions that brought about the Great Reversal in Corporate Governance securities law has a prominent position, but I pledged not to extend the scope of the legal part of this study beyond corporate law. *Prima facie* this would mean that a clear line should be drawn, so that developments in securities law are not taken under account for the PBWSV, despite the fact that this study deals exclusively with listed corporations, for the functioning of which securities

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regulation is of utmost importance. Nevertheless, in between corporate and securities law there are 'grey' territories that may formally belong to one niche, but may serve functions traditionally reserved for the other niche. Therefore, it would be a mistake to perceive modern corporate law as consisting just of that core statute that exists in most jurisdictions, which establishes the corporate form, and the decrees and case law that flow from this statute. That could be considered as '*stricto sensu* corporate law' or 'formal corporate law', but the modern legal doctrine accedes to a broader perception of corporate law that also includes those rules that may be found in territories formally considered part of securities law, but that affect *directly* the internal affairs of the corporation⁶⁵⁶. Of course the greatest part of securities law affects corporate governance, but mostly in an *indirect* way; part of '*lato sensu* corporate law' or 'functional corporate law' are only those securities law provisions that introduce procedures and requirements that are applied in the framework of the internal machinery of the (listed) corporation and thus affect the functioning of the latter in a *direct* way.

Therefore, given that corporate law here is perceived *lato sensu* the variables that are featured in the index are also to be found in sources of 'hard' and 'soft' securities law; this includes listing standards issued by the major stock exchanges of the five jurisdictions that are studied here, as well as corporate governance codes and other self-regulatory codes, compliance to which is found to be the rule in practice.

To be sure, a special issue arises with regard to the US, where corporate law is mostly state law. Which state's corporate statute will be taken under account? The answer appears to be obvious given that more than half of the Fortune 500 US firms are incorporated in Delaware⁶⁵⁷. Needless to say though, that since the study embraces the concept of *lato sensu* corporate law, US federal securities regulation that deals directly with issues of corporate governance is also to be taken under account.

1.3.2.2. Mandatory and default rules

The second methodological challenge that the PBWSV has to tackle is whether it will include only mandatory or both mandatory and default rules, the latter meaning rules that allow a divergence provision in the articles of association. The fact that the law and finance scholars did not take a position with regard to this issue is deemed as one of the LLSV index's weaknesses and one of the sources of its inaccuracies⁶⁵⁸.

My position in the PBWSV is to include both mandatory and default rules and rate the same a jurisdiction that sets as a default an arrangement that another one introduces as mandatory. The purpose of the PBWSV to show the law's attitude over time towards shareholder value, so the mere fact that a

⁶⁵⁶ See REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2009), 17-18

⁶⁵⁷ LEWIS BLACK JR., WHY CORPORATIONS CHOOSE DELAWARE (2007), 1

⁶⁵⁸ Spamann, *supra* note 642, 6

jurisdiction introduced a shareholder value-enhancing rule, even if replaceable, shows that the legislator has indeed made a step towards the promotion of shareholder value, which must be depicted on the trend line that is to be produced. Otherwise, we would have to check first if the shareholder value-enhancing default rule is indeed followed by corporations in a jurisdiction and then decide how to rate the latter with regard to this arrangement. This would lead to inconsistencies, as the PBWSV would have to rate a jurisdiction with one point at the time of the introduction of a default rule because the firms chose initially to incorporate it and after some years rate the jurisdiction for the same arrangement with no points, not because of some change in corporate law, but because the firms for extra-legal reasons chose to deviate from the rule set as default⁶⁵⁹.

1.3.2.3. Rating

Not all shareholder value-enhancing legal provisions have the same weight. Obviously, the information right of the shareholder cannot incentivize managers to think in shareholder interests as much as the granting of stock options to them can. That means that it may be appropriate to weight the variables and multiply the jurisdiction's score at each variable by the weight factor.

Nevertheless, weighting the variables would add another layer of subjective element into the PBWSV⁶⁶⁰, which in the previous section was noted as undesirable for any study in the field of social sciences. A certain shareholder value-enhancing device, for instance a shareholder suit, might in practice be the most useful weapon in shareholdership's arsenal in one jurisdiction, while in another jurisdiction the filing of such a suit might in practice be very rare. The dilemma then would be whether the weight to the variable would be attributed according to the importance that it has in the former jurisdiction or according to the importance it has in the latter. Therefore, to avoid such inconsistencies I opted for non-weighted variables in the PBWSV.

Another issue is whether the rating should be binary, i.e. '1' or '0', as in the LLSV index, or non-binary, as in the Lele/Siems index. I believe that the 'all or nothing' approach of the LLSV index is not capable of illustrating fully the progress that jurisdictions have made at the shareholder value level; therefore, in order to show the gradual progress that has been made in this respect in the post-Bretton Woods era it is decided, where this is feasible, to use non-binary rating, therefore allowing for intermediate scores (e.g. 0.5, 0.75).

Finally, there is the issue of how those rules -referred under Section 1.3.1.3 above- that have a counterbalancing effect on certain shareholder value-enhancing provisions are accommodated by the rating methodology. The

⁶⁵⁹ See for instance deviations over time in the percentage of firms replacing a default rule under Delaware law in Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REVIEW OF FINANCIAL STUDIES 783, Table I.

⁶⁶⁰ Simon Deakin & Beth Ahlring, *Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?*, 41 LAW & SOCIETY REVIEW 865, 885

counterbalancing effect is documented by subtracting points from a jurisdiction, when it has in place the ‘counter-rule’. This does not mean that the PBWSV seeks to subtract points from a jurisdiction, when for instance it has established some type of labor codetermination in public corporations’ management or some other general stakeholderist rule, because the exact mitigating effect these rules have on shareholder value is abstract and cannot be measured. The PBWSV only subtracts points from a jurisdiction, when it has in place a legal arrangement that takes away the specific benefit that flows from a specific residual loss-minimizing arrangement. For instance, corporate rules that facilitate shareholder coordination produce a residual loss-minimizing effect that is counterbalanced/mitigated by the existence of an ‘action in concert’ rule in the same legal system; in such a case, the points awarded to the jurisdiction for the shareholder coordination rules will be cancelled through the subtraction of equal points for the existence of the concerted action rule.

2. The post-Bretton Woods shareholder value index

In this part I present the PBWSV based on the principles and the methodology that was laid down in the previous section. The PBWSV consists of 18 variables. These 18 variables are classified into seven broader categories of corporate law subjects; some subjects contain more than one variable (e.g. shareholder litigation), others contain only one (e.g. independent directors). Each variable of the index is presented in three steps. First, it is explained why the subject of corporate law, in which the variable belongs, was chosen for the index. The justification for the inclusion of each subject and each subject’s variables in the index is given by identifying their residual loss-minimization effect and their potential existence in shareholder activists’ agendas (*see* Section 1.3.1.2). Secondly, the criteria, by which the jurisdictions are rated for the variable under scrutiny are presented. Third, an explanatory part is added identifying and explaining the exact rules in each jurisdiction that are responsible for the score that the latter received for the variable under scrutiny; the scores, as explained and analyzed, are inserted to the five tables that are found in the Annex to Chapter Three.

After this three-step approach is completed for all the variables of the PBWSV a graph illustrating the progress that each jurisdiction has made at the 18-point shareholder value scale over the past decades is presented on the basis of the tables of the Annex (Figure 30). Out of the graph a linear regression trend line emerges showing the overall tendency of corporate law in these five jurisdictions towards shareholder value (Figure 31).

2.1. The right to put items on the agenda of the shareholders’ meeting

2.1.1. Reasons for inclusion in the index

In order to enable shareholders to cast an informed vote at the annual or extraordinary meeting or to consciously grant power of attorney to a proxyholder to vote on their behalf, the shareholders must be aware of the agenda of the meeting and any matters being voted on. Therefore, the general rule is that the board is required to draft the meeting's agenda and to disseminate it to the shareholders prior to the meeting in a timely manner. In jurisdictions following the 'pull' system of dissemination of pre-meeting information the agenda must be included in the convocation of the general meeting⁶⁶¹, while in jurisdictions following the 'push' system of dissemination it must be included in the proxy packet mailed to the shareholders^{662 663}.

Customarily, for the greatest part of the Bretton Woods years shareholders that did not hold a dominant stake in the firm would not bother trying to influence the content of the agenda if they were dissatisfied with it; they would prefer to sell their stock and exit the firm rather than make their voice heard (a.k.a. 'the Wall Street Rule')⁶⁶⁴. From the 1970s onwards with the rise of institutional ownership of stock (see Section 3.3. of Chapter One) activist shareholders, starting from the US, began their attempts to enrich the meetings' agendas with their own resolutions⁶⁶⁵. In the 1970s shareholder proposals for the agenda were social/political, but quickly shareholder activists' focus shifted to corporate governance and their proxy proposals aspired to influence the firm's governance policies⁶⁶⁶.

Overall, it is well documented that shareholder proposals, i.e. the exercise of the right of shareholders to put items on the shareholder meeting's agenda, are very high on shareholder activists' agendas and their associations have in the past sought to shape the rules related to them⁶⁶⁷. But, do shareholder proposals have a residual loss-minimizing effect as well, so as to deserve a place on the PBWSV?

Empirical research conducted on the issue of shareholder proposals has shown that the firms, in whose general meetings shareholder proposals are submitted in both the US⁶⁶⁸ and in the EU⁶⁶⁹, are firms, whose stock

⁶⁶¹ See Art. 5(3)(a) of the Shareholder Rights Directive (Directive 2007/36/EC) ('SRD')

⁶⁶² 17 C.F.R. § 240.14a-3(a), SEC Schedule 14A

⁶⁶³ For a general overview of the differences between the 'pull' and the 'push' system of dissemination of pre-meeting information see Pavlos Masouros, *Is the EU Taking Shareholder Rights Seriously? An Essay on The Impotence of Shareholdership in Corporate Europe*, 7 EUROPEAN COMPANY LAW 195, 197

⁶⁶⁴ Gerald Davis & Tracy Thompson, *A Social Movement Perspective on Corporate Control*, 39 ADMINISTRATIVE SCIENCE QUARTERLY 141, 154

⁶⁶⁵ JAY EISENHOFER & MICHAEL BARRY, SHAREHOLDER ACTIVISM HANDBOOK (2010), §3.03[A]

⁶⁶⁶ *Id.*, at §3.03[C]

⁶⁶⁷ See PR Newswire, The Council of Institutional Investors Opposes SEC Staff Decision on Shareowner-Sponsored Access to Proposals. Available at: <http://news.findlaw.com/prnewswire/20050207/07feb2005170757.html>; Synthesis of the Comments on the Second Consultation Documents of the Internal Market and Services Directorate-General 'Fostering an Appropriate Regime for Shareholders' Rights', (Sept. 2005), 14ff.. Available at: http://ec.europa.eu/internal_market/company/docs/shareholders/consultation2_report_en.pdf

⁶⁶⁸ Luc Renneboog & Peter Szilagyi, *Shareholder Activism through the Proxy Process*, ECGI – Finance Working Paper No. 275/2010, 14ff.

⁶⁶⁹ Peter Cziraki et al., *Shareholder Activism through Proxy Proposals: The European Perspective*, 16 EUROPEAN FINANCIAL MANAGEMENT 738, 761ff.

performance has been relatively poor the period prior to the submission of the proposal, whose CEO has less exposure to the firm's equity and whose capital structure is less leveraged, a fact which in agency theory is seen as a source of management's shirking⁶⁷⁰. This profile of shareholder proposal-targeted firms shows that shareholders opt to exercise their right to put items on the agenda, when the firm is not delivering value to them to the degree that its peers do. Thus, *prima facie* shareholder proposals constitute a monitoring device that helps to better align the incentives of the management to those of the shareholders.

A closer look at the issue will reveal that shareholder proposals can be effective residual loss-minimizing mechanisms as well. This is particularly the case in the jurisdictions, where shareholder proposals may include the issue of directors' replacement. In these cases managers know that the probability to become a target of a shareholder proposal becomes greater the more its stock is underperforming the market index; therefore, in the face of the threat to be ousted as a result of such a proposal they are likely to focus more on pumping the stock price up, thus delivering more shareholder value. Consequently, the *threat* of a shareholder proposal minimizes residual loss in the jurisdictions, where shareholders may replace directors through such a proposal.

However, even in jurisdictions, where replacement of the directors is excludable as an issue of shareholder proposal from the proxy packet, shareholder proposals continue to have a residual-loss minimizing effect. In the US, where this is the case, shareholder proposals are shown to have a negative signaling effect, as their submission depresses the firm's stock price⁶⁷¹. This negative signal is due to the fact that the submission of a shareholder proposal reveals failed behind-the-scenes negotiations between shareholders and managers⁶⁷². Therefore, even there, where a simple shareholder proposal may not threaten to oust managers, the latter are again likely to want to avoid the submission of a shareholder proposal by pumping the stock price up, because the reduction in the firm's share price that will likely occur after the event of the proposal will affect their equity-based compensation.

In light of the above, whether replacing directors is includable in a shareholder proposal or not, the latter is likely to incentivize the management to think more in shareholder value terms. Therefore, the degree to which a jurisdiction's corporate law facilitates the exercise of the right to put items on the agenda is a criterion of the shareholder value orientation of this jurisdiction's corporate law and thus it should be included in the PBWSV.

2.1.2. Variables (i) - (iii): percentage required to put items on the agenda, includable items and proxy solicitation's costs allocation

⁶⁷⁰ See Jensen, *supra* note 505

⁶⁷¹ Cziraki et al., *supra* note 669, 770-771

⁶⁷² See Andrew Prevost & Ramesh Rao, *Of What Value are Shareholder Proposals Sponsored by Public Pension Funds?*, 73 JOURNAL OF BUSINESS 177

There are three things that are separately ratable with regard to this right and thus three variables [(i)-(iii)] includable in the index emerge within the scope of this activist right:

(i) *The percentage of equity that the shareholder(s) is/are required to hold in order to be allowed to submit a shareholder proposal includable in the general meeting's agenda.* A jurisdiction receives no points if according to its corporate law the minimum percentage required to submit shareholder proposals is equal to 10% of the capital or if no such right exists; 0.5 point if the minimum percentage is equal to 5% of the capital; 0.75 point if that percentage is between 1% and 5% and also if the minimum percentage of 5% decreases with firm size with the result for large firms being that eventually even a shareholder holding less than 5% is entitled to exercise the right; 1 point if the minimum percentage is equal to 1% or less.

(ii) *The permissibility of inclusion in the shareholder proposal of suggestions pertaining to the election or replacement of the directors.* A jurisdiction receives no points, if such suggestions are not includable in the shareholder proposal; 1 point if such suggestions are includable in the agenda.

(iii) *The costs of proxy solicitation to gather support for the shareholder proposal.* The sponsoring shareholder must seek the support of other shareholders, if the shareholder proposal is to have chances to pass in the general meeting. The rules and formalities of proxy solicitation are likely to have a major effect on the willingness of the shareholder to engage in the activist strategy of adding items to the agenda⁶⁷³. It makes a great difference whether the costs of proxy solicitation must be borne by the shareholder or whether the management has a 'common carrier' obligation, in the sense that the shareholder may use the company-financed proxy machinery to solicit proxies for her proposal. Thus, the approach adopted for this variable is that when costs have to be borne by the shareholder, then points have to be subtracted from the jurisdiction under scrutiny, because that rule considerably reduces in practice the overall effectiveness of variables (i)-(ii) that grant the right. In light of the above, one point is subtracted from jurisdictions, where the shareholder who added an item on the agenda has to bear the costs of proxy solicitation herself; 0.5 point is subtracted in jurisdictions, where the shareholder bears the costs of proxy solicitation only for those types of shareholder proposals that are considered non-includable in the management-sponsored agenda or where the shareholder bears the costs in principle, but her solicitation may be carried with the company's proxy packet; no points are subtracted if the jurisdiction allows shareholders to use the company-financed proxy machinery to solicit proxies.

⁶⁷³ The Hermes Focus Fund, a UK-based shareholder activist, has estimated that a shareholder-sponsored proxy solicitation amounts to 43% of the total voting costs in EU Member States; see European Commission, *Annex to the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by shareholders of Companies Having Their Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC – Impact Assessment*, 14, SEC(2006) 181. In EU Member States proxy solicitation costs have been calculated to amount to 34-69% (depending on the jurisdiction) of the total activist shareholders' activities costs; see *Id.*, at 223.

2.1.3. Score explanations for variables (i) to (iii)

The ratings in the tables of the Annex for variables (i) to (iii) of the PBWSV have been formed on the basis of the following corporate rules.

2.1.3.1. France

(i) With regard to the percentage of capital that enables shareholders to put items on the agenda of the shareholders' meeting France receives 0.75 points throughout the entire post-Bretton Woods period. This is because the general rule since 1966 is that the percentage required to submit a shareholder proposal is 5%⁶⁷⁴ and since 1967 for large firms there is a sliding scale, which depending on the firm's size allows shareholders that hold as little as 0.5% of the share capital to submit proxy proposals⁶⁷⁵.

(ii) With regard to the permissibility of inclusion in the shareholder proposal of suggestions pertaining to the election or replacement of the directors France receives one point throughout the entire post-Bretton Woods period, as since 1966 it features the most enabling regime in this respect; because of the principle of *ad nutum* revocability of directors shareholders may at their own initiative revoke and replace directors at the shareholders' meeting without this issue even be included in the agenda first⁶⁷⁶.

(iii) With regard to the issue of the costs of a proxy contest one point is subtracted from France throughout the entire post-Bretton Woods period since there are no provisions in French law that entitle insurgent shareholders of French firms to use the firm's ballot to solicit proxies (e.g. for their slate of directors) or that mandate their reimbursement in case they win the proxy battle⁶⁷⁷.

2.1.3.2. Germany

(i) With regard to the percentage of capital that enables shareholders to put items on the agenda of the shareholders' meeting Germany receives 0.75 points throughout the entire post-Bretton Woods period. This is because since 1965 the rule is that the percentage required for submitting a shareholder proposal is 5% or holdings of 500,000 EUR, which in large firms may amount to less than 5% of the share capital⁶⁷⁸.

(ii) With regard to the permissibility of inclusion in the shareholder proposal of suggestions pertaining to the election or replacement of the directors

⁶⁷⁴ Loi n 66-537 du 24 juillet 1966 sur les sociétés commerciales, art. 160; since the year 2000 this provision is codified into art. L. 225-105 of the French Commercial Code ('**Code de Commerce**').

⁶⁷⁵ Décret n° 67-236 du 23 mars 1967 sur les sociétés commerciales, art. 128 ; Art. L. 225-120 Code de Commerce

⁶⁷⁶ Loi n 66-537 du 24 juillet 1966 sur les sociétés commerciales, art. 160 ; since the year 2000 this provision is codified into Code de Commerce art. L. 225-105.

⁶⁷⁷ See Eric Cafritz et al., *Will Eurotunnel Inspire French Proxy Battles?*, 23 INTERNATIONAL FINANCIAL LAW REVIEW 33

⁶⁷⁸ AktG §122(2) (the AktG was entered into force in 06.09.1965)

Germany receives one point throughout the entire post-Bretton Woods period, as since 1965 shareholders are allowed to include a proposal for the election of directors in the agenda without having to justify it further⁶⁷⁹.

(iii) With regard to the issue of the costs of a proxy contest one point is subtracted from Germany throughout the entire post-Bretton Woods period since there are no provisions in German law that entitle insurgent shareholders of German firms to use the firm's ballot to solicit proxies or that mandate their reimbursement in case they win the proxy battle.

2.1.3.3. The Netherlands

(i) With regard to the percentage of capital that enables shareholders to put items on the agenda of the shareholders' meeting The Netherlands receives no points until 2003 and one point from 2004 onwards because that year a provision was added into the Dutch Civil Code allowing shareholders and depositary receipts holders holding a percentage equal to 1% of the share capital or shares of 50mn EUR in value to request in writing the addition of an item in the agenda⁶⁸⁰. There is evidence that Dutch corporations were granting the right to put items on the agenda by virtue of their articles of association even before 2004, but this was a result of private ordering rather than of formal law⁶⁸¹.

(ii) With regard to the permissibility of inclusion in the shareholder proposal of suggestions pertaining to the election or replacement of the directors The Netherlands receives no points until 2003, one point from 2004 to 2006 and 0.5 point in 2007. This variation is due to the idiosyncratic regime governing Dutch public corporations. Since 1971 there is in place the so-called 'structure regime' (*structuurregime*) that requires public corporations to have a two-tier board⁶⁸²; a supervisory board and a management board. The powers that shareholders had regarding the appointment and dismissal of the members of the supervisory board were very limited until 2004; under a system of 'controlled determination' (*gecontroleerde coöptatie*) the shareholders' role in the appointment and dismissal of the members of the supervisory board was essentially advisory in nature⁶⁸³. In 2004 the structure regime was amended increasing the power of the shareholders with regard to the appointment and dismissal of the members of the supervisory board⁶⁸⁴; shareholders are able to introduce in the agenda a resolution to vote on, by which confidence in the supervisory board is removed and all the members are dismissed⁶⁸⁵. The point that The Netherlands receives on the PBWSV with regard to this variable from 2004 to 2006 is attributed to this amendment. Nevertheless, in 2007

⁶⁷⁹ AktG §127

⁶⁸⁰ BW 2:114a §§ 2 and 4 introduced by Wet aanpaasing structuurregeling (Stb. 2004, 370), which was entered into force on 1.10.2004.

⁶⁸¹ Rapport Commissie Peters (1997), 5.7. Available at: http://www.ecgi.org/codes/documents/nl-peters_report.pdf

⁶⁸² BW 2:158 §1

⁶⁸³ PETER VAN SCHILFGAARDE & JAAP WINTER, VAN DE BV EN DE NV (15th ed.) (2009), 415

⁶⁸⁴ Wet aanpaasing structuurregeling (Stb. 2004, 370)

⁶⁸⁵ BW 2:161a §1

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Amsterdam's Enterprise Chamber draw some limitations to the exercise of the right⁶⁸⁶, as it adjudicated that the exercise of this right of dismissal on behalf of shareholders is subject to the general requirements of 'reasonableness and fairness' that govern all the actions of the constituents of a Dutch legal person⁶⁸⁷. This reduced the discretion that shareholders had in this respect and thus in 2007 The Netherlands' score in this variable fell to 0.5 points.

(iii) With regard to the issue of the costs of a proxy contest one point is subtracted from The Netherlands throughout the entire post-Bretton Woods period since until 2007 there were no provisions in Dutch law that entitle insurgent shareholders of Dutch firms to use the firm's ballot to solicit proxies or that mandate their reimbursement in case they win the proxy battle⁶⁸⁸.

2.1.3.4. United Kingdom

(i) With regard to the percentage of capital that enables shareholders to put items on the agenda of the shareholders' meeting the UK receives 0.75 points throughout the entire post-Bretton Woods period. This is because of a provision dating back to 1948 that enables shareholders representing 5% of the voting capital⁶⁸⁹ or 100 shareholders holding shares, on which there has been paid up an average sum per shareholder of at least £100, to require the inclusion of their proposal in the agenda⁶⁹⁰. In the latter case, the percentage enabling the submission of a shareholder proposal may effectively be well below 5%.

(ii) With regard to the permissibility of inclusion in the shareholder proposal of issues relating to the appointment or removal of directors the UK receives one point throughout the entire post-Bretton Woods period. The fact that this issue was always includable in the right to put items on the agenda granted to shareholders is evident from its inclusion in the official model articles of association that accompany the Companies Act of each period⁶⁹¹.

(iii) With regard to the issue of proxy solicitation costs one point is subtracted from the UK from 1973 until 1984 and half a point from 1985 onwards. This is due to the fact that with the Companies Act 1985 insurgent shareholders were granted the right to request the board to circulate to the shareholders along with the notice of the meeting a statement of 1,000 words setting out the merits of their proposed resolution⁶⁹². While in theory the

⁶⁸⁶ OK 17 januari 2007, JOR 2007, 42 (*Stork*)

⁶⁸⁷ BW 2:8

⁶⁸⁸ There is lately a proposal to allow investors that hold 10% of the stock to request the firm to distribute on their behalf information to shareholders, possibly including proxy materials; Jaron van Bekkum et al., *Corporate Governance in The Netherlands*, 14.3 ELECTRONIC JOURNAL OF COMPARATIVE LAW, (December 2010), 15. Available at <http://www.ejcl.org/143/abs143-17.html>

⁶⁸⁹ Whether the fact that UK corporate law requires a minimum percentage of the voting capital and not of the share capital makes the threshold easier for the shareholders to reach depends on the shareholder structure of the company. If the company has issued non-voting shares then it might be more difficult to exercise this right, as non-voting shares do not count for the 5%, but if the company has issued multiple voting shares then the 5% target will be easier to get.

⁶⁹⁰ Companies Act of 1948, s. 140; Companies Act of 1985, s.376; Companies Act of 2006, s.314(2)

⁶⁹¹ Table A prescribed by Companies Act 1948, art. 93; Companies Table A Regulations 1985, art. 76(b) (including the amendments by SI 2007/2541 and SI 2007/2826).

⁶⁹² Companies Act 1985, s. 367(1)(b) & (5); Companies Act 2006, s. 314(1) & 315(1)

circulation must be done on the insurgent shareholders' own expense, in practice the costs of this circulation should not be large, given that the statements soliciting the proxies –which since 1984 are 'two-way'⁶⁹³ - are being carried with the company-sponsored materials⁶⁹⁴. This is why shareholder activists name British law as the most favorable in the EU for proxy solicitations⁶⁹⁵.

2.1.3.5. United States

US: (i) With regard to the percentage of capital that enables shareholders to put items on the agenda of the shareholders' meeting the US receives one point throughout the entire post-Bretton Woods period. This is because for those shareholder-sponsored issues that are considered according to federal securities regulation includable in the agenda shareholders who have owned 1% or \$2,000 worth of a public company's shares for at least one year may submit a proposal⁶⁹⁶.

(ii) With regard to the permissibility of inclusion of suggestions pertaining to the appointment and dismissal of directors in the agenda of the shareholders' meeting the US receives one point throughout the entire post-Bretton Woods period. Due to the fact that issues related to election to office can be excluded from the proxy packet that the management distributes to shareholders prior to the meeting⁶⁹⁷, technically shareholders of US corporations must follow a more difficult route in order to add this issue in the agenda than the one they follow with regard to other issues. Nevertheless, the issue can still be raised on the shareholders' initiative, so the US deserves a score of one; the costly route that is followed to raise the issue of appointment to the office is controlled in this index under variable (iii) below.

(iii) With regard to proxy solicitation costs half a point is subtracted from the US for the years 1973 to 2003 and 0.25 point from 2004 onwards. The US has a somewhat complicated system governing shareholder proposals. There is a range of shareholder proposals that can be included in the management's proxy packet; for this kind of proposals the costs of proxy solicitation are essentially borne by the firm, as a proxy form requesting shareholders to vote on the proposal must be included in the firm's mailings. There is, however, a range of issues⁶⁹⁸ that are considered excludable from the company's ballot and for which shareholders must finance a proxy battle, in order to have the shareholders' meeting vote on the resolution they suggest⁶⁹⁹. The differentiation in the points of subtraction from 2004 onwards is due to the fact that in that year there was a change in the way SEC interprets some of the excludable issues.

⁶⁹³ Listing Rules 1984, s 5.36; Two-way proxies are forms, which enable shareholders to direct the proxy whether to vote for or against any resolution; two-way proxies are considered to be in favor of shareholders. Now FSA Listing Rules (9.3.6.) require 'three-way' proxies (for, against or abstain)

⁶⁹⁴ PAUL DAVIES, GOWER AND DAVIES – PRINCIPLES OF MODERN COMPANY LAW, 8TH ED. (2008), 447

⁶⁹⁵ European Commission, *supra* note 673, 14

⁶⁹⁶ SEC Rule 14a-8(b)(1) (17 C.F.R. §240.14a-8) promulgated under the Securities and Exchange Act of 1934 (15 U.S.C. §78a, et seq.)

⁶⁹⁷ SEC Rule 14a-8(i)(8)

⁶⁹⁸ SEC Rule 14a-8(i)(1)-(13)

⁶⁹⁹ SEC Rule 14a-7

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That amendment resulted in shareholders thenceforth being able to include in the company-financed proxy packet mandatory bylaw amendment proposals related to certain issues bearing on executive compensation⁷⁰⁰. This development considerably increased US shareholders' say on corporate affairs.

2.2. The right to call an extraordinary meeting

2.2.1. Reasons for inclusion in the index

The threat of calling an extraordinary general meeting ('EGM') is thought of as forcing managers to sit at the same table with activist shareholders and find solutions to the latter's concerns⁷⁰¹. The typology of shareholder activism shows that activists usually begin their actions by employing private engagement strategies; they first write letters to management expressing their dissatisfaction with certain business policies and indicating alternative routes and if management remains unresponsive then they escalate their pressure by using institutional routes⁷⁰². How responsive management will be to the shareholders' letter depends on what are the tools that activists have at their disposal. If shareholders can call an EGM, collect proxies and replace the managers, then the latter know they have to try more to deliver value to the shareholders. As Bob Monks, a pioneer shareholder activist, has noted: 'I fully acknowledge that the US is in a far worse state than the UK [...] the UK market benefits [...] from a clause in the Companies Act, stating that 10 per cent of shareholders can requisition a meeting to dislodge any or all of the directors of a company at any time'⁷⁰³. It is evident then, that the threat of calling an EGM is potent enough to bring the firm's governance closer to the alignment of the interests of management to those of the shareholdership.

In addition to this, the existence of the possibility by shareholders to call an EGM is increasing the firm's vulnerability to hostile takeovers, thus exposing managers to the disciplining device of the market for corporate control. It is not a coincidence that in the US, where Delaware corporate law does not award the right to shareholders to call an EGM but leaves it to the corporate charter to provide for it, standardized legal due diligence reports for target firms require the legal counsel to the potential acquiror to report whether the target grants the EGM right to shareholders or not. If the right exists then the acquiror shortly after the takeover can call a shareholders' meeting and oust incumbent management, thus taking officially control of the corporate affairs. Without the possibility of an EGM the acquiror will have to wait until the next annual meeting to dismiss the incumbent directors –provided there is no

⁷⁰⁰ *Verizon Communication, Inc.*, SEC No-Action Letter, 2004 WL 213377 (Feb 2, 2004)

⁷⁰¹ Marco Becht, *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 REVIEW OF FINANCIAL STUDIES 3093, 3096

⁷⁰² See Carine Girard, *Une Typologie de l'Activisme des Actionnaires Minoritaires en France*, 4 FINANCE CONTRÔLE STRATÉGIE 123

⁷⁰³ *Stock in Trade, Reach*. THE FINANCIAL COMMUNICATIONS QUARTERLY FROM THE LSE EXCHANGE (2005)

staggered board defense- and that considerably reduces its motivation to launch a tender offer for the firm. The more potent the threat of a hostile takeover becomes because of the increased vulnerability that the possibility of calling an EGM causes, the more management will have to focus on pumping the share price up, so it can make it more expensive for potential acquirors to launch a hostile bid. The EGM thus indirectly nudges management to deliver more value to the shareholders.

2.2.2. Variables (iv) and (v): percentage required to call an EGM and the interference of the court in the convocation of an EGM

There are two things that are separately ratable with regard to this right and thus two variables [(iv)-(v)] includable in the index emerge within the scope of this activist right:

(iv) *The percentage of share capital that the shareholder(s) must hold in order to be eligible to call an EGM.* A jurisdiction receives no points, if the required percentage is more than 10% or if no such right exists. A jurisdiction receives 0.5 point if it requires shareholders, who want to call an EGM, to hold a percentage equal to 10% of the share capital. Finally, a jurisdiction receives one point if it allows shareholders holding percentage equal to 5% of the share capital to call an EGM.

(v) *The interference of the court in the convocation of the EGM.* 0.25 point is subtracted from a jurisdiction, if the call of the EGM has to be done after an application to the court on behalf of the shareholders. This is because this extra step reduces the effectiveness of the right, as there might be additional delays. No points are subtracted from jurisdictions, where there is no interference by the court for the calling of the EGM.

2.2.3. Score explanations for variables (iv) and (v)

The ratings in the tables of the Annex for variables (iv) and (v) of the PBWSV have been formed on the basis of the following corporate rules.

2.2.3.1. France

(iv) With regard to the percentage of capital that is required for shareholders to call an EGM France receives half a point until 1993, 0.75 from 1994 until 2000 and one point for the years 2001 onwards. From 1966 onwards French corporate law required a minimum percentage of 10% for shareholders to be able to call an EGM⁷⁰⁴. The restrictive effects of this high threshold were somewhat mitigated in 1994, when shareholders of listed companies collectively holding at least 5% of the voting capital (and less than 5% in large firms) could form an association registered with the Securities Commission and then be able to exercise the right to call an EGM⁷⁰⁵. The fact that an association must be

⁷⁰⁴ Art. 158 Loi no 66-537 du 24 juillet 1966

⁷⁰⁵ Art. 30 Loi no 94-670 du 8 août 1994

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formed and registered first is a formality that prevents us from rating France with an even higher score for this reform. In 2001 with a major reform of corporate law the minimum percentage required to exercise the right to call an EGM was reduced to 5% of the share capital.

(v) With regard to the interference of a court in the convocation of an EGM 0.25 points are subtracted from France for the entire post-Bretton Woods period since French corporate law provides that the convocation of the EGM is issued by a representative appointed by the court on application by the eligible shareholders⁷⁰⁶.

2.2.3.2. Germany

(iv) With regard to the percentage that is required for shareholders to call an EGM Germany receives one point for the entire post-Bretton Woods period, as according to German corporate law 5% of the share capital is required if shareholders want to call an EGM⁷⁰⁷.

(v) With regard to the interference of a court in the convocation of an extraordinary meeting no points are subtracted from Germany for the entire post-Bretton Woods period since under German law a court does not mediate in the calling of an EGM.

2.2.3.3. The Netherlands

(iv) With regard to the percentage that is required for shareholders to call an EGM The Netherlands receives half a point for the entire post-Bretton Woods period, as according to Dutch corporate law a 10% of the share capital is required if shareholders want to call an EGM⁷⁰⁸.

(v) With regard to court interference in the convocation of an EGM no points are subtracted from The Netherlands for the entire post-Bretton Woods period, as according to Dutch corporate law the judge enters the scene and convenes a meeting only if the supervisory or the management board, to which the EGM request was made by the shareholders, have not convened the meeting within six weeks⁷⁰⁹.

2.2.3.4. United Kingdom

(iv) With regard to the percentage that is required for shareholders to call an EGM the UK receives half a point for the entire post-Bretton Woods

⁷⁰⁶ Art. 158(2) Loi no 66-537 du 24 juillet 1966 ; Code de Commerce L.225-103(II)(2)

⁷⁰⁷ §122(1) AktG

⁷⁰⁸ BW 2:110 § 1; There is, however, the opinion that the general principles of reasonableness and fairness that govern the entirety of Dutch corporate law would require under special circumstances the judge, who is asked by the shareholders to issue the convocation of the EGM, to allow shareholders representing even less than 10% to exercise this right. Nevertheless, there doesn't seem to be case law confirming this opinion. See MARIAN KOELEMEEIJER, REDELJKHEID EN BILLJKHEID IN KAPITAALVENNOOTSCHAPPEN: BESCHOUWINGEN ROND AANDEELHOUDERS EN BESTUURDERS IN RECHTSVERGELJKEND PERSPECTIEF (1999), 112

⁷⁰⁹ BW 2:110

period, as according to UK corporate law 10% of the share capital is required if shareholders want to call an EGM⁷¹⁰.

(v) With regard to the interference of a court in the convocation of an extraordinary meeting no points are subtracted from the UK for the entire post-Bretton Woods period since under UK law a court does not mediate in the calling of an EGM.

2.2.3.5. United States

(iv) With regard to the percentage that is required for shareholders to call an EGM the US receives no points for the entire post-Bretton Woods period, as under Delaware corporate law there is no such right.

(v) Given that Delaware law has no provision regarding the calling of an EGM no rating has been given to the US with regard to this variable.

2.3. Right to coordinate with other shareholders

2.3.1. Reasons for inclusion in the index

The exercise of the rights analyzed in Sections 2.1. and 2.2. above depend on the shareholders holding the prescribed percentages of the share or the voting capital. Nevertheless, particularly due to the rise of dispersed ownership in listed corporations of both insider and outsider countries the holdings of single shareholders may be below the 5% or 10% thresholds required by corporate laws to exercise the rights. Thus, shareholders will often have to join forces with other shareholders in order to be able to put items on the agenda, to call an EGM or even to initiate shareholder litigation (*see* below Section 2.4)⁷¹¹.

The first step for a small shareholder to move towards such an alliance is to identify other shareholders and communicate with them⁷¹². Without the availability of mechanisms that will help a shareholder identify her fellow shareholders, so as to be able to coordinate her actions with them and exercise the activist rights, the latter are effectively an empty threat for management. If managers know that shareholders are unable to identify each other and join forces, then they are unlikely to perceive the threat posed by activist rights as credible and thus the latter's potential of nudging them to deliver more shareholder value won't materialize.

Therefore, the provisions of corporate laws that touch upon the right of shareholders to request from the firm a list of other shareholders should be taken under account in the framework of the PBWSV. However, merely tracking the evolution of this type of provision may not be enough to develop an appropriate scoring methodology. The variables that are to emerge from this right cannot ignore the reality of modern equity markets that have moved away from a direct

⁷¹⁰ Companies Act 1948, s. 132(1); Companies Act 1985, s. 368(2); Companies Act 2006, s. 303(3)

⁷¹¹ MATHIAS SIEMS, *CONVERGENCE IN SHAREHOLDER LAW* (2008), 136

⁷¹² Masouros, *supra* note 663, 200

holding system, where the person who is registered as shareholder (in the case of registered shares) or the person who holds the share (in the case of bearer shares) is also the true investor⁷¹³. All the jurisdictions under scrutiny in the index employ an indirect holding system, in which the ultimate beneficial owner of the shares may hold her entitlement in the firm through a security account established with a financial intermediary⁷¹⁴, who appears vis-à-vis the firm as the formal shareholder. Given that the financial intermediary is not the residual risk bearer, it makes a difference whether the legal right granted to a shareholder is to identify the formal shareholder or the beneficial owner of the shares, since only the latter has the economic interest to engage in activism. Consequently, a higher score should be given to jurisdictions that allow the shareholder to pierce through the chain of intermediaries and ‘wake up’ the real beneficiary of the shares and a lower one to jurisdictions that grant shareholders the right to merely inspect the registry of formal shareholders.

In addition to this, it makes a difference whether the quoted shares are registered or bearer shares, as in the latter case identification may be practically impossible and very costly even for the issuer.

Finally, in consistency with the principle of functionality legal forces that act in a counterbalancing way to the right of shareholders to identify each other and coordinate their behavior should be taken under account. Shareholders may be discouraged from joining forces and exercising their activist rights, if there is the risk that their collective behavior will be viewed as ‘concerted action’ under corporate law that will then require them to launch a mandatory bid for the rest of the shares⁷¹⁵. Shareholders may also be discouraged from joining forces and exercising their activist rights, if they have to abide by proxy solicitation rules in order to communicate to each other.

2.3.2. Variables (vi) and (vii): the identification right, ‘acting in concert’ and proxy solicitation rules

In light of the above analysis, there are two things that are separately ratable with regard to this right and thus two variables [(vi)-(vii)] includable in the index emerge within the scope of this right:

(vi) *The scope of the identification right.* A jurisdiction receives no points if there is no right at all for the shareholders to inspect the registry or to be provided with a list of the shareholders; no points are given to jurisdictions, where quoted shares are exclusively bearer shares and to jurisdictions that

⁷¹³ *Id.*, at 196

⁷¹⁴ Jaap Winter, *The European Union’s Involvement in Company Law and Corporate Governance*, in THE EUROPEAN COMPANY LAW ACTION PLAN REVISITED (K. GEENS & K. HOPT, EDS.) (2010), 73

⁷¹⁵ See Takeover Panel, Public Consultation Paper 10/2002, *Shareholder Activism and Acting in Concert*, <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/pcp10.pdf>

require a percentage equal to or greater than 5% for shareholders to be able to inspect the registry. 0.5 point is given to jurisdictions that grant the right to inspect the registry to a single shareholder or to shareholders holding less than 5% of the capital; one point is given to jurisdictions that grant to shareholders both the right to inspect the registry of shareholders and the right to pierce through the chain of intermediaries, so as to identify the beneficial owners of stock.

(vii) *The existence of legal counterbalancing forces to shareholder coordination.* 0.25 is subtracted from jurisdictions that feature a mandatory bid rule for concerted action. 0.25 is subtracted from jurisdictions that require shareholders to abide by the proxy solicitation rules before being able to communicate to each other. As it was mentioned in Section 1.3.2.3, this variable introduces a distinguishing characteristic of the PBWSV; the introduction of the mandatory bid rule is perceived by shareholder protection indexes as a positive development for corporate law in respect to shareholder protection, as indeed it protects the minority from the controlling shareholder's behavior⁷¹⁶. Nevertheless, when we examine the rule from the perspective of the question of how does it influence the incentives of managers, we draw the conclusion that since the rule is able to curb shareholder activism it indirectly relieves management from the pressure of the latter. Thus, in this index it must be coded as a negative development.

2.3.3. Score explanations for variables (vi) and (vii)

The ratings in the tables of the Annex for variables (vi) and (vii) of the PBWSV have been formed on the basis of the following corporate rules.

2.3.3.1. France

(vi) With regard to the right of shareholders to identify fellow shareholders and beneficial owners of stock France receives 0.25 points for the years until 2000, 0.35 for the years 2001 and 2002 and half a point thereafter. This is because French corporate law provides since 1967 that a single shareholder is entitled to obtain a list of the shareholders holding registered shares during the 15 days preceding the general meeting⁷¹⁷, but the reality is that most listed corporations were issuing and still issue bearer shares⁷¹⁸. Therefore, the reality of bearer shares does not allow us to evaluate the right to obtain a list of registered shareholders as potent enough in France compared to other jurisdictions that have only registered shares. The route that shareholders who want to identify bearer shareholders must follow is to exercise their general information right to acquire a list of the shareholders that voted in the last

⁷¹⁶ Giorgos Psaroudakis, *The Mandatory Bid and Company Law in Europe*, 7 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 550, 554

⁷¹⁷ Art. 169, Loi 66-537 du 24 juillet 1966 ; Art. 140 Décret 67-236 du 23 mars 1967 ; Code de Commerce L.225-116

⁷¹⁸ Art. 263, Loi 66-537 ; Code de Commerce L.228-1

general meeting ('**attestation sheet**')⁷¹⁹. Although, this right could allow us to rate French corporate law with 0.5 from the beginning of the post-Bretton Woods period, the attestation sheet cannot always convey adequate information for the bearer shareholders due to two restrictions. Firstly, before 2001 it was very difficult for non-resident bearer shareholders to be able to vote at a general meeting, if the issuer didn't provide in its articles of association for a special identification procedure for so-called 'identifiable bearer securities'⁷²⁰. Thus, fellow shareholders would not be able to identify non-resident bearer shareholders, even after acquiring the last general meeting's attestation sheet. In 2001 though a reform allowed non-resident shareholders holding their shares in intermediated accounts to vote even in the absence of the special identification procedure, so if they were active they would henceforth appear in the attestation sheet⁷²¹. The second restriction that remained until 2003 was that share blocking was mandated; that meant that many bearer shareholders would prefer not to deposit their shares and be able to vote at the meeting, in order to be able to trade their shares during the days immediately preceding the meeting⁷²². Therefore, many (resident or non-resident bearer shareholders) would not appear on the attestation sheet for fellow shareholders to identify them, if coordinated shareholder action was sought. But, in 2003 share blocking ended in France and thus more bearer shareholders would get to appear on the attestation sheet, effectively allowing French shareholders to identify them⁷²³.

(vii) With regard to the legal counterbalancing forces impeding the coordination of shareholder behavior no points are subtracted from France until 1988, but 0.25 is subtracted thereafter as a result of the introduction of the mandatory bid rule in 1989⁷²⁴.

2.3.3.2. *Germany*

(vi) With regard to the right of shareholders to identify fellow shareholders Germany receives no points until 2004 and half a point thereafter. In 2000 Germany introduced a law that removed the right that was previously granted to shareholders to inspect the firm's share registry⁷²⁵. Nevertheless, even during the existence of this right shareholders did not in practice have great potential of identifying fellow shareholders, since the right allowed them to identify registered shareholders⁷²⁶ at a time, when the vast majority of shares

⁷¹⁹ Art. 170, Loi 66-537 ; Code de Commerce L.225-17. See Michel Germain, *Les Droits des Minoritaires (Droit Français des Sociétés)*, 54 REVUE INTERNATIONALE DE DROIT COMPARE 401, 406

⁷²⁰ Association Nationale des Sociétés par Actions, *Proxy Voting Reform in France : A Guide for Non-Resident Shareholders*, Jan. 2003, 22, 25

⁷²¹ Commercial Code L.228-3-2

⁷²² Art. 136 Décret 67-236 du 23 mars 1967

⁷²³ Art. 38 Décret 2002-775 du 3 mai 2002

⁷²⁴ Loi 89-531 due 2 août 1989 ; Code de Commerce L. 233-10(I)

⁷²⁵ Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung (NaStraG) (entered into force on 25 January 2001).

⁷²⁶ Then Akt §67(5)

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issued by listed German firms were bearer shares⁷²⁷. Therefore, in practice shareholders of German firms did not have a formal mechanism to initiate collective shareholder action. Consequently, even before 2000 the score that Germany receives cannot be greater than zero. The increase in Germany's score in 2005 with regard to this variable is not because that year shareholders were granted enhanced inspection rights; it is rather because the German legislator introduced a unique platform, by virtue of which shareholders could let other shareholders know that they have the intent to engage in activist activities⁷²⁸. The law introduced a special section of the electronic version of the Federal Bulletin, in which shareholders may give notice of their intent to file a derivative action, to add an item on the agenda or to call an EGM⁷²⁹.

(vii) With regard to the legal counterbalancing force generated by the mandatory bid rule 0.25 is subtracted from Germany from 2001 to 2003. No points are subtracted for 2004, 0.15 is subtracted in 2005 and no points from 2006 onwards. The mandatory bid rule was introduced into German law in 2001 and in theory it reduced the already minimal chances of shareholders in Germany to coordinate their behavior vis-à-vis management; this is because the wording used in the rule was far-reaching, as not only explicit agreements would fall under its scope and qualify as concerted action, but also voting conduct 'in any other way' (*in sonstiger Weise*)⁷³⁰. Nevertheless, German case law in 2004 indicated that the rule was not to affect shareholder coordination that didn't manifest a certain degree of sustainability and continuity⁷³¹. That meant that isolated efforts of shareholders to put an item on the agenda or to call an EGM did not run the risk of being qualified as concerted action. In 2005 though an isolated coordinating voting conduct, by virtue of which shareholders were able to replace the chairman of the supervisory board was deemed as concerted action⁷³². Although that case concerned a coordinated shareholder behavior that resulted in exerting a substantial influence over the corporate affairs and did not change German law's attitude towards milder types of activism, it may have discouraged shareholder coordination pertaining to more fundamental issues of corporate governance. Eventually though the adjudication, by which the replacement of the chairman of the supervisory was deemed as concerted action, was overruled by the Supreme Court in 2006 that held that coordinated voting on a single item of the agenda does not constitute concerted action⁷³³.

2.3.3.3. The Netherlands

⁷²⁷ In 1999, two years before the enactment of the NaStraG, 85% of the shares issued by German listed firms were still bearer shares.

⁷²⁸ Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts vom 8.7.2005

⁷²⁹ AktG 127

⁷³⁰ §§30(2), 29(2), 35 WpÜG

⁷³¹ OLG Frankfurt am Main, Urt. Vom 25.06.2004, NEUE JURISTISCHE WOCHENSCHRIFT (2004) 3716, 3718; OLG München, Urt. Vom 4.04.2005, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (2005) 1005, 1008

⁷³² OLG München, Urt. Vom 27.04.2005, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (2005) 856

⁷³³ BGH, II ZR 137/05, 18 September 2006

(v) With regard to the right of shareholders to identify fellow shareholders The Netherlands receives no points for the entire post-Bretton Woods period. This is not only because listed shares of Dutch corporations are bearer shares, but also because Dutch corporate law provides for no such right. There is a general information right that shareholders have in connection with the general meeting⁷³⁴, according to which the boards are required to provide at the general meeting information that have been requested even by an individual shareholder. But, that right cannot be exercised outside the general meeting and even the general principles of reasonableness and fairness have not been useful to shareholders that have litigated for the acknowledgment of such right⁷³⁵.

(vii) With regard to the mandatory bid rule no points are subtracted from The Netherlands for the entire post-Bretton Woods period. The rule was introduced into Dutch law in 2007 by virtue of transposition of Directive 2004/25/EC⁷³⁶, but it is commonly interpreted as not covering situations where shareholders simply communicate to each other⁷³⁷. Therefore, it is not *prima facie* a disincentive for shareholders that want to coordinate their behavior.

2.3.3.4. United Kingdom

(vi) With regard to the right of shareholders to identify fellow shareholders the UK receives half a point until 1980 and 1 point thereafter. This is because until an amendment of the Companies Act of 1948 in 1981⁷³⁸ UK corporate law granted to shareholders only the right to inspect the registry and thus learn the name of the formal shareholders, not the beneficial owners⁷³⁹. From 1981 onwards the right was granted to shareholders representing 10% of the capital to request an inquiry into the beneficial ownership of shares⁷⁴⁰.

(vii) With regard to the legal counterbalancing force generated to shareholder activism by the mandatory bid rule no points are subtracted from the UK for the entire post-Bretton Woods period. The mandatory bid rule existed in the City Code on Takeovers and Mergers⁷⁴¹ throughout this period, but it covered the coordinated acquisition of shares rather than the coordinated use of voting rights⁷⁴². The rule wasn't meant to overturn the traditional shareholder-

⁷³⁴ BW 2:217 § 2

⁷³⁵ Levinus Timmerman & Alexander Doorman, *Rights of Minority Shareholders in The Netherlands*, in *RIGHTS OF MINORITY SHAREHOLDERS*, XVIIITH CONGRESS OF THE INTERNATIONAL ACADEMY OF COMPARATIVE LAW (E. PERAKIS, ED.) (2002) 181, no. 46

⁷³⁶ 5:70 Wet op het financieel toezicht (Law on Financial Supervision)

⁷³⁷ See Josephus Jitta, *Openbaar Bod op Effecten*, in *ONDERNEMINGSRECHT EFFECTENRECHT – TEKST & COMMENTAAR* (VIJFDE DRUK) (J.M. VAN DIJK ET AL, EDS.) (2009), 1980

⁷³⁸ The change was effectuated through Companies Act 1981, ss. 75, 76(1)-(4), (12) & 83(8)

⁷³⁹ Companies Act 1948, s. 113(1); Companies Act 1985, s.356; Companies Act 2006, s. 1085

⁷⁴⁰ Companies Act 1985, s. 213 & 214; Companies Act 2006, s. 793 & 803

⁷⁴¹ Rule 9.1.

⁷⁴² See Matthias Casper, *Acting in Concert – Grundlagen eines neuen kapitalmarktrechtlichen Zurechnung*, *ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT* (2003), 1468, 1470

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friendly approach of British corporate governance⁷⁴³ and the Financial Services Authority made sure to make this clear recently⁷⁴⁴.

2.3.3.5. United States

(vi) With regard to the right of identification of fellow shareholders the US receives half a point for the period up to 1985 because of Delaware's right to shareholders to inspect the registry⁷⁴⁵ and 1 point from 1986 onwards because of the combined effect of an SEC Rule that allowed the company to inquire into the beneficial ownership of shares⁷⁴⁶ and of Delaware case law that allowed shareholders to access the results of this inquiry⁷⁴⁷.

(vii) With regard to legal counterbalancing forces to shareholder coordination 0.25 is subtracted from the US until 1991 and no points are subtracted thereafter. This is because of the fact that until 1991 communicating with other shareholders was thought of as proxy solicitation and shareholders thus had to bear the costs. In 1992 after a lengthy regulatory process the SEC decided that communication between shareholders no longer requires them to file proxy materials and abide by the cumbersome proxy rules⁷⁴⁸.

2.4. Shareholder litigation

2.4.1. Reasons for (and scope of) inclusion in the index

The risk that the director runs to be found liable vis-à-vis the corporation by means of a derivative suit or vis-à-vis individual shareholders by means of a direct suit is a disciplining mechanism that prompts the director to observe her duties towards the corporation. Corporate law provisions pertaining to shareholder litigation serve a preventive function⁷⁴⁹ and can be thought of as residual loss-reducing devices. Empirical studies show that the precipitating event for almost all shareholder litigation is a drop in the stock price⁷⁵⁰. It follows, then, that in order to minimize the chances of the filing of a shareholder suit, what management needs to do is simple: pump up the share price. This is

⁷⁴³ See Listing Rules 10.2.2.R(3)m 10.5.1R, 10 Annex 1, which indicate the encouragement for shareholder engagement in corporate governance.

⁷⁴⁴ FSA, Shareholder Engagement and the Current Regulatory Regime, Aug. 2009. Available at: http://www.frc.org.uk/documents/pagemanager/Corporate_Governance/Related_documents/shareholder_engagement_FSA_letter.pdf

⁷⁴⁵ DGCL §220(b)

⁷⁴⁶ SEC Rule 14b-11

⁷⁴⁷ *Shamrock Assocs. v. Texas Am. Energy Corp.*, 517 A.2d 658 (Del. Ch. 1986)

⁷⁴⁸ Final Proxy Rule Amendments, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 85,051, at 83,353 (Oct. 16, 1992); See Norma Sharara & Anne Hoke-Witherspoon, *The Evolution of the 1992 Shareholder Communication Proxy Rules and Their Impact on Corporate Governance*, 49 BUSINESS LAWYER 327

⁷⁴⁹ Susanne Kalss, *Shareholder Suits: Common Problems, Different Solutions and First Steps Towards a Possible Harmonisation by Means of a European Model Code*, 6 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 324, 329

⁷⁵⁰ TOM BAKER & SEAN GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION (2011), 182

translated as delivering value to the shareholders. Thus, the risk of a liability suit is a nudge to managers to think more in shareholder value terms.

Even if managers have hedged against the risk of being held liable as a result of a lawsuit by having bought D&O insurance, the filing of a lawsuit is still unpleasant because it may signal to the market that there are in reality higher agency costs inside the firm. Investors may react by disinvesting from the firm, which will result in a decline of the share price that will harm the equity-based part of executive compensation or expose the firm more to the takeover threat. Thus, it is in the interest of managers to keep the shareholders happy and avoid a liability suit, even if they are insured against liability damages.

In light of the above, the issue of liability suits must be included in the PBWSV. There are two questions that emerge though in this respect: (a) should other forms of shareholder litigation remedies, such as injunction remedies or nullification suits, that do not involve the liability of managers be included in the index?; and (b) should both derivative and direct liability suits be included in the index?

With regard to the first question the answer should be negative with regard to temporary measures and injunction remedies that are regulated by rules resting largely outside corporate law and positive with regard to nullification suits that are creatures of corporate law.

This is not to say that temporary measures and injunction remedies are not important determinants of good corporate governance and do not protect the interests of shareholders. In fact, these remedies apart from being effective monitoring mechanisms can even help reduce residual loss. This is especially true in cases, where the temporary measure sought would result in the suspension of directors with conflicting interests⁷⁵¹ and the appointment of interim directors that will carry out a specific transaction free of conflicts⁷⁵² and won't deprive shareholders of the benefits that would accrue to them by the pursuance of a corporate opportunity. Still though in many jurisdictions the aspects of these types of shareholder litigation are regulated by rules resting outside corporate laws, e.g. in civil procedure. Therefore, their inclusion in the PBWSV would not serve the latter's objective, which is to track the developments in corporate law over the past decades that brought about the Great Reversal in Corporate Governance. Despite the undisputed role that these litigation remedies have played in the proliferation of shareholder value in the corporate affairs their inclusion here would force us to track changes in civil procedure codes and in the case law that relates to the ordering of injunction remedies.

This choice though may expose the index to the criticism that it leaves out temporary and injunction remedies that in certain jurisdictions are found in national corporate law. Indeed for the sake of preserving the comparability of the institutions in the five jurisdictions that are under scrutiny here crucial

⁷⁵¹ BW 2:356(b) (The Netherlands)

⁷⁵² See Bernard Grelon, *Shareholders' Lawsuits Against the Management of a Company and its Shareholders under French Law*, 6 ECFR 205, 209

shareholder value-enhancing mechanisms, unique to one jurisdiction, are left out of the comparison. This is the case for The Netherlands, where since 1971 an idiosyncratic right has been granted by Dutch corporate law to shareholders to initiate a special audit into the corporate affairs: the right of inquiry (*'enquêterecht'*)⁷⁵³. The Dutch right of inquiry, apart from aspiring to cause the production of an investigation report for establishing misconduct⁷⁵⁴, entitles the shareholders to request from the court drastic immediate measures, such as the dismissal of directors and the temporary appointment of others or the suspension of a resolution of the management (e.g. regarding the adoption of takeover defenses)⁷⁵⁵. Therefore, excluding the second prong of the right of inquiry from the analysis here may convey an inaccurate picture of the development of Dutch corporate law in the post-Bretton Woods period, but to preserve the integrity of the comparability effort here we are forced to leave it out of the index.

As far as nullification suits are concerned, there is no doubt that they constitute creatures of corporate law. Therefore, they fall within the scope of the objective of the index at hand. But, at first sight nullification lawsuits may seem to be irrelevant to shareholder value. Nullification lawsuits are supposed to be restorative measures, by which shareholders may correct irregularities in the corporate decision-making process and challenge the validity of resolutions of the shareholders' meeting, when the process has not been in accordance with the law or the articles of association. How can these litigation tools nudge managers to think more in shareholder value terms?

Empirical studies have shown that nullification suits are often used as bargaining tools against the management⁷⁵⁶. Nullification suits allow shareholders to block important transactions that require the approval of the general meeting of shareholders, such as a legal merger⁷⁵⁷. The threat of raising a nullification suit and blocking such a transaction, usually on the basis of the allegation that inadequate information have been furnished to shareholders within the scope of the meeting⁷⁵⁸, can nudge managers to design the transactions in more generous terms for the shareholders. Depending on how potent this threat is in a national corporate legal system the nullification suit can end up being an effective indirect pressure mechanism for managers to unlock shareholder value. Therefore, they deserve a place in the index.

With regard to question (b) above the answer is that derivative suits should be included in the PBWSV, but direct liability suits should not. Direct

⁷⁵³ BW 2:344ff.

⁷⁵⁴ Timmerman & Doorman, *supra* note 735, no. 49

⁷⁵⁵ To be sure, although the scope of the right of inquiry would render from a procedural point of view any request to the court to suspend or avoid a resolution of the board permissible [BW 2:356(a)], from a substantive point of view rulings of the Enterprise Chamber that have suspended decisions of the board, by which takeover defenses were adopted, have in the past been overturned by the Dutch Supreme Court as being contrary to Dutch corporate law; see HR 18 April 2003, NJ 2003, 286 (*RNA*)

⁷⁵⁶ Pierre-Henri Conac et al., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 491, 513

⁷⁵⁷ Art. 7, Directive 78/855/EEC (Third Directive); DGCL §251I

⁷⁵⁸ Erik Vermeulen & Dirk Zetzsche, *The Use and Abuse of Investor Suits – An Inquiry into the Dark Side of Shareholder Activism*, 7 ECFR 1, 27

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liability suits although relevant for corporate governance and very efficient in holding managers accountable –perhaps even more efficient than derivative suits, especially in jurisdictions where class actions are allowed- are not based entirely on provisions of *lato sensu* corporate law. While indeed the direct suit may constitute an alternative way of bringing the issue of breach of directors' fiduciary duties under judicial scrutiny⁷⁵⁹, the manager's wrongdoing and the damage that the suing shareholder has suffered often has to be determined on the basis of securities regulation and the principles of tort law⁷⁶⁰. Additionally, the rules governing the procedure of the direct suit against managers are found in general procedural law and therefore, because of the fact that procedural rules play a crucial role in the effectiveness of the shareholder remedy, the index would end up comparing and tracking the development of procedural law, which rests outside the Second Hypothesis's goals. Therefore, direct liability suits have to be excluded from the PBWSV, but derivative suits and all types of liability remedies, which without being precisely derivative (i.e. without having a shareholder litigating on behalf and for the benefit of the firm) seek payment of damages to the corporation, must be included in it.

2.4.2. Variables (viii) to (xiv): nullification lawsuits, pre-suit special audit, pre-suit screening devices, standing requirements, allocation of costs, standard of review for duty of care and duty of loyalty

In light of the above analysis, there are seven things that are separately ratable with regard to this right and thus seven variables [(viii)-(xiv)] includable in the index emerge within the scope of shareholder litigation:

(viii) *With regard to the issue of nullification lawsuits the one thing that is ratable in national corporate laws is the percentage required to file the suit that seeks the rescission of the resolution of the general meeting.* A jurisdiction receives no points if that percentage is more than 10% or if the right does not exist at all; 0.5 point if the percentage required is 5%; 0.75 points if the percentage is less than 5% and one point if a single shareholder can file a nullification lawsuit.

(ix) *The facilitation of the gathering of the information required for preparing and conducting the liability proceedings.* The collection of evidence in order to substantiate a liability remedy against management is a burdensome task and an especially acute challenge given the information asymmetry that exists between shareholders and the management. The existence of institutions that will facilitate the gathering of evidence is of utmost importance for the decision to file a liability suit. Most jurisdictions have introduced special audit proceedings that precede the liability suit for this very purpose. A jurisdiction is rated here with one point, if it features that institution while its non-existence is

⁷⁵⁹ See in Delaware the seminal cases enforcing fiduciary duties that were brought as direct class actions, *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) and *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)

⁷⁶⁰ See e.g. Grelon, *supra* note 752, 213

rated with no points. An intermediate rating scale is also applicable depending on the percentages or holding values required to initiate the procedure.

(x) *The existence of pre-suit screening devices.* The filing of a derivative suit by shareholders is in many jurisdictions preceded by the observance of certain formalities that are meant to discourage frivolous litigation. Shareholders may have to make a demand on the board first to resolve the dispute or to file the suit; in other cases, the filing of a derivative suit may have to be approved first by the shareholders' meeting. In jurisdictions where there is no derivative suit, the exercise of the legal remedy that seeks the declaration of director's liability and the payment of damages to the corporation rests usually at the discretion of some corporate organ, so that essentially the shareholder right to seek redress to the corporation is reduced to a mere initiative right; shareholders merely stimulate the firm to exert its right against the management⁷⁶¹. The existence of pre-suit screening devices reduces the potency of the threat that a liability suit poses for management. Apart from providing to the wrongdoers the ability to influence litigation decisions at either board or shareholder level, a demand forewarns the defendants on an impending suit for damages and thus allows them the time to take evasive actions. Litigation is delayed as the shareholder waits for the board or the general meeting to respond on her demand and thus creates high opportunity costs for the shareholder, who may decide that it is better to choose the 'exit' path, i.e. sell her stock, rather than the 'voice' one, i.e., insist on litigation. In jurisdictions where the demand is excused on the condition that the shareholder explains before the court why she chose not to make it, then the suit becomes costlier and the shareholder is deterred from filing it eventually. Therefore, all pre-suit screening devices, although teleologically justified, must be evaluated negatively from a shareholder value perspective, as they reduce managers' exposure to litigation risk and thus weaken their incentives to unlock value to the shareholders. In light of the above, a jurisdiction receives no points if it has in place a pre-suit screening device and one point if it hasn't one. Pre-suit screening devices designed in ways that produce milder legal hurdles to litigating shareholders are rated on a scale between zero and one depending on the nature of the hurdle.

(xi) *The standing requirements.* The minimum share stake that a shareholder or a group of shareholders must hold in order to be able to file the suit is of great importance for the potency of the threat of derivative litigation. The smaller the percentage of share capital is, the greater the chances that a shareholder will appear and be ready to hold directors liable. However, reference must be made to the opinion that minimum share stakes are of minor importance, as the financial motivation to file a suit decreases with the percentage that a shareholder holds; a small stake will be entitled only to a very small fraction of the proportionate benefit that bounces back indirectly to the

⁷⁶¹ Dario Latella, *Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive*, 6 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 307, 317

shareholders through payment of damages to the corporation. If we were using a weighted index here, we would assign a smaller weight to this variable, but for reasons explained in Section 1.3.2.3 this is not the methodological option here. Therefore, jurisdictions that require a percentage greater than 10% receive no points; jurisdictions that require a minimum of 10% receive 0.25; jurisdictions that require a minimum of 5% receive 0.5 point; jurisdictions requiring a percentage less than 5% receive 0.75 and jurisdictions granting the right to any individual shareholder or to shareholders holding 1% receive one point. Of course in jurisdictions where the shareholder's power is reduced to the mere initiative to stimulate the board or the shareholders' meeting to decide to file the liability suit against the wrongdoers, there can be no discussion for standing requirements, so these jurisdictions are excluded from rating here.

(xii) *The allocation of costs.* The shareholder who plans to file a derivative suit or to instigate the company to file a liability suit makes a cost-benefit analysis before deciding whether it is in her interest to proceed with these actions. The benefit bouncing back to the shareholders as a result of the compensation that will be paid to the company is only indirect and is proportionate to the shareholder's stake in the company. That means that, unless the shareholder has a really considerable percentage of share holdings in the firm, the benefit side of the cost-benefit equation won't make the difference. Consequently, it is the costs side that has to be minimal, if the shareholder is to ever be financially motivated to take the necessary actions for the liability suit. If the shareholder knows that in case she loses she will have to reimburse the directors' costs, then it is unlikely that the costs side will look appealing. It cannot be emphasized enough how crucial the costs factor is in the issue of shareholder litigation. In fact, it is alleged that the reason why the derivative action has come to play such an important role in the US system of corporate governance is not because of a better design of the institution of the derivative action *per se*, but because of a very favorable system of allocation of the litigation costs⁷⁶². Indeed, much more important than the existence of pre-suit screening devices, than the standing requirements, than the facilitation of information gathering is the way costs are allocated between the litigants in a shareholder suit⁷⁶³. Jurisdictions that have in place the 'loser pays' rule are unlikely to see a large number of derivative or liability suits being filed⁷⁶⁴; this rule introduces a disproportionately high cost risk for the shareholder. Even if running the risk to expose the PBWSV to the US-bias criticism, the more a jurisdiction's system of allocation of litigation costs resembles to the US system, the higher the score it receives on the index should be. In the US it is normally the so-called 'American Rule' that prevails, according to which litigants bear their own litigation costs and the loser is not obliged to indemnify the winner

⁷⁶² See Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 THE JOURNAL OF LAW, ECONOMICS AND ORGANIZATION 55

⁷⁶³ See ARAD REISBERG, *DERIVATIVE ACTIONS & CORPORATE GOVERNANCE* (2003), ch.5 – ch. 7

⁷⁶⁴ Kalss, *supra* note 749, 345; James Cox & Thomas Randall, *Common Challenges Facing Shareholder Suits in Europe and the United States*, 6 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 348, 355

in the end⁷⁶⁵. In derivative litigation though the American Rule is not fully applicable; if the shareholder loses she won't have to pay attorney's fees to the corporation, but if she wins then she won't have to bear her own expenses, but instead the corporation will pay them. All US states follow the 'common fund' theory, pursuant to which the plaintiff's counsel expenses are paid out of the recovery received by the corporation; the underlying *rationale* for this is that the plaintiff and her attorney have produced a benefit to the corporation and they should be reimbursed for their effort. In light of the above, with regard to the costs issue a jurisdiction is to receive no points, if it has in place the 'loser pays' rule and one point if it implements the common fund theory. Intermediate solutions that allow the shareholder in some circumstances not to pay all the costs even if she loses or to get reimbursed if she wins are rated on a scale between zero and one.

(xiii) *The standard of review employed by courts in order to evaluate the fulfillment of the duty of care.* Shareholder litigation may fall short of fulfilling its residual loss-minimizing role, if the standard of review employed by the courts in the *ex post* control of managers' conduct is lenient enough, so as to virtually exclude liability. A standard of review –regardless of whether it is judicially created or based on a statutory rule- may in practice be introducing very narrow criteria that will contribute in only few managerial conducts qualifying as violations of the duty of care. Therefore, the extent to which a national corporate law promotes shareholder value depends on the extent, to which directors are eventually immunized from being held liable for their conduct by the relevant standard of review. In light of the above, a jurisdiction receives on the PBWSV no points if the relative standards or rules essentially exclude liability for breach of the duty of care; 0.5 point if the jurisdiction employs some variation of a gross negligence standard or if it has shaped the business judgment rule or a variation of it in such a way, so that it becomes very difficult for shareholders to rebut the presumption that directors have not breached their duty of care; one point if the jurisdiction employs the business judgment rule or a variation of it in such a way, so that there are little restrictions in holding management liable for the breach of the duty of care⁷⁶⁶. Of course one cannot draw definite lines, as to the scale, into which the standard of review in a jurisdiction should be classified, but even if comparisons between national corporate systems are by their nature unsettled with regard to this variable, the direction of a trend line towards rigor or leniency vis-à-vis the managerial conduct can be safely drawn.

⁷⁶⁵ Cox & Randall, *supra* note 764, 354

⁷⁶⁶ To be sure, while many would object to the fact that the business judgment rule is a liability metric that –even in its mild form- deserves to be evaluated as shareholder value-enhancing and thus receive full points, it seems to be the best shareholders can get in the capitalist system, which has excluded courts from second-guessing management's decisions. 'Capitalism is all about taking risks' the saying goes and corporate legal systems around the world have empowered managers to make and pursue risky business decisions, since it is perceived to be their flexibility and their speed and efficiency that modern commerce demands that ultimately produces corporate wealth; See Leo Strine, *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 Harvard Law Review 1759, 1763.

(xiv) *The existence of a duty of loyalty.* Shareholder value is harmed when managers are slack or incompetent, but it's also harmed when they are active but not in the direction of promoting shareholders' interests. If shareholders cannot hold managers liable for self-dealing or lighter forms of conflict-of-interest transactions, then shareholder value-detrimental asset diversion is likely to occur within the company. Therefore, it is essential for the shareholder value-friendliness of a national corporate legal system to introduce a duty of loyalty for managers. On the PBWSV a jurisdiction receives no points if it has not institutionalized the duty of loyalty and one point if it has done so.

2.4.3. Score explanations for variables (viii) to (xiv)

The ratings in the tables of the Annex for variables (viii) to (xiv) of the PBWSV have been formed on the basis of the following corporate rules.

2.4.3.1. France

(viii) With regard to nullification suits France receives one point for the entire post-Bretton Woods period since according to French corporate law a nullification lawsuit may be brought by a single shareholder⁷⁶⁷.

(ix) With regard to the facilitation of the information gathering for a liability suit France receives 0.25 until 1993, 0.5 from 1994 to 2000 and 0.75 thereafter. French law grants shareholders the possibility to request from a court the appointment of an investigating expert (*'expert de gestion'*), who will investigate the actions of the management board and record her findings in a report. Until 1993 this right was granted to shareholders representing at least 10% of the capital⁷⁶⁸. In 1994 registered shareholder associations representing at least 5% of the capital became eligible to exercise this right⁷⁶⁹, while in 2001 individual shareholders holding this percentage were also allowed to request the appointment of an investigating expert⁷⁷⁰.

(x) With regard to pre-suit screening devices France receives one point for the entire post-Bretton Woods period. This is because French corporate law does not require a demand to be made on the board before filing the derivative suit or previous approval by the shareholders' meeting⁷⁷¹. To be sure, clauses in the articles of association subjecting the filing of a suit conditional on shareholder approval are deemed null by law⁷⁷².

(xi) With regard to the standing requirements France receives one point throughout the entire post-Bretton Woods period. This is because French corporate law grants the right of derivative action to any individual shareholder⁷⁷³.

⁷⁶⁷ Art. 360, Loi no 66-537 ; Code de Commerce, L. 235-1

⁷⁶⁸ Art. 226 Loi no 66-537

⁷⁶⁹ Art. 30, Loi no 94-679

⁷⁷⁰ Art. 113, Loi no 2001-420 du 15 mai 2001 ; Code de Commerce, L. 235-231

⁷⁷¹ Art. 245, Loi no 66-537 ; Code de Commerce, L. 225-252

⁷⁷² Art. 246, Loi no 66-537 ; Code de Commerce, L. 225-253

⁷⁷³ Art. 245, Loi no 66-537 ; Code de Commerce, L. 225-252

(xii) With regard to the costs issue France receives no points for the entire post-Bretton Woods period. According to French law, when exercising the derivative action the shareholder must advance legal costs and expenses, as contingency fees do not exist in France. In addition to this, if the shareholder loses she is burdened with her own fees and even if she wins the suit she is in practice not fully reimbursed by the company⁷⁷⁴.

(xiii) With regard to the standard of review for the breach of the duty of care France receives one point throughout the entire post-Bretton Woods period, as French corporate case law does not seem to have deviated much over the past decades from a standard of review that results in the acknowledgement of liability for directors at least in cases of manifestly absurd conduct⁷⁷⁵. It seems that an implicit business judgment rule of mild form which, as far as the managers' duty of diligence (*dévoir de diligence*) is concerned, grants managers the right to be wrong in their business decisions (*'droit à l'erreur'*)⁷⁷⁶, has always been present in judicial evaluations of managerial conduct in France. It is true that French corporate law has been over the past decades receptive of US-style fiduciary duties in its corporate legal order, but it cannot be alleged that the traditional French legal concept of good faith (*'bonne foi'*) that shaped the French standard of review for the duty of care has undergone such a major transformation after its interpretation was influenced by the US-style business judgment rule⁷⁷⁷, so as to justify a change in France's score with regard to this variable.

(xiv) With regard to the duty of loyalty France receives half a point until 1995 and one point thereafter. During the first period French corporate law entailed provisions relating to the process that must be followed for self-dealing transactions to be valid⁷⁷⁸, but in 1996 the French Supreme Court acknowledged a *devoir de loyauté* for corporate directors, a duty of loyalty that runs to the shareholders⁷⁷⁹ that was later complemented by the acknowledgment of a duty of loyalty that runs to the corporation as such⁷⁸⁰.

2.4.3.2. Germany

(viii) With regard to nullification suits Germany receives one point for the entire post-Bretton Woods period since according to German corporate law a nullification lawsuit may be brought by a single shareholder⁷⁸¹.

(ix) With regard to the facilitation of the information gathering for a liability suit Germany receives 0.5 up to 2004, because shareholders holding at least 10% of the stock or 1mn EUR in value were eligible to file a petition to

⁷⁷⁴ Grelon, *supra* note 776, 212

⁷⁷⁵ YVES GUYON, DROIT DES AFFAIRES (2001), § 459

⁷⁷⁶ See Cass. Com., 2 juillet 1985, *Cointreau c/ Rémy Martin*, D. 1986, 351, note Loussouarn, JCP 1985, II no 20518, note Vlandier, REV. SOC. 1986, 231

⁷⁷⁷ David Freedman, *L'Américanisation du Droit Français par la Vie Economique*, 45 ARCHIVES DE PHILOSOPHIE DU DROIT 207, 209

⁷⁷⁸ Arts. 101ff., Loi no 66-537 ; Code de Commerce L.225-38ff.

⁷⁷⁹ Cass. Com. 27 fév. 1996, *Vilgrain*, JCP, 1996, ii, 22665

⁷⁸⁰ Cass. Com. 24 fév. 1998, *K*, JCP E 1998, no 17 pan. 637

⁷⁸¹ AktG §§ 243(1) & 249

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court to appoint a special auditor and one point from 2005 onwards because with a reform that year this percentage dropped to 1% or 100,000 EUR in value⁷⁸².

(x) With regard to pre-suit screening devices Germany receives one point for the entire post-Bretton Woods period. Before the enactment of a reform in 2005⁷⁸³ German corporate law did not feature a derivative action; the filing of a liability suit required a shareholder approval or an initiative by shareholders holding 10% of the capital to request the court to appoint a special representative to conduct the proceedings⁷⁸⁴. The 2005 reform introduced the derivative action for shareholders requiring no system of prior approval for its filing⁷⁸⁵. Nevertheless, technically even the pre-2005 system did not feature a pre-screening device, when the minority chose to follow the route of requesting the court to appoint a special representative to conduct the liability proceedings. Therefore, with regard to this variable Germany must receive one point for all the years under scrutiny. The indisputable amelioration of the conditions of liability suits that was realized by the introduction of the derivative action in 2005 is controlled in the PBWSV under variable (xi) below.

(xi) With regard to the issue of standing requirements Germany receives 0.25 until 2004 and 1 point thereafter. This is because until 2004 shareholders holding 10% of the capital could request the court to appoint a special representative to conduct liability proceedings⁷⁸⁶, while from 2005 onwards shareholders representing 1% of the share capital or holding shares of 100,000 EUR in value may file a derivative action⁷⁸⁷.

(xii) With regard to the costs issue Germany receives no points until 2004 and 0.75 thereafter. This is because before the 2005 reform, if the company lost in court the liability suit, then the company could recover its expenses from the shareholders who had induced the suit by requesting from the court the appointment of a special representative ('loser pays')⁷⁸⁸. In 2005 two changes were made in favor of suitor shareholders. As far as the shareholder-induced liability suit that is conducted through a special representative is concerned, it is now provided that if the court grants the motion for an appointment of a special representative, then it is the company that will bear the costs of the proceedings in any case⁷⁸⁹. As far as the newly introduced derivative action is concerned, should the application to the court for admission of the derivative action be refused, then the shareholders are liable for the costs of the admission stage of the procedure only⁷⁹⁰. But, there is a cap in these costs⁷⁹¹ and in case that the refusal is based on the interests of the company that the latter has

⁷⁸² AktG §142(2)

⁷⁸³ Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts vom 8.7.2005 („UMAG“)

⁷⁸⁴ AktG §147

⁷⁸⁵ AktG §148

⁷⁸⁶ AktG §147

⁷⁸⁷ AktG §148

⁷⁸⁸ AktG §147(4) [repealed]

⁷⁸⁹ AktG §147(2)

⁷⁹⁰ AktG §148(6)

⁷⁹¹ Gerichtskosten gesetz §53(1)

failed to substantiate in due course, then the company will be liable even for the costs of the admission stage. If the application for admission of the derivative action is accepted by the court, then for the costs of the main proceedings stage the loser will be formally liable⁷⁹²; but, if it is the shareholder, who is the loser, then the company has an obligation to indemnify her not only for the main proceedings stage⁷⁹³, but also for the costs of the admission stage⁷⁹⁴.

(xiii) With regard to the standard of review for the breach of the duty of care Germany receives half a point until 1996 and one point thereafter. Until 1996 it seems that directors' liability played an insignificant role in German court practice⁷⁹⁵. A duty of care ('*Sorgfaltspflicht*')⁷⁹⁶ did exist in statute⁷⁹⁷ even prior to 1997, but was rarely enforced in the post-Bretton Woods years and was not clarified adequately, so as to constitute a potent threat for management. That year the Federal Supreme Court⁷⁹⁸ introduced a variation of the business judgment rule in the German corporate legal order essentially turning an irresponsible conduct on behalf of the directors into a subjective liability element for directors⁷⁹⁹. The judicial standard was in 2005 codified into a statutory rule⁸⁰⁰ creating a safe harbor for the directors along the lines of the function of the US business judgment rule⁸⁰¹.

(xiv) With regard to the duty of loyalty Germany receives one point for the entire post-Bretton Woods period. There are several statutory provisions prohibiting and regulating transactions that fall in the general category of self-dealing⁸⁰², but in addition to this an implicit general duty of loyalty ('*Treuepflicht*') is acknowledged in theory⁸⁰³ and in case law.

2.4.3.3. The Netherlands

(viii) The Netherlands receives one point for the entire post-Bretton Woods period since according to Dutch corporate law a nullification lawsuit

⁷⁹² ZPO §§ 91 & 92

⁷⁹³ AktG §148(6)

⁷⁹⁴ Explanatory Notes of the UMAG, RegE-UMAG, BT-Drucks 15/5092, 23

⁷⁹⁵ Markus Roth, *Outside Director Liability: German Stock Corporation Law in Transatlantic Perspective*, 8 JOURNAL OF CORPORATE LAW STUDIES 337, 341

⁷⁹⁶ Klaus Hopt, *Die Haftung von Vorstand und Aufsichtsrat – Zugleich ein Beitrag zur Corporate Governance-Debatte*, in FESTSCHRIFT FÜR MESTMÄCKER (1996), 909, 917

⁷⁹⁷ AktG § 93(1)

⁷⁹⁸ BGHZ 135, 244, 253ff.: „Die Grenzen, in denen sich ein von Verantwortungsbewusstsein getragenes, ausschließlich am Unternehmenswohl orientiertes, auf sorgfältiger Ermittlung der Entscheidungsgrundlagen beruhendes unternehmerisches Handeln bewegen muss, deutlich überschritten sind, die Bereitschaft unternehmerische Risiken einzugehen, in unverantwortlicher Weise überspannt worden ist oder das Verhalten des Vorstandes aus anderen Gründen als pflichtwidrig gelten muss“.

⁷⁹⁹ Ulrich Ehrlicke, *Verantwortlichkeit des Vorstands und des Aufsichtsrats*, in AKTIENGESETZ: EINLEITUNG. §1-53: Bd. 1 (2004), §48, no. 17

⁸⁰⁰ AktG § 93 I 2

⁸⁰¹ UWE HÜFFER, AKTIENGESETZ, 7. AUFL. (2006), § 93, no. 4c

⁸⁰² AktG §§ 88, 89, 112, 115

⁸⁰³ See Hopt, *supra* note 820, 917; HERBERT WIEDEMANN, ORGANVERANTWORTUNG UND GESELLSCHAFTERKLAGEN IN DER AKTIENGESELLSCHAFT (1990), 12

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may be brought by a single shareholder⁸⁰⁴, as well as by a depositary receipt holder.

(ix) With regard to the facilitation of the information gathering for a liability suit The Netherlands receives one point throughout the entire post-Bretton Woods period because according to Dutch corporate law shareholders holding 10% or 225,000 EUR in value are eligible to file an application for the initiation of inquiry proceedings (*'enquêterecht'*)⁸⁰⁵, within the scope of which an investigator will be appointed, who eventually drafts a report showing whether there has indeed been mismanagement. The mismanagement ruling is not binding upon the court that will later evaluate the issue of liability⁸⁰⁶, but information collected during the inquiry proceedings can be used as evidence in liability proceedings later⁸⁰⁷.

(x) With regard to pre-suit screening devices The Netherlands receives no points for the entire post-Bretton Woods period. Dutch corporate law does not feature a derivative action; it is possible for the company to hold directors liable for mismanagement⁸⁰⁸, but this cannot be done directly on the initiative of the minority. As there are no special provisions regarding any formalities that must be followed in the preparatory phase of liability proceedings, it is accepted that if the shareholders want to nudge the supervisory board to file a liability suit on behalf of the company, they will have to induce the shareholders' meeting approval first⁸⁰⁹.

(xi) With regard to standing requirements The Netherlands remains unrated because Dutch law features neither a derivative suit nor a liability suit that can be instigated by the minority and conducted by a special representative.

(xii) With regard to the costs issue The Netherlands receives 0.75 for the entire post-Bretton Woods period, since the liability suit is an issue instigated by the company itself with a mere indirect involvement of the shareholders. Shareholders do not have to bear any expenses for the suit, but the fact that there are no contingent fees for lawyers in The Netherlands⁸¹⁰ may discourage to some extent the general meeting or the board to proceed with the filing of a liability suit against managers.

(xiii) With regard to the standard of review for the duty of care The Netherlands receives half a point until 1996 and one point thereafter. Before 1997 the standard implemented by courts in liability proceedings was a gross negligence standard⁸¹¹ akin to the standard of review for the liability of an

⁸⁰⁴ BW 2:15 §3(a)

⁸⁰⁵ BW 2:346(b)

⁸⁰⁶ HR 4 April 2003, JOR 2003, 134

⁸⁰⁷ Levinus Timmerman, *Review of Management Decision by the Courts, Seen Partly from a Comparative Legal Perspective*, in THE COMPANIES AND BUSINESS COURT FROM A COMPARATIVE LAW PERSPECTIVE (M. JITTA, ED.) (2004), 51

⁸⁰⁸ BW 2:9

⁸⁰⁹ Timmerman & Doorman, *supra* note 735, 52

⁸¹⁰ Willem Calkoen & Daniella Strik, *The Netherlands*, in DIRECTOR'S LIABILITY: A WORLDWIDE REVIEW (A. LOOS & M. AVILLEZ PEREIRA, EDS.) (2006), 353

⁸¹¹ Van Bekkum, *supra* note 688, 7

employee⁸¹². This was proven to be an almost insurmountable hurdle for plaintiffs to hold the defendant directors liable, as it required them to prove that the defendants were subjectively aware of the reckless nature of their conduct⁸¹³. In 1997 though the Dutch Supreme Court started applying a lighter standard, that of serious personal blame (*ernstig verwijt*)⁸¹⁴, in order to diagnose whether a director is liable for ‘improper performance’ (*onbehoorlijke taakvervulling*)⁸¹⁵, which allows more directorial actions to be held as breaching the duty of care.

(xiv) With regard to the duty of loyalty The Netherlands receives half a point until 2006 and one point for the last year on the index. Dutch corporate law does not contain an explicit duty of loyalty for board members⁸¹⁶. Nevertheless, it was always acknowledged⁸¹⁷ that a duty of loyalty can be inferred both from the general principles of reasonableness and fairness that govern the behavior of all corporate organs⁸¹⁸ and from the provision of the Dutch Civil Code that forms the basis of directors’ liability⁸¹⁹. In addition to this, Amsterdam’s Enterprise Chamber had prior to 2007 systematically upheld certain conflict-of-interest transactions as cases of mismanagement⁸²⁰. In 2007 though the Dutch Supreme Court held the provisions of the Dutch Corporate Governance Code, which increased the responsibility for conflicted transactions, to be mandatory as a matter of law⁸²¹. This constituted an evolution with regard to the responsibilities that flow for Dutch boards from the duty of loyalty, since a soft law vehicle, such as the Corporate Governance Code⁸²², that featured detailed provisions on this issue was rendered mandatory in this respect.

2.4.3.4. United Kingdom

(viii) With regard to the issue of nullification lawsuits the UK receives one point for the entire post-Bretton Woods period since British case law has since the 1950s recognized the right of every shareholder to bring a personal action against the resolution of the general meeting⁸²³.

(ix) With regard to the facilitation of the information gathering for the liability suit the UK receives 0.25 for the entire post-Bretton Woods period. This is due to the fact that 10% of the shareholders of a British firm must request the Secretary of State to appoint an inspector that will investigate the affairs of the

⁸¹² BW 7:658(2)

⁸¹³ See W.H.A.C.M. BOUWENS & R.A.A. DUK, VAN DER GRINTEN – ARBEIDSOVEREENKOMSTENRECHT (2011), 261-265

⁸¹⁴ HR 10 jan. 1997, NJ 97, 360 (*Staleman van de Ven*)

⁸¹⁵ BW 2:9

⁸¹⁶ Van Bakkum, *supra* note 688, 7

⁸¹⁷ A.F.J.A. Leijten, *Tegenstrijdig Belang in het Enquêterecht*, in GESCHRIFTEN VANWEGE DE VERENIGING CORPORATE LITIGATION 2005-2006 (M. HOLTZER ET AL., EDS.) (2006), 130

⁸¹⁸ BW 2:8

⁸¹⁹ BW 2:9

⁸²⁰ See Leijten, *supra* note 817, fn. 41-44

⁸²¹ HR 14 September 2007, JOR 2007, 239 (*Versatel*)

⁸²² Steef Bartman, *De Code-Tabaksblad: een Juridisch Lichtgewicht*, ONDERNEMINGSRECHT 2004-4, 123

⁸²³ *Edwards v. Halliwell* [1950] 2 All E.R. 1064, 1067

company and report on them⁸²⁴. The Secretary of State has the discretion to deny the appointment of an inspector; his refusal is reviewable by a court. Nevertheless, the application must be supported by evidence that there are good reasons for the investigation to take place; this has contributed to the institution having been practically useless over the past 20 years⁸²⁵.

(x) With regard to pre-suit screening devices the UK receives no points until 1979, half a point from 1980 until 2005 and 0.75 thereafter. The common law derivative action deriving from the rule in *Foss v. Harbottle*⁸²⁶ essentially required the court to answer the question of whether the individual shareholder should be allowed to sue derivatively or whether the litigation question should be left to the company itself⁸²⁷. The principle was that the right to vindicate a wrong against the company belongs to the company itself⁸²⁸; it was considered a decision, which the board was qualified to make⁸²⁹ and only when directors were interested in the transaction that would be challenged, the decision-making authority would shift to the shareholders' meeting⁸³⁰. An individual shareholder was able to overcome the collective action problem that shareholder decision-making posed by raising a derivative action only under very restrictive conditions that required her to show that the wrong could not be validly ratified by the majority because it was a fraud on the minority and that those who committed the fraud were in control of the firm⁸³¹. These conditions were not clear and therefore they limited the remedy's reach rendering the derivative action of little significance prior to the reform of the Companies Act in 2006. The only reason why the UK receives half a point from 1980 to 2005 is because shareholders had in cases of corporate wrongdoing recourse to a remedy that was functionally equivalent to the derivative action, which however didn't have the procedural complexity of the latter⁸³². This remedy is the claim for unfair prejudice⁸³³ that allows a shareholder to petition for an order, when the corporate affairs have been conducted in a manner which is unfairly prejudicial to the interests of shareholders in general and may allow the suitor in specific cases to request damages to be paid to the company instead of directly to her. In the 2006 reform of the Companies Act a new statutory derivative claim replaced the common law one⁸³⁴ and the rule in *Foss v. Harbottle* and rendered the pre-

⁸²⁴ s. 164, Companies Act 1948; s. 431 Companies Act 1985 (remaining in force after enactment of Companies Act 2006)

⁸²⁵ DAVIES, *supra* note 694, 635 (fn. 36)

⁸²⁶ (1843), 2 Hare 461

⁸²⁷ Davies, *supra* note 694, 610

⁸²⁸ Arad Reisberg, *Shareholders' Remedies : In Search of Consistency of Principle in English Law*, 16 EUROPEAN BUSINESS LAW REVIEW 1065, 1068 (fn. 18)

⁸²⁹ Brian Cheffins, *Reforming the Derivative Action: The Canadian Experience and British Prospects*, 2 COMPANY FINANCIAL AND INSOLVENCY LAW REVIEW 227, 230

⁸³⁰ *Movitex v. Bulfield* [1988] BCLC 104

⁸³¹ Arad Reisberg, *Theoretical Reflections on Derivative Actions in English Law: The Representative Problem*, 3 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 69, 76

⁸³² Reisberg, *supra* note 828, 1065

⁸³³ Introduced with the Companies Act 1980 (s. 75) and consolidated as s. 459 in the Companies Act 1985; Now Companies Act 2006, s. 994

⁸³⁴ Companies Act 2006, Part 11

suit screening somewhat more lenient, thus giving hope that shareholders would thenceforth go derivatively rather than through the unfair prejudice claim, which couldn't replace entirely the derivative action despite its functional equivalency. After 2006 it is up to the court as a third party to decide whether it is in the best interests of the company for the suit to be brought.

(xi) With regard to standing requirements the UK receives one point for the entire post-Bretton Woods period since the common law derivative action, the unfair prejudice claim and the new statutory derivative action can all be exercised by an individual shareholder.

(xii) With regard to the costs issue the UK receives no points the years 1973 and 1974, 0.25 from 1975 to 2002 and 0.5 thereafter. The first two years of the index there is an absolute application of the 'loser pays' rule. In 1975 a court decision introduced the discretion of the court to order the company to indemnify the suitor in those cases where in the court's view a reasonable independent board would authorize the exercise of the liability suit⁸³⁵ ('*Wallersteiner* principle'). In 2003 the possibility was introduced for a more favorable allocation of litigation costs in the framework of unfair prejudice claims, the functional equivalent of derivative actions in the UK. Until then indemnity for the costs of the shareholder filing the unfair prejudice remedy was not available⁸³⁶, but following a certain court decision the shareholder became entitled to seek a recovery order against the company for the costs it incurred, when the relief sought under the unfair prejudice claim was for the benefit of the company⁸³⁷. With the introduction of the statutory derivative action in 2006 the costs issue did not become more favorable, as it continues to rest under the court's discretion to order the indemnification of the shareholder after it grants leave to continue the suit and thus the cautious position of the *Wallersteiner* principle has not been changed⁸³⁸.

(xiii) With regard to the standard of review for the duty of care the UK receives 0.25 until 1993, half a point from 1994 to 2005 and one point thereafter. During the first period the common law related to the duty of care was based on a very low standard of care shaped in highly subjective terms, as the reference point for the evaluation of whether the duty has been violated or not was the knowledge and experience of the very director, whose behavior was under judicial scrutiny⁸³⁹. In 1994 in the framework of cases dealing with the directorial conduct in insolvent firms, the duty of care was objectified⁸⁴⁰ along the lines of the objective statutory standards set for the tortuous conduct of wrongful trading of the Insolvency Act⁸⁴¹. This objectified approach largely

⁸³⁵ *Wallersteiner v. Moir* (No. 2) [1975] QB 373; CPR r19.9(7) (now CPR r19.9E)

⁸³⁶ *Re a Company* (No. 005136 of 1986) [1987] BCLC 82

⁸³⁷ *Clark v. Cutland* [2003] 2 BCLC 393, 35

⁸³⁸ Arad Reisberg, *Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?*, in RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF D D PRENTICE (J. ARMOUR & J. PAYNE, EDS.) (2009), fn. 245

⁸³⁹ DAVIES, *supra* note 694, 489 (citing *City Equitable Fire Insurance Co. Re.* [1925] Ch. 407, 427)

⁸⁴⁰ *D'Jan of London Ltd, Re* [1994] 1 B.C.L.C. 561

⁸⁴¹ s.214(4)

formed the basis of s. 174 of the Companies Act 2006 that to a certain extent combined the previous subjective approach to the recent objective one, as it sets as the standard of review both the reasonably expected knowledge, skill and experience of directors as a class *and* the personal knowledge, skill and experience of the director, whose conduct is each time under scrutiny. The subjective element allows for the standard of review to become stricter for the director depending on the circumstances of each case⁸⁴².

(xiv) With regard to the duty of loyalty the UK receives 0.75 until 2002 and one point thereafter. Under the British corporate law doctrine the ‘no conflict’ principle, whose analysis embraces all aspects of the duty of loyalty discourse, is sub-divided into three groups of rules: (a) rules related to self-dealing transactions; (b) rules related to the usurpation of a corporate opportunity; (c) rules related to the requirement not to receive benefits from third parties in exchange for the exercise of directorial powers⁸⁴³. With regard to the group of rules pertaining to self-dealing transactions there have not been any significant developments since the collapse of the Bretton Woods agreements; a disclosure of conflicts to the board was always required⁸⁴⁴. With regard to the group of rules pertaining to the prohibition of receipt of benefits from third parties there have also not been any significant developments since the 1970s; the required shareholder authorization of the common law is preserved in s. 180(4)(a) of the Companies Act 2006. There has been though a development in the group of rules related to the usurpation of corporate opportunities, which justifies the higher rating that UK corporate law receives for the duty of loyalty from 2003 onwards. A crucial question connected to the issue of usurpation of a corporate opportunity is how such an opportunity is identified according to the law⁸⁴⁵. Case law until 2003 disqualified directors or officers from diverting to themselves an opportunity, which the company was actively pursuing⁸⁴⁶, on the basis of the thought that the opportunity was considered to be the property of the company⁸⁴⁷. In 2003 with *Bhullar v. Bhullar*⁸⁴⁸ English case law moved closer to the US ‘line of business’ test⁸⁴⁹ and extended the criteria used for identifying a corporate opportunity; if the opportunity falls within the company’s existing business activities, then an opportunity the director comes across is a corporate one, even if no property or information was deployed by the director to obtain

⁸⁴² For the fact that the new statutory rule effects a change in the standard of review for the duty of care and that courts should be cautious in invoking older common law for their guidance henceforth *see* DAVIES, *supra* note 719, 491

⁸⁴³ DAVIES, *supra* note 694, 497

⁸⁴⁴ Since the Companies Act 1929 the rule has always been to disclose conflicted proposed and existing transactions to the board; with regard to existing transactions the obligation was statutory (*see* s. 317 Companies Act 1985), while with regard to proposed transactions the obligation derived from common law. The Companies Act 2006, apart from s. 182 that repeated the statutory disclosure requirement for existing transactions, codified in s. 177 the common law with regard to the disclosure of proposed transactions.

⁸⁴⁵ DAVIES, *supra* note 694, 559-560

⁸⁴⁶ *Canadian Aero Service v. O’Malley*, [1973] 40 D.L.R. (3d) 371, at 382

⁸⁴⁷ *CMS Dolphin Ltd. V. Simonet*, [2001] 2 B.C.L.C. 704, at 733

⁸⁴⁸ [2003] 2 B.C.L.C. 241

⁸⁴⁹ *See Guth v. Loft, Inc.*, 5 A.2d. 503 (Del. 1939)

the opportunity⁸⁵⁰. *Bhullar* is said to leave little room for maneuver for directors of competing companies who have not had their positions approved by the firm⁸⁵¹ and thus justifies the higher rating UK corporate law receives in this respect after the decision was issued.

2.4.3.5. United States

(viii) With regard to the issue of nullification lawsuits the US receives one point for the entire post-Bretton Woods period since Delaware law provides that the Court of Chancery may after the application of any shareholder hear and determine the result of any shareholder's meeting⁸⁵².

(ix) With regard to the facilitation of the information gathering for the liability suit the US receives no points for the entire post-Bretton Woods period. There are no special audit proceedings, nor special representative conducting the proceedings under Delaware law. The usual practice of special litigation committees consisting of independent directors that investigate and prepare a report after a demand is made to the board by shareholders for the filing of a derivative suit is a private ordering development that cannot be coded here. Only the Model Business Corporation Act –which is not taken under account for US's score on the index- features the possibility for the court to appoint an independent panel that will undertake a preliminary investigation and decide whether the shareholders' demand for the initiation of a derivative suit is meritless or not⁸⁵³.

(x) With regard to pre-suit screening devices the US receives no points until 1983 and half a point thereafter. The procedural code of Delaware⁸⁵⁴ assumes the demand requirement without directly stating it⁸⁵⁵. In 1984 the Delaware Supreme Court issued a ruling that indicated what particular facts the shareholder, who wants to proceed with a derivative suit, must allege in her suit in order for the demand on the board to be excused ('*Aronson test*')⁸⁵⁶. The shareholder-plaintiff must create before the court either a reasonable doubt that a majority of current directors are disinterested or a reasonable doubt that the challenged transactions were protected by the business judgment rule. While still the shareholder must surpass a legal hurdle to substantiate the excuse from the demand requirement, the pre-suit screening requirements became after *Aronson* somewhat more favorable to shareholders from a formal point of view.

(xi) With regard to standing requirements the US receives one point for the entire post-Bretton Woods period since Delaware law allows any individual shareholder to bring a derivative suit.

⁸⁵⁰ Davies, *supra* note 694, 566

⁸⁵¹ John Armour, *Corporate Opportunities : If in Doubt, Disclose (But How ?)*, THE CAMBRIDGE LAW JOURNAL (2004) 33, 34

⁸⁵² DGCL §225(b)

⁸⁵³ MBCA §7.44(f)

⁸⁵⁴ Del. Ch. Ct. R. 23.1; Fed. R. Civ. P. 23.1

⁸⁵⁵ ROBERT CLARK, CORPORATE LAW (1986), 640

⁸⁵⁶ *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)

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(xii) With regard to the costs issue the US receives one point for the entire post-Bretton Woods period for employing the common fund theory, as explained above in the general analysis of this variable.

(xiii) With regard to the standard of review for the duty of care the US receives 0.5 until 1984, 0.75 from 1985 to 1992 and one point thereafter. Until 1984 the Delaware judiciary employed a strong form of the business judgment rule that provided shareholders with little leeway to hold managers liable for breaching the duty of care. Then in the framework of the takeover frenzy of the 1980s the Delaware Supreme Court issued the *Smith v. Van Gorkom*⁸⁵⁷ ruling that surprised the corporate bar, as it was the first Delaware case to actually hold directors liable for breach of the duty of care for the making of a business decision⁸⁵⁸. Its impact was such that it led in the following years to a dramatic rise in the level of D&O insurance premia. In 1993 the Delaware Supreme Court exposed directors to liability for the breach of the duty of care even more with its adjudication in *Cede & Co v. Technicolor, Inc.*⁸⁵⁹, another case that arose in a takeover context. In that ruling the court adjudicated that ‘a breach of [...] the duty of care rebuts the presumption that the directors have acted in the best interests of the shareholders and requires the directors to prove that the transaction was entirely fair’.

(xiv) With regard to the duty of loyalty the US receives half a point until 1993 and 0.75 thereafter. Early courts of the 19th century in the US held self-dealing transactions as voidable at the request of the corporation regardless of whether the transaction was fair or not. The collapse of the Bretton Woods arrangements found Delaware courts having long abandoned the rule of voidability and instead upholding self-dealing if disinterested directors approved the transaction⁸⁶⁰. Delaware courts seemed to be treating though the statutory rule that required disinterested directors to approve the conflicted transaction⁸⁶¹ as a safe harbor for directors⁸⁶². Therefore, US’s score on the PBWSV with regard to this variable is 0.5 until 1993, because in 1994 Delaware courts made clear that the disinterested approval does not displace the court’s role to measure the transaction’s entire fairness⁸⁶³. However, since disinterested director approval was decided to merely shift the burden to the plaintiff to prove that the transaction was not entirely fair, the result was not so favorable for plaintiff-shareholders, so as to justify the award of one point to the US with regard to this variable from 1994 onwards.

⁸⁵⁷ 488 A.2d 858 (Del. 1985)

⁸⁵⁸ WILLIAM ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS (2006), 257-258

⁸⁵⁹ 634 A.2d 345 (Del. 1993) (‘Cede I’)

⁸⁶⁰ See *Puma v. Marriott*, 283 A.2d 693 (Del. Ch. 1971)

⁸⁶¹ DGCL §144

⁸⁶² *Marciano v. Nakash*, 535 A.2d 400 (Del. 1987)

⁸⁶³ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134 (Del. Ch. 1994)

2.5. Executive compensation

2.5.1. Reasons for inclusion in the index

There is no issue more closely connected to the problem of agency costs and particularly to that of residual loss than executive compensation⁸⁶⁴. Nevertheless, executive compensation has a Janus face⁸⁶⁵; it can be residual loss-minimizing, if remuneration packages are designed properly, but it also has the potential of increasing residual loss, as shown by corporate scandals (e.g. Enron)⁸⁶⁶, which were attributed to perverse incentives provided to managers by their remuneration packages⁸⁶⁷.

Within the scope of the agency theory it is believed that the alignment of managers' incentives with shareholders' interests can be best achieved by aligning their risk appetite. Managers and shareholders start with different attitudes towards risk; managers make a firm-specific investment, so it is natural that they are more risk averse, while shareholders have a diversified portfolio that allows them to have a more risk neutral approach vis-à-vis the investments undertaken by the firm. So, managers may opt for strategies that yield lower expected returns but less uncertainty, while shareholders would prefer the opposite⁸⁶⁸. In other words, because managers will bear the full cost of a failed strategy, but won't benefit from the strategy's potential upside, they might opt for projects that from the shareholders' viewpoint are suboptimal⁸⁶⁹. But, if managers were to be compensated for that additional risk, which would be preferred by shareholders, then they could undertake the projects that would be more appealing to the latter. This is where equity-based executive compensation kicks in.

Equity-based executive compensation schemes entail some variation of stock options. A stock option is the right granted to the manager to buy stock in the firm in the future at a price, which is usually determined at the time that right is granted⁸⁷⁰. The general idea is that a stock option provides the manager with the opportunity to earn compensation in the future, if she contributes to the share price going up. Obviously, in theory any stock option scheme, regardless of its

⁸⁶⁴ See Lucian Bebchuk & Jesse Fried, *Executive Compensation as an Agency Problem*, 17 JOURNAL OF ECONOMIC PERSPECTIVES 71

⁸⁶⁵ Jan Lieder & Philipp Fischer, *The Say-on-Pay Movement – Evidence From a Comparative Perspective*, 8 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 376, 379

⁸⁶⁶ As one commentator stated 'the revelations of corporate misdeeds at Enron, Global Crossing, and WorldCom confirm[ed] that there is an urgent need to rein in greedy and overmighty chief executives, and to curb rampant abuses of stock options', *WorldCom: Accounting for Change*, ECONOMIST, June 29, 2002, at 13.

⁸⁶⁷ See Jaap Winter, *Corporate Governance Going Astray: Executive Remuneration Built to Fail*, in Festschrift für Klaus Hopt (S. Grundmann et al., eds.) (2010) 1521; Aglietta & Reberlioux, *supra* note 502, 241

⁸⁶⁸ Jeffrey Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, in THEORIES OF CORPORATE GOVERNANCE: THE PHILOSOPHICAL FOUNDATIONS OF CORPORATE GOVERNANCE (T. Clarke, ed.) (2004), 328

⁸⁶⁹ Lucian Bebchuk & Jesse Fried, *Pay Without Performance* (2006), 16

⁸⁷⁰ Michael Sirkin & Lawrence Cagney, *Executive Compensation* (1996), 5-22

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vesting schedule, is well-equipped to minimize the residual loss portion of agency costs⁸⁷¹ and therefore corporate rules that facilitate or prevent stock option-based executive compensation should be taken under account within the scope of the PBWSV.

However, if the index would merely control the degree, to which corporate law facilitates or prevents the issuance and use of stock options, then the Janus face of equity-based executive compensation would be disregarded. The index needs to control the extent, to which a corporate legal system attempts to mitigate the potential residual loss-maximizing effects of variable pay. Executive option plans are by their nature asymmetrical, as they reward success, but fail to punish failure⁸⁷². Therefore, these plans are likely to induce managers to take excessive risks. In addition to this, when remuneration packages are designed inside the boardroom by a board captured by senior management, then the pay schemes are likely to skim wealth from the shareholders directly to management's pockets⁸⁷³. Consequently, the processes that corporate laws around the world follow to ensure that the performance link and the incentive mechanism of variable pay are not damaged must be taken under account here.

In an effort to mitigate the management's influence on the designing of executive compensation and to spur its setting on an arm's length basis, legislators have adopted various regulatory strategies that allow shareholders to control or at least monitor the executive pay-setting process.

The first regulatory strategy is to induce the transparency of executive pay. This is done –particularly with regard to listed companies- through requirements concerning annual disclosure to shareholders. While disclosure requirements do contribute to enhanced shareholder protection, they do not seem to produce direct results for the maximization of shareholder value; the mere reporting of their remuneration packages to the investor community is unlikely to urge managers to set schemes that will allow them to cater more for the share price. Therefore, legal developments with regard to disclosure requirements are not controlled in the framework of the PBWSV.

The second regulatory strategy is the establishment of remuneration committees that are delegated the task of setting executive pay. Listing rules may require the establishment of such committees and corporate governance codes may encourage it under 'comply or explain' structures. These remuneration committees –where applicable- are composed exclusively or predominantly by independent directors, who in corporate governance discourse are viewed as guardians of shareholders' interests. Nevertheless, since legal developments regarding independent directors are controlled below under variable (xvii), the issue of remuneration committees won't be taken under

⁸⁷¹ See Kevin Murphy, *Explaining Executive Compensation: Managerial Power versus the Perceived Cost of Stock Options*, 69 UNIVERSITY OF CHICAGO LAW REVIEW 847

⁸⁷² Guido Ferrarini et al., *Executive Remuneration in the EU: Comparative Law and Practice*, ECGI Working Paper 9/2003, 9. Available at SSRN: <http://ssrn.com/abstract=419120>

⁸⁷³ *Id.*

account within the scope of the variables concerned with executive compensation.

The third regulatory strategy in respect of mitigating the damaging effects of executive compensation packages is the introduction of ‘say on pay’ mechanisms. Under such mechanisms shareholders are called to hold an advisory or binding vote on the firm’s overall remuneration policy. This is a legal development that must be taken under account in the framework of the executive compensation variables of the PBWSV. In theory, this vote is a residual loss-minimizing mechanism, as it helps shareholders ensure that stock option plans won’t be used in an agency costs-maximizing way. This theoretical conclusion is backed by empirical evidence that shows how shareholder activists have embraced these mechanisms. Before the enactment of ‘say on pay’ regulation in the US, in the proxy season of 2006 there were 131 ‘say on pay’ proposals in US public firms, while in the proxy season of 2007 this number doubled to 161 proposals⁸⁷⁴. Therefore, corporate rules related to ‘say on pay’ fulfill both the theoretical and the empirical criteria that were set in Section 1.3.1.3. for the construction of the PBWSV. After all, (quasi-)legislative measures promoting ‘say on pay’ arrangements have stressed the latter’s shareholder value effect⁸⁷⁵.

Nevertheless, it must be stated here that not all authors embrace the shareholder value-enhancing approach to ‘say on pay’ rights. Three hypotheses have been developed in connection with the effect of ‘say on pay’ arrangements on corporate governance: the alignment hypothesis, the interference hypothesis and the neutral effect hypothesis⁸⁷⁶. Empirical evidence does not back clearly one hypothesis over the others. The passage of the Say-on-Pay Bill (H.R. 1257) in the US House of Representatives in 2007 led to positive returns for the firms that had the highest level of abnormal CEO pay⁸⁷⁷. This signals that ‘say on pay’ rights are welcomed by the shareholder community in those cases, where there are suspicions that the executive remuneration package is skimming wealth from shareholders. At the same time, there seems to be a neutral to positive market reaction, when ‘say on pay’ proposals are voted down in firms that would not benefit from them⁸⁷⁸. These results both back the alignment hypothesis at least with regard to advisory ‘say on pay’ arrangements and indicate that it may be indeed justified to price in this group of corporate rules in the PBWSV.

2.5.2. Variables (xv) – (xvi): stock options & ‘say on pay’

⁸⁷⁴ Stephen Deane, *Say on Pay: Results from Overseas*, THE CORPORATE BOARD July/August 2007 11, 11

⁸⁷⁵ See Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies

⁸⁷⁶ See Jie Cai & Ralph Walkling, *Shareholders’ Say on Pay: Does it Create Value?*, JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS (forthcoming). Available at SSRN: <http://ssrn.com/abstract=1030925>

⁸⁷⁷ *Id.*, Table III

⁸⁷⁸ *Id.*, Panel B of Table X

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In light of the above analysis, there are two things that are separately ratable with regard to executive compensation and thus two variables [(xv) and (xvi)] emerge that are includable in the index:

(xv) *The degree, by which a corporate legal system facilitates the issuance and use of stock options as an executive compensation mechanism.* Corporate laws may feature several structures that impede the use of stock options. There may be an outright prohibition of the issuance of ‘naked’ options by a corporation or restrictions as to the share buybacks that will create treasury shares, out of which stock will be issued to managers who will exercise their options. No points are awarded to jurisdictions that prohibit the issuance of ‘naked’ stock options or that prohibit stock buybacks for the purpose of awarding shares to directors and officers; 0.5 to jurisdictions that allow the issuance of stock options, but feature a prohibition to proceed to a share buyback in order to issue stock to members of the board; one point to jurisdictions that allow the issuance of stock options and that allow the issuance of shares to both officers and members of the board (excluding the supervisory board in two-tier systems). To be sure, legal developments in the issue of transparency of executive compensation through stock options, as well as developments in the tax or accounting treatment of stock options are not taken under account here.

(xvi) *The enactment of ‘say on pay’ regulation.* Traditionally, corporate laws especially in continental Europe feature a requirement that the shareholders’ meeting approves the creation of authorized or contingent capital, out of which shares will be distributed to executive option-holders, who are exercising their right. Thus, by means of these rules shareholders have an indirect say on stock option plans and may influence their structuring, but this is not what is meant here by ‘say on pay’ regulation. This variable controls legal developments that have granted shareholders a direct say on executive remuneration packages *per se* and not merely a say on the issuance of new stock that necessarily accompanies such packages. No points are awarded to a jurisdiction that does not feature any requirement or any ‘soft law’ rule for shareholders to vote on executive remuneration; 0.5 is awarded to jurisdictions that allow shareholders to vote on a stock option plan, but leave other aspects of executive compensation to be set by the board; one point is awarded to jurisdictions that allow shareholders to vote on all aspects of executive remuneration, regardless of whether this vote is advisory or binding. The fact that advisory and binding ‘say on pay’ votes are both rated here with one point derives from empirical evidence that shows that even, where ‘say on pay’ votes are advisory, management enters into discussions with shareholders in order to draft a compensation plan that won’t be rejected by the meeting and bring negative publicity to the company⁸⁷⁹.

⁸⁷⁹ Stephen Davis, *Does Say on Pay Work? Lessons on Making CEO Compensation Accountable*, 10, Yale Milstein Center Policy Briefing No. 1 (2007). Available at http://www.shareholderforum.com/op/Library/20070620_Davis-briefing.pdf

2.5.3. Score explanation for variables (xv) – (xvi)

The ratings in the tables of the Annex for variables (xv) to (xvi) of the PBWSV have been formed on the basis of the following corporate rules:

2.5.3.1. France

(xv) With regard to the degree of facilitation of executive compensation through stock options France receives half a point until 1984 and one point thereafter. This is because before 1985 stock options could not be issued to members of the board, but only to officers⁸⁸⁰. A legal reform in 1985⁸⁸¹ allowed the granting of stock options to certain members of the board as well⁸⁸².

(xvi) With regard to ‘say on pay’ arrangements France receives one point throughout the entire post-Bretton Woods period. This is because in France the shareholders’ meeting gets to determine the total amount of directors’ fees allocated to the board with the board then apportioning the fees among its members⁸⁸³ and also because the general meeting authorizes the board to grant stock options to all or certain of the company’s employees, to the chairman of the board of directors, to the managing director, the deputy managing directors or members of the management board⁸⁸⁴.

2.5.3.2. Germany

(xv) With regard to the degree of facilitation of executive compensation through stock options Germany receives no points until 1997 and one point thereafter. This is because before 1998 the issuance of ‘naked’ stock options by a firm was prohibited under German corporate law⁸⁸⁵. Firms were forced either to issue bonds to managers with a warrant granting the right to acquire shares attached to the bonds or to design phantom stock option plans, within the scope of which managers were not granted a real participation in the company, but only a remuneration based on a fictitious participation in the company⁸⁸⁶. Following a reform in 1998⁸⁸⁷ the issuance of ‘naked’ stock options became permissible and German firms were permitted to repurchase shares for the sake of creating a contingent capital, out of which shares would be issued to the

⁸⁸⁰ Arts. 208-1 & 208-8-1, Loi no 66-537 du 24 juillet 1966

⁸⁸¹ Art. 37, Loi no. 85-695 du 11 juillet 1985

⁸⁸² Art. 208-8-1, Loi no 66-537 was reformed accordingly; now Code de Commerce L. 225-185 (in conjunction with L. 225-177)

⁸⁸³ Art. 108 Loi no 66-537 ; Code de Commerce L. 225-45

⁸⁸⁴ Art. 208, Loi no 66-537 ; Code de Commerce L. 225-177

⁸⁸⁵ AktG §113 (pre-1998); see Uwe Hüffer, *Aktienbezugsrechte als Bestandteil der Vergütung von Vorstandsmitgliedern und Mitarbeitern - gesellschaftsrechtliche Analyse*, 161 ZHR 214, 223

⁸⁸⁶ Ingrid Kalisch, *Stock Options: Will the Upcoming Amendment of the German Stock Corporation Act facilitate their introduction by German Stock Corporations?*, INTERNATIONAL COMPANY AND COMMERCIAL LAW REVIEW (1998) 111, 112-113

⁸⁸⁷ Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)

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members of the managing board and to senior executives, who exercise their options⁸⁸⁸.

(xvi) With regard to the 'say on pay' arrangements Germany receives no points until 2001 and 0.25 thereafter. Before the enactment of the Executive Compensation Adequacy Act in 2009 (which remains outside the time scope of the PBWSV) that established an optional advisory shareholder vote on executive compensation⁸⁸⁹, the only requirement relevant to this variable was the recommendation of the German Corporate Governance Code (first version in 2002) for the compensation of supervisory board members to be specified by a resolution of the general meeting⁸⁹⁰. Given that a few years ago it was found that 81.8% of listed German firms comply with this provision, the relevant provision is coded in the PBWSV although it's soft law⁸⁹¹. Management board remuneration became subject to shareholder approval with the aforementioned act in 2009 and before that there does not seem to have been any other requirements concerning the shareholder ratification of remuneration that could be coded in the index⁸⁹².

2.5.3.3. The Netherlands

(xv) With regard to the degree of facilitation of the issuance of stock options to directors and officers The Netherlands receives one point throughout the entire post-Bretton Woods period. Dutch corporate law never impeded the issuance of stock options as part of their remuneration to officers and members of the management board; it is only members of the supervisory board that may not be granted shares or stock options⁸⁹³.

(xvi) With regard to the 'say on pay' arrangements The Netherlands receives no points until 2003 and one point thereafter. In 2004 an amendment was introduced into the Dutch Civil Code that made shareholder vote on a public firm's remuneration policy binding⁸⁹⁴. The remuneration policy for members of the management board is drawn by the remuneration committee of the supervisory board⁸⁹⁵ and then it is submitted to shareholder approval⁸⁹⁶. Although the fixing of individual remuneration packages may be delegated to another corporate organ⁸⁹⁷, usually to the remuneration committee, the shareholders still get to approve the component of the package that relates to the granting of executive stock options⁸⁹⁸.

⁸⁸⁸ AktG §192(2)

⁸⁸⁹ AktG §120(4)

⁸⁹⁰ German Corporate Governance Code (2002), No. 5.4.5

⁸⁹¹ Axel v. Werder & Till Talaulicar, *Kodex Report 2009: Die Akzeptanz der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex*, 62 DER BETRIEB 689, 693

⁸⁹² Commission Staff Working Document, *Report on the Application by Member States of the EU of the Commission Recommendation on directors' remuneration*, SEC(2007) 1022, 11

⁸⁹³ See Van Bekkum, *supra* note 688, 8; Corporate Governance Code (2008), III.7.1

⁸⁹⁴ Wet aanpassing structuuregeling (Stb. 2004, 370)

⁸⁹⁵ Corporate Governance Code (2003 and 2008) III.5

⁸⁹⁶ BW 2:135(1)

⁸⁹⁷ BW 2:135(3)

⁸⁹⁸ BW 2:135(4)

2.5.3.4. United Kingdom

(xv) With regard to the degree of facilitation of the issuance of stock options to directors and officers the UK receives one point throughout the entire post-Bretton Woods. UK corporate law has never posed any significant restrictions to the use of stock options as a remuneration scheme, although in practice their use has proliferated from the late 1980s⁸⁹⁹; developments have taken place with the advent of Corporate Governance Codes at the level of disclosure of equity-based schemes to shareholders, which are however not taken under account in this variable.

(xvi) With regard to 'say on pay' arrangements the UK receives no points until 2001 and one point thereafter. In 2002 the Companies Act 1985⁹⁰⁰ introduced for every listed corporation the requirement of an advisory shareholder vote on an annual directors' remuneration report⁹⁰¹.

2.5.3.5. United States

(xv) With regard to the degree of facilitation of the issuance of stock options to directors and officers the US receives one point throughout the entire post-Bretton Woods. Delaware law since 1967 authorizes explicitly the corporation to remunerate directors and officers through stock options⁹⁰².

(xvi) With regard to 'say on pay' arrangements the US receives 0.25 until 1996, 0.4 in 1997, 0.3 in 1998 to 2002 and 0.5 from 2003 to 2007. In the period between 1973 and 1996 NYSE listing rules mandated shareholder ratification of stock option plans, with the exception of 'broadly based' plans⁹⁰³. Although the term 'broadly based' was not defined, it was understood that plans involving executives and ordinary employees were exempt from shareholder vote⁹⁰⁴. In 1997 the state layer of regulation of corporate governance, Delaware corporate law, encouraged further the ratification of stock option plans by shareholders; in a fiduciary duty case the Delaware Chancery Court ruled that the shareholder ratification of stock option plans shifts the burden to the shareholder challenger to show waste, if the setting of executive compensation is to amount to a breach of fiduciary duty⁹⁰⁵. Despite this transient empowerment of 'say on pay' mechanisms in US public corporations, an amendment in NYSE listing rules in 1998 weakened again shareholder rights in this respect. The broadly based stock option plan, which was exempted from shareholder ratification, was defined by the listing rules as any plan, under

⁸⁹⁹ See Brian Main, *The Rise and Fall of Executive Share Options in Britain*, in EXECUTIVE COMPENSATION AND SHAREHOLDER VALUE: THEORY AND EVIDENCE (J. CARPENTER & D. YERMACK, EDS.) (1999), 83

⁹⁰⁰ Directors' Remuneration Report Regulations 2002, 2002, S.I. 2002/1986

⁹⁰¹ s.420-422, 439, 447, 454(3) Companies Act 2006

⁹⁰² DGCL (1967) s. 122(15)

⁹⁰³ NYSE Listed Company Manual Section 312.03

⁹⁰⁴ Margaret Foran, *Current Issues Concerning Stock Options*, in COUNSELING THE CORPORATE BOARD & AUDIT COMMITTEE IN AN ERA OF CHANGE: SEC DISCLOSURE & THE INTERSECTION OF CORPORATE GOVERNANCE, 336 (PLI Corporate Law & Practice Course Handbook Series No. B0-01EO 2002)

⁹⁰⁵ *Lewis v. Vogelstein*, 669 A.2d 327 (Del. Ch. 1997)

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which at least 20% of the firm's employees are covered⁹⁰⁶. Thus, effectively a 'safe harbor' was created, in which shareholder ratification of stock option plans was legitimately exempted. In 2003 though the NYSE listing rules changed again, this time to the direction of shareholder empowerment. According to the new rules a corporation must gain shareholder approval for *all* equity compensation plans⁹⁰⁷. In 2007 a 'say on pay' bill that would grant shareholders with an advisory vote on executive compensation passed the House of Representatives, but stalled in the Senate. A paradigm 'say on pay' arrangement was entered into force in the US in 2010 with the Dodd-Frank Act that mandated non-binding say-on-pay shareholder votes, but this year falls outside the scope of the PBWSV.

2.6 Independent directors

2.6.1. Reasons for inclusion in the index

The agency theory has at its core the issue of separation of ownership and control (*see* Section 6.3. of Chapter One). Separation of ownership and control means essentially the separation of the decision and risk-bearing functions inside an organization. In the framework of such a structure the decision agents do not bear a major share of the wealth effects of their decisions and thus agency costs increase bringing about a reduction in the value of the residual claims⁹⁰⁸. In order to control agency problems but be able to keep the benefits of specialization that flow from the separation of ownership of control in public corporations, an effective system of decision-process control must be in place. Such a system would effectively mean the separation of decision control, i.e. the ratification and monitoring of decisions, from decision management, i.e. the initiation and implementation of decisions⁹⁰⁹. Under such a system an agent would not get to exercise both management and control rights over the same decisions and thus the agency problem would be mitigated.

In theory, inside a corporation residual claimants delegate internal decision control to the directors. Thus, the separation of decision control and decision management is obtained through the existence of a board of directors that exercises top-level decision control rights, such as hiring, firing and compensating top-level decision managers, as well as monitoring and ratifying important decisions⁹¹⁰. What shareholders ideally expect from board members is to step in when incumbent executive officers prove ineffective and take action.

⁹⁰⁶ NYSE Listed Company Manual Section 312.04(g)

⁹⁰⁷ Order Approving NYSE and NASDAQ Proposed Rule Changes Relating to Equity Compensation Plans, Exchange Act Release No. 48, 108, 68 Fed. Reg. 39, 995 (July 3, 2003); NYSE Listed Company Manual Sections 312.03(a) & 303A.08

⁹⁰⁸ *See* Eugene Fama & Michael Jensen, *Separation of Ownership and Control*, 26 JOURNAL OF LAW AND ECONOMICS 301

⁹⁰⁹ *Id.*, at 304

⁹¹⁰ *Id.*, at 311

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Nevertheless, according to the ‘managerial hegemony theory’ the board of directors is powerless to control executives’ mismanagement because it is effectively controlled by the executive managers⁹¹¹. When the corporate governance debate heated up in the 1980s it became clear that despite the fact that –at least in one-tier board jurisdictions- members of the board were formally elected by the shareholders, the latter’s collective action problem led to them simply voting for whomever was nominated either by the incumbent board that was often chaired by the CEO herself⁹¹² or by the nominating committee, for which the CEO served according to empirical studies as the main source of identifying new candidates⁹¹³. Especially when the nominated and eventually elected directors were themselves insiders, i.e. officers or employees of the firm, then they were clearly inclined to be deferential to senior management’s interests and thus not really helpful in mitigating the effects of the separation of ownership and control⁹¹⁴.

Initially, it was thought that the monitoring function of the board of directors would be restored if more of its members were outside directors, i.e. non-executives. But, quickly it became evident that, although outside, these directors were not independent; they were thus characterized as ‘grey’ directors⁹¹⁵. They were those, who while not employees or managers of the firm, were not independent of incumbent management either because they depended on the CEO for their tenure on the board given the aforementioned nomination process⁹¹⁶ or because they had some other affiliation with the corporation; they were relatives of an officer, did business with the corporation, were members of interlocking directorates etc.

Outside directors that were not independent were just as likely to engage in ‘back scratching’, as inside directors. After all, even if these ‘grey’ directors wanted to discharge their monitoring function over management efficiently, they were constrained in their efforts in boards, whose chairman was the CEO herself and who thus could control the amount of information provided to them and the agenda of the board’s meeting⁹¹⁷.

It was then when the call for independent directors entered into the corporate governance debate. Independent directors would be individuals with no connection to the company other than their seat on the board. They would not

⁹¹¹ Rita Kosnik, *Greenmail: A Study of Board Performance in Corporate Governance*, 32 ADMINISTRATIVE SCIENCE QUARTERLY 163, 166-67; Paul Mallette & Karen Fowler, *The Effects of Board Composition and Stock Ownership on the Adoption of ‘Poison Pills’*, 35 ACADEMY OF MANAGEMENT JOURNAL 1010, 1014

⁹¹² ROBERT CLARK, CORPORATE LAW (1986), 109

⁹¹³ JAY LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA’S CORPORATE BOARDS (1989), 20

⁹¹⁴ Michael Jensen, *The Modern Industrial Revolution, Exit and the Failure of Internal Control System*, 48 JOURNAL OF FINANCE 831, 865

⁹¹⁵ See Michael Weisbach, *Outside Directors and CEO Turnover*, 20 JOURNAL OF FINANCIAL ECONOMICS 431

⁹¹⁶ Ronald Gilson & Reinier Kraakman, *Reinventing the Outside Directors: An Agenda for Institutional Investors*, 43 STANFORD LAW REVIEW 863, 875

⁹¹⁷ Jensen, *supra* note 914, 864

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be employees of the company, family members of managers or major shareholders and ideally they would not be connected in any way to the firm's bank, suppliers, law firm or be part of a network of interlocking directorates⁹¹⁸. Independence would mean freedom from conflicts of interests with other entities and autonomy vis-à-vis the management⁹¹⁹. Independent directors would ideally be managers of other corporations or important decision agents in other complex organizations and given that they would care about their reputation when accepting directorships in other companies, they would have the necessary incentives to monitor effectively and produce value for the company⁹²⁰.

The call for independence though was not restricted to one-tier board jurisdictions that seem to have the most acute problems with inside directors. Two-tier board jurisdictions (e.g. Germany, The Netherlands) seemed to secure independence of the monitoring function by having all executive directors in one board, the management board, and all non-executive directors in another board, the supervisory board. The roles of chairman and CEO were thus separated⁹²¹, since the CEO sat on the management board that was supervised by the supervisory board. The decision control responsibilities were delegated to the supervisory board and the decision management to the management board and thus commentators from one-tier jurisdictions traditionally perceived that the supervisory board could take an entirely independent view of the reactions of management⁹²². Nevertheless, empirical studies conducted in two-tier board jurisdictions had shown already from the early 1990s that the perceived trait of independence within two-tier directorship should be put in question⁹²³. Supervisory board responsibilities were found to often interfere with decision management, so that the decision control and decision management functions coincided in the same organ, audit and remuneration committees assisting the board in discharging its functions often consisted of members of both the management and the supervisory board, while frequently it was former members of the management board that were appointed at the supervisory board⁹²⁴. It was natural then, that the new 'holy grail' for shareholders, i.e. independent directorship, concerned shareholders of both one-tier and two-tier board jurisdictions.

Independent directors are thought of as minimizing the residual loss that is produced by the non-sufficient separation of decision management and decision control in public corporations. Thus, they are viewed as guardians of shareholders' interests. Empirical studies have indeed shown a link between the

⁹¹⁸ ROBERT MONKS & NELL MINOW, *CORPORATE GOVERNANCE* (2004), 227

⁹¹⁹ Myles Mace, *Directors: Myth and Reality*, in *THEORIES OF CORPORATE GOVERNANCE – THE PHILOSOPHICAL FOUNDATIONS OF CORPORATE GOVERNANCE* (T. CLARKE, ED.) (2004), 312

⁹²⁰ Fama & Jensen, *supra* note 908, 315

⁹²¹ See Ada Demb & Franz-Friedrich Neubauer, *The Corporate Board, Confronting the Paradoxes*, 25 *LONG RANGE PLANNING* 9

⁹²² See ADRIAN CADBURY, *THE COMPANY CHAIRMAN* (1995), 66

⁹²³ Gregory Maassen & Frans van den Bosch, *On the Supposed Independence of Two-tier Boards: Formal Structure and Reality in The Netherlands*, 7 *CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW* 31, 35ff.

⁹²⁴ *Id.*

presence of independent directors on the board and shareholder value. For instance, the shareholder wealth effect of a tender offer is found to be greater, when at least half of the board is independent compared to when less than half of the board is independent⁹²⁵. The fact that the shareholder community views independent directors as beneficial for their interests is also signaled by the fact that in the event of a sudden death of an independent director the share price drops⁹²⁶, but also by the fact that the adoption of takeover defenses by firms that have independent boards is welcomed by the markets with a rise in the share price rather than with a drop⁹²⁷. Consequently, it seems that corporate law's arrangements with regard to independent directorship deserve a place in the PBWSV as residual loss-minimizing.

2.6.2. Variable (xvii): independent board members

In light of the above analysis, there is one thing that is ratable with regard to the institution of independent directors and thus only one variable (xvii) emerges that is includable in the index:

(xvii) *The degree of board independence.* Jurisdictions that have no requirement for independent seats on the board or that require less than 1/3 of the board to be independent receive no points on the PBWSV. Jurisdictions that require at least 1/3 of directors sitting on the board to be independent receive half a point on the index. Jurisdictions requiring half of the board seats to be held by independent directors receive one point⁹²⁸. To be sure, in two-tier board jurisdictions the independence requirement concerns the supervisory board.

2.6.3. Score explanations for variable (xvii)

The ratings in the tables of the Annex for variable (xvii) of the PBWSV have been formed on the basis of the following corporate rules.

2.6.3.1. France

(xvii) With regard to the degree of board independence France receives no points until 1998, half a point from 1999 to 2002 and 0.75 thereafter. In 1999 a set of recommendations for the corporate governance of French firms, the 'rapport Viénot' (a predecessor of the French Corporate Governance Principles),

⁹²⁵ See James Cotter et al., *Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?*, 43 JOURNAL OF FINANCIAL ECONOMICS 195; John Byrd & Kent Hickman, *Do Outside Directors Monitor Managers? Evidence from Tender Offer Bids*, 32 JOURNAL OF FINANCIAL ECONOMICS 195, 207

⁹²⁶ See Bang Dang Nguyen & Kasper Meisner Nielsen, *The Value of Independent Directors: Evidence from Sudden Deaths*, 98 JOURNAL OF FINANCIAL ECONOMICS 550

⁹²⁷ James Brickley et al., *Outside Directors and the Adoption of Poison Pills*, 35 JOURNAL OF FINANCIAL ECONOMICS 371, 387

⁹²⁸ Nevertheless, it should be mentioned here that there are studies that could not find evidence that firms with a majority of independent board members perform better than other companies; Sanjai Bhagat & Bernard Black, *Independent Directors*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW (P. NEWMAN, ED.) (1998), 283. Accession to this view could lead some to reduce variable (xvii) to binary coding (0 and 1).

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appeared on the French corporate governance scene and recommended that independent directors occupy at least 1/3 of the seats on the board⁹²⁹. Data show that despite their non-mandatory character these recommendations were followed by the vast majority of French firms⁹³⁰. Then in 2003, drawing largely on the rapport Viénot, the French Corporate Governance Principles⁹³¹ were introduced into the French corporate legal system and required on a 'comply or explain' basis French corporations to have a significant number of independent directors on the board⁹³²; for firms with dispersed ownership the recommendation is to have at least half of the board composed by independent directors and for other firms at least 1/3 of the board independent⁹³³. France is awarded less than one point for the post-2003 period despite the ½ independent requirement for dispersed ownership firms, because reports have shown that in practice less than half of the board of the CAC 40 firms is actually independent⁹³⁴.

2.6.3.2. Germany

(xvii) With regard to the degree of board independence Germany receives no points until 2001, 0.25 for the years 2002 to 2004 and 0.4 thereafter. The German Corporate Governance Code that was introduced in 2002 recommended that no more than two members of the supervisory board be former members of the management board⁹³⁵. This is not a pure independence requirement, but, as it was explained above under 2.6.1., the main problem with regard to the independence of supervisory board members in two-tier board jurisdictions was their previous service on the firm's management board. Therefore, this constitutes a move towards independence in the case of Germany and should not be ignored within the scope of the PBWSV. The 2005 version of the German Corporate Governance Code in response to the European Commission's recommendation on the role of supervisory directors⁹³⁶ defined independent directorship, as the non-existence of business or personal relations with the company or the management board on behalf of the supervisory director⁹³⁷. At the same time the requirement regarding the number of independent seats on the supervisory board was improved by the Code that recommended that 'an adequate number' of the directors must be

⁹²⁹ Association Française des Entreprises Privées ('AFEP') & Mouvement des Entreprises de France ('MEDEF'), *Rapport du Comité sur le Gouvernement d'Entreprise preside par M. Marc Vienot* (Juillet 1999), no. 23

⁹³⁰ ROBERT MONKS & NEL MINOW, *CORPORATE GOVERNANCE* (2001), 292

⁹³¹ *Principes de gouvernement d'entreprise résultant de la consolidation des rapports conjoints de l'AFEP et du MEDEF*.

⁹³² *Id.*, no 8.2.

⁹³³ *Ibid.*

⁹³⁴ Michel Storck, *Corporate Governance à la Française – Current Trends*, 1 ECFR 36, 47

⁹³⁵ German Corporate Governance Code (2002), No. 5.4.2

⁹³⁶ See Arts. 4 & 13.1 of the Recommendation 2005/162/EC of the European Commission on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

⁹³⁷ German Corporate Governance Code (2005), No. 5.4.2

independent⁹³⁸. Given that evidence shows that the overwhelming majority of German listed firms complies with this recommendation⁹³⁹, Germany could be rated with 0.4 for this quasi-legal development. A higher score for that development cannot be awarded to Germany for two reasons: (a) there is no clear requirement for 1/3 of the supervisory board to be independent; and (b) given the appointment of half of the supervisory board by the employees (*Mitbestimmung*)⁹⁴⁰, which renders half of the members of the supervisory board by definition non-independent, it is doubtful whether the mere requirement for ‘an adequate number’ of independent directors is enough to eventually result in 1/3 of the seats of the entire supervisory board being independent.

2.6.3.3. *The Netherlands*

(xvii) With regard to the degree of board independence The Netherlands receives no points until 2003 and one point thereafter. This is because in 2004 the Tabaksblat Code for listed companies was entered into force requiring all but one members of the supervisory board to be independent⁹⁴¹. Given that non-compliance with the Code may constitute mismanagement under Dutch corporate law the real force of this quasi-legal text is more than what the ‘comply or explain’ approach it adopts appears *prima facie* to generate. Therefore, this is a development that should be taken under account within the scope of the PBWSV.

2.6.3.4. *United Kingdom*

(xvii) With regard to the degree of board independence the UK receives no points until 1992, half a point from 1993 to 2002 and one point thereafter. In December 1992 the Code of Best Practice of the Committee on the Financial Aspects of Corporate Governance (‘**Cadbury Committee**’) was published and recommended that a majority of the firm’s non-executive directors be independent⁹⁴². The recommendations of the Code were voluntary, as firms were only obliged to issue a statement of compliance with it, but widespread compliance has been reported⁹⁴³. The Cadbury Code was followed by the Greenbury Code of Best Practice of 1995 and by the Hampel Combined Code of Best Practice of 1998 that was amended in 2003 to include an improvement of the regime of independent directorship. The new version of the Combined Code recommended that at least half of the board members be independent⁹⁴⁴.

2.6.3.5. *United States*

⁹³⁸ *Id.*

⁹³⁹ v. Werder & Talaulicar, *supra* note 891, 693

⁹⁴⁰ See *infra* text surrounding footnotes 75ff.

⁹⁴¹ Tabaksblat Code (2003), III.2.1 & III.2.2

⁹⁴² Cadbury Code of Best Practice, s. 2.2

⁹⁴³ See Elisabeth Dedman, *The Cadbury Committee Recommendations on Corporate Governance – A Review of Compliance and Performance Impacts*, 4 INTERNATIONAL JOURNAL OF MANAGEMENT REVIEW 335, 340

⁹⁴⁴ Combined Code 2003, A.3.2.

(xvii) With regard to the degree of board independence the US receives 0.25 until 2002 and one point thereafter. The issue of independent directorship is regulated in the US through the listing rules. The NYSE listing rules required since 1966 at least two of the directors to be independent⁹⁴⁵ and from 2003 onwards at least half of the board to be independent⁹⁴⁶.

2.7. Takeover Regulation

2.7.1. Reasons for inclusion in the index

A tender offer provides the shareholders of a corporation with the opportunity to sell their share at a premium over the market price. The management of the offeree firm though may oppose the offer and take measures to impede it either because it perceives the premium offered to the shareholders to be insufficient or because other stakeholders of the firm would be harmed by the acquisition⁹⁴⁷.

In paradigm agency theory those defensive tactics that managers adopt in the face of an impending hostile bid (**'takeover defenses'**) are considered to have negative wealth effects for the shareholders. Not only because they deprive shareholders from the premium of the tender offer, but also because they shield the management from the disciplinary effects of the market of corporate control. If the board of the target knows that it has the legal power to adopt a takeover defense, when a tender offer for the target's shares is unleashed, then the directors do not have to worry about keeping the share price high enough, so that a 'natural' barrier exists around their firm against potential acquirors.

Therefore, on the basis of what has been called the 'entrenchment hypothesis' takeover defenses are deemed to be destructive for shareholder value. Incumbent management is dominated by an entrenchment motive that dictates that any hostile bid must be defeated for the sake of perseverance of its position in the company. The entrenchment hypothesis suggests further that in the presence of a takeover defense targets experience less positive share revaluations from defeated bids. This assumption is backed by empirical studies that show that after a bid is defeated target firm shares trade at an average discount of 18% to the last takeover bid price⁹⁴⁸. Furthermore, empirical evidence backs the spirit of the entrenchment hypothesis by showing that both in

⁹⁴⁵ NYSE Listed Company Manual B-23

⁹⁴⁶ NYSE Listed Company Manual Section 303.A.01 [SEC Order Approving Proposed Rule Changes, 68 Fed. Reg. 64154, (Nov. 12, 2003)]

⁹⁴⁷ Frank Easterbrook & Daniel Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARVARD LAW REVIEW 1161, 1161

⁹⁴⁸ See Frank Easterbrook & Gregg Jarrell, *Do Targets Gain From Defeating Tender Offers?*, 99 NEW YORK UNIVERSITY LAW REVIEW 277; Richard Ruback, *Do Target Shareholders Loose in Unsuccessful Control Contests?*, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES (A. AUERBACH, ED.) (1988), 137; James Cotter & Marc Zenne, *How Managerial Wealth Affects the Tender Offer Process*, 35 JOURNAL OF FINANCIAL ECONOMICS 63; Michael Ryngaert & Ralph Scholten, *Have Changing Takeover Defense Rules and Strategies Entrenched Management and Damaged Shareholders? The Case of Defeated Takeover Bids*, 16 JOURNAL OF CORPORATE FINANCE 18

the US and in Europe the mere post-bid adoption of takeover defenses drives the share price down without the bid having to be defeated first; for instance, in the US announcements of poison pills have been found to be associated with stock price declines⁹⁴⁹, while in The Netherlands shares decline in value after a firm has issued preference shares to friendly investors (a common Dutch takeover defense) in response to a tender offer⁹⁵⁰. There is indeed an abundance of event studies documenting the negative valuation effect around the announcements of adoption of takeover defenses⁹⁵¹, but also of long-term studies that indicate the negative link between antitakeover indices that count the number of antitakeover provisions a firm has in place and measures of corporate performance, such as Tobin's Q⁹⁵². Finally, the disciplining effect of the market of corporate control, which takeover defenses prevent to unfold, is also indirectly backed by empirical studies that have found that targets of takeovers, where management departed following the takeover, were firms that were performing worse than their industry average⁹⁵³; that shows that it is the worst performing managers that will have an interest in shielding their firm against a hostile bid.

On the basis of the entrenchment hypothesis the so-called 'passivity thesis' has emerged in normative discussions on takeover defenses. The passivity thesis advocates that in the face a tender offer for the firm's shares, the board of the target must remain passive and not take any measures that would impede the bid. In legal terms that would be translated as support for the prohibition of the adoption of takeover defenses by the board in the post-bid phase: the board neutrality rule.

While empirical findings on the impact of post-bid takeover defenses on shareholder wealth are overwhelming, it must be noted here that whether takeover defenses are harmful to shareholders has been a subject of controversy. There is a competing view, the 'bargaining hypothesis', which views the board as a well-positioned bargaining agent that, if equipped with antitakeover provisions, can negotiate with bidders and induce better bids at the end of the day⁹⁵⁴. The bargaining hypothesis in essence views takeover defenses as beneficial for shareholder value, because their existence may result in the target shares being acquired either by the initial bidder or by another acquiror at a

⁹⁴⁹ See Michael Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 JOURNAL OF FINANCIAL ECONOMICS 377

⁹⁵⁰ See Rezaul Kabir et al., *Takeover Defenses, Ownership Structure and Stock Returns in The Netherlands: An Empirical Analysis*, 18 STRATEGIC MANAGEMENT JOURNAL 97

⁹⁵¹ See Gregg Jarrell & Annette Poulsen, *Shark Repellents and Stock Prices: The Impact of Antitakeover Charter Amendments Since 1980*, 19 JOURNAL OF FINANCIAL ECONOMICS 127; Paul Malatesta & Ralph Walkling, *Poison Pill Securities, Stockholder Wealth, Profitability, and Ownership Structure*, 20 JOURNAL OF FINANCIAL ECONOMICS 347; Sanjai Bhagat & Richard Jefferis, *Voting Power in the Proxy Process: The Case of Antitakeover Charter Amendments*, 30 JOURNAL OF FINANCIAL ECONOMICS 193

⁹⁵² See Gompers et al., *supra* note 654; Lucian Bebchuk et al., *What Matters in Corporate Governance*, 22 REVIEW OF FINANCIAL STUDIES 783

⁹⁵³ See Kenneth Martin & John McConnell, *Corporate Performance, Corporate Takeovers and Management Turnover*, 40 JOURNAL OF FINANCE 671

⁹⁵⁴ See Jonathan Macey et al., *Property Rights to Assets and Resistance to Tender Offers*, 17 VIRGINIA LAW REVIEW 705

price above that of the initial bid⁹⁵⁵. The bargaining hypothesis's supporters oppose the findings of empirical studies that back the entrenchment hypothesis and the concomitant passivity thesis by putting forward methodology concerns about the latter⁹⁵⁶ and by indicating endogeneity issues⁹⁵⁷, but also by offering empirical findings that show that antitakeover provisions are not universally harmful for shareholders⁹⁵⁸ or that they actually increase the portion of total gains received by target shareholders⁹⁵⁹. The supposed negative effect of takeover defenses on the disciplining role of the market of corporate control is also disputed by empirical studies that find little evidence that targets with poison pills are less likely to be acquired⁹⁶⁰.

On the basis of the bargaining hypothesis the so-called 'activist thesis' has emerged in normative discussions on takeover defenses. The activist thesis advocates that in the face of a tender offer for the firm's shares, the board of the target must not remain passive, but ought to be able to take measures to impede the bid, as long as this can strengthen the bargaining position of the target and induce a better bid for shareholders. In legal terms that would be translated as a rejection of the board neutrality rule. The activist thesis is of course supported not only by those who view takeover defenses as eventually improving shareholder wealth, but also by those that accede to a more stakeholderist stance vis-à-vis takeovers and want the board to be able to fend off against hostile bids that would result in damage to other stakeholders' interests, particularly to those of the employees of the target.

Despite the controversy that prevails, the empirical findings documenting the negative shareholder wealth effects of post-bid takeover defenses seem to be more convincing. When management is allowed to adopt takeover defenses following the announcement of a tender offer for the firm's stock, then it has been documented that in many cases the defensive measures were actually used to extract better personal deals for the managers at the expense of higher takeover premiums⁹⁶¹. This conclusion is further reinforced from the fact that within the scope of the most recent official normative discussion on the issue, i.e. the one that took place during the preparatory phase of the EU Takeover Directive, the entrenchment hypothesis and the concomitant passivity thesis were the ones that prevailed⁹⁶². The compromise that was

⁹⁵⁵ See Jensen & Smith, *supra* note 501, 107

⁹⁵⁶ See John Core et al., *Does Weak Governance Cause Weak Stock Returns? An Examination of Firm Operating Performance and Analysts' Expectations*, 61 JOURNAL OF FINANCE 655

⁹⁵⁷ See Kenneth Lehn et al., *Governance Indexes and Valuation: Which Causes Which?*, 13 JOURNAL OF CORPORATE FINANCE 907

⁹⁵⁸ See Miroslava Straska & Gregory Waller, *Do Antitakeover Provisions Harm Shareholders*, 16 JOURNAL OF CORPORATE FINANCE 487

⁹⁵⁹ See M. Sinan Goktan & Robert Kieschnick, *Wealth Effects of Antitakeover Provisions in Mergers*, (2009). Available at http://69.175.2.130/~finman/Reno/Papers/wealth_effects_ATPs_FMA_version.pdf

⁹⁶⁰ See Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrents and Wealth Effects on Modern Antitakeover Measures*, 39 JOURNAL OF FINANCIAL ECONOMICS 39

⁹⁶¹ See Jay Hartzell et al., *What's In It for Me: CEOs Whose Firms Are Acquired*, 17 REVIEW OF FINANCIAL STUDIES 379

⁹⁶² See The High Level Group of Company Law Experts on Issues Relating to Takeover Bids (2002), at 21: 'management are faced with a significant conflict of interest if a takeover bid is made [...] their

reached by Member-States with regard to the voluntary nature of the board neutrality rule was not the result of an accession to the bargaining hypothesis, but a result of the prevalence of stakeholderist views vis-à-vis takeovers; *a contrario* that indicates that indeed the board neutrality rule was viewed upon as shareholder value-enhancing.

Consequently, it seems that the identification by this study of the board neutrality rule as a residual-loss minimizing arrangement that deserves to be included in the PBWSV won't be disputed by many. To be sure, the analysis here takes a position only with regard to *post*-bid takeover defenses and avoids inclusion in the index of legal arrangements related to *pre*-bid takeover defenses -which usually take the form of deviations from the one-share/one-vote principle- as their effects on shareholder value are not clear enough⁹⁶³.

2.7.2. Variable (xviii): the board neutrality rule

In light of the above analysis, there is one thing that is ratable with regard to takeover regulation and thus only one variable (xviii) emerges that is includable in the index:

(xviii) *The existence of the board neutrality rule.* A jurisdiction receives no points if it leaves the adoption of post-bid takeover defenses at the discretion of the board of directors. A jurisdiction receives half a point if there is no strict board neutrality rule, but there are certain exceptions in the defensive measures a board can take in the post-bid phase. A jurisdiction receives one point if it mandates the board to remain passive and not adopt takeover defenses after a tender offer for the firm's shares has been submitted.

2.7.3. Score explanations for variable (xviii)

The ratings in the tables of the Annex for variable (xviii) of the PBWSV have been formed on the basis of the following corporate rules.

2.7.3.1. France

(xviii) France receives 0.25 until 1988, half a point from 1989 to 2005 and one point thereafter. For the period until 1988 it is stated that there was in place a limited duty of neutrality on behalf of the board⁹⁶⁴. This is because any measures adopted by the target's board that were beyond the ordinary conduct of business and were not specifically authorized by the shareholders' meeting had to be notified to the exchange authority⁹⁶⁵ without the latter though having

interest is in saving their jobs and reputation instead of maximizing the value of the company for the shareholders. Their claims to represent the interests of shareholders or other stakeholders are likely to be tainted by self-interest. Shareholders should be able to decide for themselves'.

⁹⁶³ See Renée Adams & Daniel Ferreira, *One Share, One Vote: The Empirical Evidence*, ECGI Finance Working Paper No. 177/2007

⁹⁶⁴ SIEMS, *supra* note 711, 185

⁹⁶⁵ Now see Art. 4(3) Règlement n.2002-4 de la Commission des Opérations de Bourse (COB)

the right to prohibit these measures. In 1989 an amendment to the existing rules deprived the board of a target company of the legal power to issue new shares out of the authorized capital after a tender offer for the firm's stock was unleashed⁹⁶⁶; therefore an effective takeover defense that would make the acquisition more expensive for the bidder was banned. In 2006 the Takeover Directive⁹⁶⁷ was transposed into French law and France was one of the few Member States that opted in to Art. 9 of the Directive that featured the board neutrality rule⁹⁶⁸.

2.7.3.2. Germany

(xviii) Germany receives no points for the entire post-Bretton Woods period. In the period preceding the enactment of the Takeover Act, i.e. until 2001, the dominant view in theory was that the discretion of the board did not encompass the power to adopt takeover defenses; in other words, in theory there was in essence an undisputable board neutrality rule⁹⁶⁹. Nevertheless, because of the absence of hostile takeovers in Germany, at least until the Vodafone/Mannesmann takeover in 1999, this doctrinal approach to the board neutrality rule was not given the chance to be tested in court. Therefore, it cannot be alleged that there was a solid position taken by corporate law in favor of the board neutrality rule. In 2001 though the Takeover Act⁹⁷⁰, largely in response to the hostile takeover of the German Mannesmann by the British telecommunications provider Vodafone, did take a clearer stance with regard to the issue of post-bid takeover defenses. After a tender offer is launched the management must react by taking the interests of the target company into account⁹⁷¹. The concept of the 'interest of the firm' is viewed as allowing the board to take under account other stakeholders' interests and thus to adopt takeover defenses by invoking the potential harmful effects of the acquisition on the employees⁹⁷². Finally, within the scope of the transposition of the Takeover Directive into German law Germany opted out of Art. 9 that features the board neutrality rule, thus not making the board neutrality rule mandatory for German public corporations⁹⁷³.

2.7.3.3. The Netherlands

(xviii) The Netherlands receives no points until 2002, 0.25 from 2003 to 2006 and half a point for the final year of the index. To be sure, formally, Dutch

⁹⁶⁶ Art. 180(4), Loi no 66-537 (as amended by Loi no 89-531 du 2 août 1989); later Code de Commerce, L. 225-129-3

⁹⁶⁷ Directive 2004/25/EC of 21 April 2004 on takeover bids

⁹⁶⁸ Code de Commerce, L. 233-32

⁹⁶⁹ See Klaus Hopt, *Aktionärskreis und Vorstandsneutralität*, 22 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 534, 545ff.; Heinz-Dieter Assmann & Friedrich Bozenhardt, *Übernahmeangebote als Regelungsprobleme zwischen Gesellschaftsrechtlichen Normen und zivilrechtlich begründeten Verhaltensgeboten*, ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT – Sonderheft 9 (1990), 1, 112ff.

⁹⁷⁰ Unternehmensübernahme-Regelungsgesetz

⁹⁷¹ § 3(3) WpÜG

⁹⁷² SIEMS, *supra* note 711, 185

⁹⁷³ § 33(a) WpÜG

corporate law has not introduced the board neutrality rule; even the Takeover Directive was transposed into Dutch law with The Netherlands opting out of Art. 9. Nevertheless, case law developments in 2003 and 2007 subjected the adoption of post-bid takeover defenses to certain rules that moved Dutch corporate law away from a typical ‘just say no’ approach to the target board’s post-bid behavior. In 2003 the Dutch Supreme Court introduced some requirements for post-bid takeover defenses that if not observed may lead to the invalidity of such measures⁹⁷⁴; the takeover defense should be of temporary nature, should be proportional and should not be irreversible. If the board observes these traits, then it can still defeat a takeover bid for the sake of the continuity of the firm and its stakeholders⁹⁷⁵; the threshold is not very high, so this is why The Netherlands’ score following the issuance of this ruling does not amount yet to half a point. In 2007 Amsterdam’s Enterprise Chamber, without overturning the general principle of the 2003 ruling, set some guiding principles with regard to the most popular Dutch takeover defense, which is the issuance of preference shares by the firm to a friendly foundation. In cases where the shareholders’ meeting has authorized the board to effectuate a share capital increase in the future, the firm has usually granted a call option to the friendly foundation, which when it deems it necessary may exercise it and receive new stock from the authorized capital. When the option is exercised following a hostile bid, this is supposed to dilute the acquiror’s shareholdings and therefore reduce her voting power. Before 2007 the foundation would exercise its call option in the face of a takeover to ensure the independence of the corporation, which was after all the foundation’s formal objective stated in its articles of association. In 2007 though the Enterprise Chamber stated that the intended effect of the exercise of the call option should be to maintain the *status quo* pending negotiations between the target, the bidder and pending the exploration of other options by the board⁹⁷⁶; this underlined in accordance with the principle set forth in 2003 that the most popular Dutch post-bid takeover defense should be merely temporary in nature and not prone to defeat the takeover determinatively. This is a legal development that deserves to be rated with an upgrade in The Netherlands’ score with regard to this variable.

2.7.3.4. United Kingdom

(xviii) The UK receives one point for the entire post-Bretton Woods period. The board neutrality rule is of British origin and exists in the City Code on Takeovers and Mergers of the Panel on Takeovers and Mergers since its inception in 1968⁹⁷⁷. The City Code on Takeovers and Mergers is an instrument of self-regulation, to which British firms adhere overwhelmingly, which is now even formally part of the UK corporate regulatory framework⁹⁷⁸.

⁹⁷⁴ HR 18 April 2003, JOR 2003, 110 m.nt. Blanco Fernandez (*RNA*)

⁹⁷⁵ See HR 13 Juli 2007, NJ 2007, 434 m.nt. Maeijer (*ABN AMRO*)

⁹⁷⁶ OK 17 Januari 2007, JOR 2007/42 (*Stork*)

⁹⁷⁷ Principle 7 and Rule 21

⁹⁷⁸ Companies Act 2006, s. 943

2.7.3.5. *United States*

(xviii) The US receives no points until 1984, 0.25 in 1985, half a point from 1986 to 1989, 0.25 from 1990 to 1992, half a point from 1993 to 1994 and 0.25 from 1995 to 2007. Prior to 1985 the approach to the issue of post-bid takeover defenses under Delaware corporate law was the so-called ‘dominant-motive analysis’⁹⁷⁹. Under this approach Delaware courts would accept takeover defenses if the management would point to a plausible business purpose for the defense; in practice, almost any business justification was accepted and therefore the board had in essence an unlimited power to defeat hostile bids. In 1985 the Delaware Supreme Court set some more concrete limits to the board’s ability to adopt defensive measures in the face of a takeover. In *Unocal Corp. v. Mesa Petroleum Co.*⁹⁸⁰ a two-prong test was introduced to scrutinize the adoption of takeover defenses: (i) the board must reasonably perceive the bidder’s action as a threat to corporate policy; and (ii) the defensive measure adopted must be proportional to the threat posed. While in the *Unocal* case the defensive action under scrutiny was upheld, as was the defense in a subsequent case, whose reasoning was based on the *Unocal* test⁹⁸¹, the *Unocal* test proved to be eventually shareholder-friendlier than it first seemed, when the Delaware Chancery Court held that under *Unocal* the board had the fiduciary duty to redeem poison pill rights in the face of a non-coercive, any-and-all cash tender offer⁹⁸². This development requires us to award a quarter of a point to the US for this variable from the time of the *Unocal* ruling. To that quarter of a point, with which *Unocal* endows the US in 1985, we add another quarter of a point for the *Revlon* ruling that was issued by the Delaware Supreme Court in 1986⁹⁸³. In *Revlon* the Delaware Supreme Court in a clear turn towards shareholder value held that in a takeover context the board ought to conduct a fair and impartial auction with bidders in order to maximize returns to shareholders. The high standards for conducting an impartial auction, when the firm is up for sale, were reiterated in 1989 in *Mills Acquisition Co. v. Macmillan, Inc.*⁹⁸⁴, where it was stated that when the management has an interest in a bid (e.g. in a management buy-out scenario) the auction process must withstand rigorous scrutiny under the ‘intrinsic fairness’ standard. In 1990 though the Delaware Supreme Court issued a ruling that represents a significant retrenchment in the judicial scrutiny of takeover defenses. In *Time-Warner*⁹⁸⁵ the so-called ‘just say no’ defense was introduced, since the court ruled that the target shareholders might have been ignorant about the strategic benefit of combining with management’s preferred, but less generous, bidder and that this justified the takeover defenses

⁹⁷⁹ The case credited with originating the dominant-motive analysis is *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964)

⁹⁸⁰ 493 A.2d 946 (Del. 1985)

⁹⁸¹ *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985)

⁹⁸² *City Capital Associates v. Interco*, 551 A.2d 787 (Del. Ch. 1988)

⁹⁸³ *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986)

⁹⁸⁴ 599 A.2d 261 (Del. 1989)

⁹⁸⁵ *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990)

adopted by the board against the more generous bidder. In 1993 Delaware made the scrutiny of takeover defenses somewhat stricter again by moving away from the ‘just say no’ direction, as it prohibited a target board from preferring one offer over another without considering the alternative⁹⁸⁶. In 1995 Delaware moved again towards the direction of greater deference to defensive actions by allowing the board to defend against a two-step proxy fight and tender offer bid on the *Time-Warner* basis that shareholders might be ignorant⁹⁸⁷.

3. Illustrating corporate law’s orientation towards shareholder value in the post-Bretton Woods period

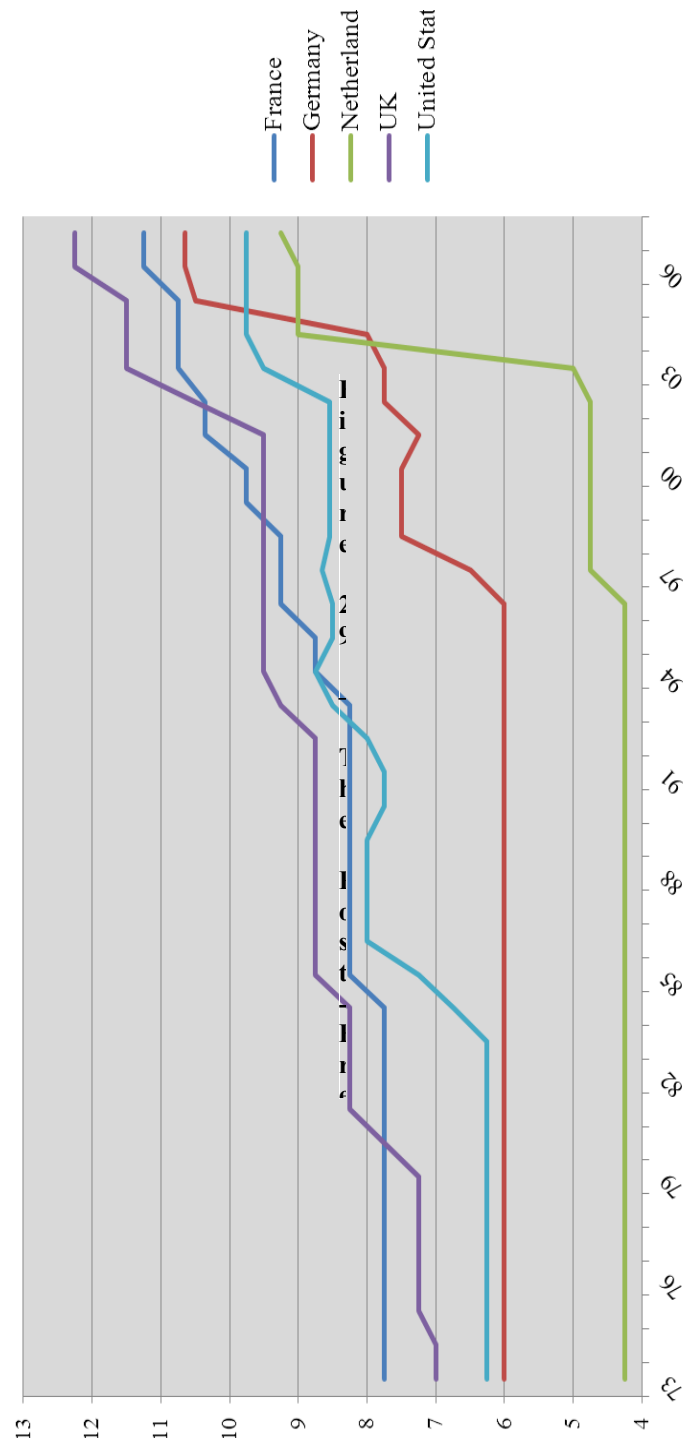
The objective of the PBWSV is to illustrate this study’s argument that corporate law in both insider and outsider systems of corporate governance has moved in the decades following the collapse of the Bretton Woods arrangements towards the promotion of shareholder value. This corporate law-propelled deference to shareholder interests in public corporations has contributed to higher equity payout ratios in general and thus to reduced rates of growth in business capital accumulation. The PBWSV quantified several arrangements in the corporate laws of France, Germany, The Netherlands, the United Kingdom and the United States and pledged to produce a trend line that would illustrate corporate law’s incremental move in these jurisdictions towards shareholder value.

As it was mentioned in the introductory part of this Chapter only if the PBWSV trend line is found to have an upwards direction for these five jurisdictions (i.e. a direction *towards* shareholder value), will there be an indication that the Second Hypothesis holds true and the foundations of the ‘inertia’ or the ‘indifference’ claim regarding corporate law’s role in the Great Reversal in Corporate Governance will be shaken. On the basis of the coding efforts undertaken under the previous part of this Chapter and the ensuing entries in the tables of the Annex Figures 30 and 31 have been produced. The two Figures fully back this study’s Second Hypothesis and leaves us with the duty of backing the Third Hypothesis to complete this study’s positive analysis.

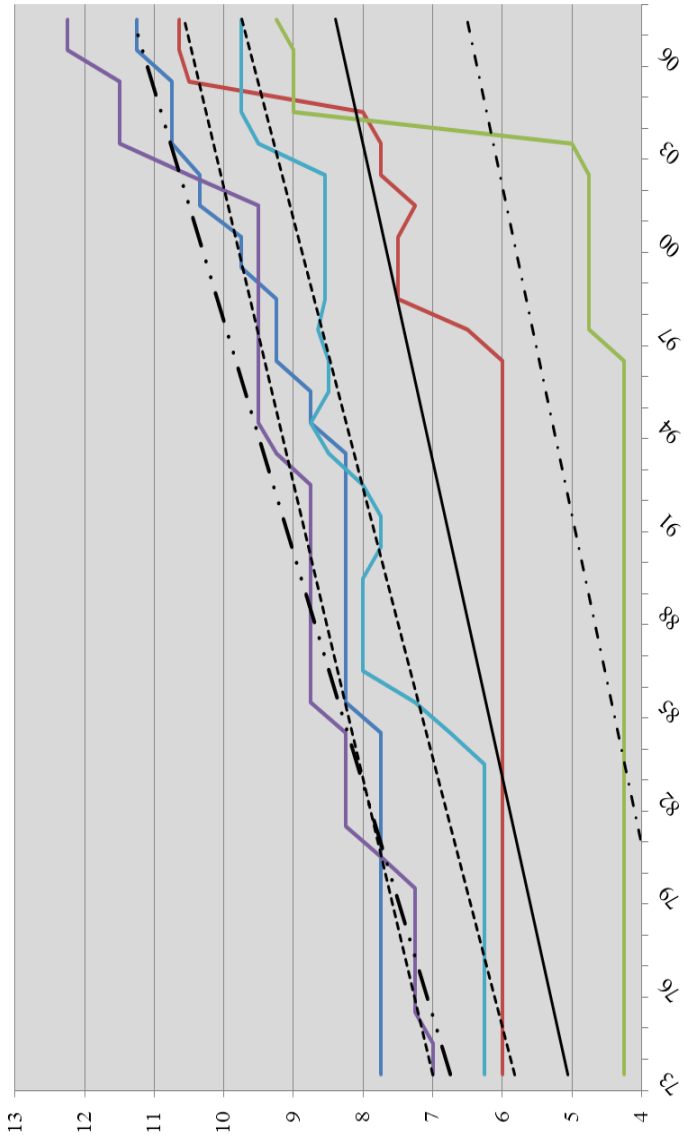
⁹⁸⁶ *Paramount Communications Inc., v. QVC Network Inc.*, 637 A.2d 34 (Del. 1993)

⁹⁸⁷ *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995)

The Post-Bretton Woods Shareholder Value Index



The Post-Bretton Woods Shareholder Value Index
(Linear Regression Trend Lines)



France
Germany
Netherlands
UK
United States
Trendline (France)
Trendline (Germany)
Trendline (Netherlands)
Trendline (UK)
Trendline (US)

Post-Bretton Woods Shareholder Value Index - France

[illegible]

Post-Bretton Woods
Shareholder Value
Index – Germany

	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
(i)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(ii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(iii)	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
(iv)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(v)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
(vi)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.5	0.5	0.5
(vii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	-0.25	-0.25	0	-0.25	0	0	0
(viii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(ix)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1
(x)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(xi)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1	1	1
(xii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.25	0.25	0.25
(xiii)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1	1	1	1	1	1	1	1
(xiv)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(xv)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
(xvi)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.25	0.25	0.25	0.25	0.25
(xvii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.25	0.25	0.25	0.4	0.4	0.4
(xviii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Post-Bretton Woods
Shareholder Value
Index – The
Netherlands

CORPORATE LAW AND

	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
(i)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	1	1	
(ii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	1	0.5	
(iii)	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	
(iv)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(v)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(vi)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(vii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(viii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(ix)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(x)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(xi)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
(xii)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
(xiii)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(xiv)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(xv)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(xvi)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(xvii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(xviii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.5	

Post-Bretton Woods
Shareholder Value
Index – United
Kingdom

CORPORATE LAW & ECON

	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
(i)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	
(ii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(iii)	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	
(iv)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
(v)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(vi)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(vii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(viii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(ix)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	
(x)	0	0	0	0	0	0	0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(xi)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(xii)	0	0	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	
(xiii)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	
(xiv)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	
(xv)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(xvi)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(xvii)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(xviii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	

CORPORATE LAW AND

**Post-Bretton Woods
Shareholder Value
Index – United States**

	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
(i)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(ii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(iii)	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	
(iv)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(v)
(vi)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(vii)	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(ix)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
(x)	0	0	0	0	0	0	0	0	0	0	0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
(xi)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(xii)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	
(xiii)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
(xiv)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(xv)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
(xvi)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
(xvii)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
(xviii)	0	0	0	0	0	0	0	0	0	0	0	0	0.2	0.5	0.5	0.5	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2

