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Current Reform Initiatives: Challenges and Opportunities

by

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PRELIMINARY

The overview that follows attempts to summarise the information that the OECD member states have communicated to the Secretariat in response to a questionnaire that was circulated by the Secretariat. In this questionnaire, four areas of special interest for the Conference have been identified. These are also the four parts in which the paper is subdivided. At the end of each party some reflections have been developed taking stock of the present state of development and indicating the most interesting, future developments that one can expect to take place.

To a large extent the following report is tributary to the reports that have been received from the member states. It is inevitable in the survey technique that the answer delivered by each of the members states will show differences in terms of ambit, depth of analysis and interrelationship with other matters. Therefore, participants in the conference are very welcome to supplement the information that was summarised, or correct any imprecision, or other defective insight for which the author takes full responsibility.

The following overview does not cover all of the subjects that could be brought under the heading of each of the subparts. This would have required a "summa" of company law in all of the OECD members states, a task that is clearly beyond the means of a single writer. Therefore mainly the items that were brought forward by the national contributors have been dealt with, along with those additions that could stimulate the discussion in the other sessions of the conference.

PART I. THE GENERAL MEETING OF SHAREHOLDERS

a) Comparative Survey

1. All company law systems compared organise a general meeting of shareholders, at least if the company has more than one shareholder. In all systems, the general meeting is vested with the ultimate decision power in the company structure: the shareholders are the final risks bearers and have the right to decide on the fundamental changes of the company. However, this privilege is limited by the company remaining a going concern: in case of insolvency, the legal system or the creditors take over part of the decision power. In case of a take-over, the decisional power passes to the shareholders individually.

2. Theoretically the functioning of the general meeting is based on a system of apparently democratic decision-making. All shareholders are entitled to take part in the decision, and decisions are reached with a simple or qualified majority, according to the importance of the subject matter. Shareholders that are prevented from taking part can vote by proxy, in some systems by mail, or even electronically. Shareholders can put proposals on the agenda, and have these voted on. A simple majority could vote away the board, and install new board members, in most systems without the general meeting being restricted by any requirement: the agent should clearly undergo the will of his principal.

In some systems however, the board is less under the influence of the general meeting: this divergence is due to co-determination rules, giving a certain direct or indirect influence to the employees as the primary other stakeholders, along with the creditors, whose protection is laid down in the rules on the legal capital (see part III), and in the rules on insolvency.

Much of the more detailed regulation relating to the general meeting serves this purpose: how to ensure that the voice of the shareholders can be fully expressed and heard.

This technical legal approach makes abstraction of the de facto relationships at the general meeting. Here, a considerable difference exists between the continental European companies and the US-UK and, to a lesser extent, the Canadian and the Australian companies. Where in the former the decisions of the general meeting are usually dominated by significant if not controlling shareholders, the other shareholders having no real influence on the decisions, in the mentioned "Anglo-Saxon" systems, due to the wide dispersion of ownership of the shares, the general meeting can be assumed to play a more important role. But then again, the board would be more powerful.

3. In fact the influence exercised by the shareholders and the directors and officers of the company is a more complex one than can be expressed in the analysis of the general meeting.

Often the members of the board are also important shareholders, or are related to the most important shareholders. If measures have to be taken, these will be initiated by these shareholders in private, and not in the general meeting.

In widely owned companies, the role of the securities market should not be neglected: if, due to management failures, the stock prices go down considerably, the position of the board, or of the chairman, often becomes untenable: the share price, as is well known, often rebounds after the news of his resignation or his ousting becomes known to the markets.

Institutional investors have these last years also been mentioned as exercising considerable monitoring influence on boards: unsatisfactory results will lead to pressure on the board and on "voluntary" resignation.

The most drastic, but also the most effective disciplining instruments are without doubt the take-overs (see n° 87 e.s.), which often have lead to profound restructuring of the companies and renewals of the board's composition. To be assimilated are the mergers, the going private transactions and the management buy-outs.

In all these cases the shareholder, member of the company as assembled in the general meeting, plays only a minor role. He can weigh on the decision process either by selling his shares, and triggering a price fall, by tendering his shares in a take-over, or finally by giving his vote to a proxy solicitation group or firm, that will try to bend over the orientation of the company's policies. The last method has become more popular now that, it seems, the interest for take-overs has waned, for a variety of reasons going from state anti-take-over statutes, the cost of the transaction to the bidder, to the sheer volume of some of the potential targets.

4. Does this mean that, except in the case of a take-over or a proxy fight, the votes attached to the individual share is in practice of little or no importance?

The answer is clearly no: in principle all shares have voting rights, whether the shareholder owns a large block or only a few shares. Voting rights have a financial value, which is proved by the price difference between identical shares with or without voting rights. In take-overs the voting privilege clearly comes to the forefront in terms of the control premium, which is paid by the bidder. Finally, voting rights insure that there always will be an ultimate decision power, even if the board is no longer able to keep the company under control.

It is on the basis of these general considerations that the following analysis of the detailed provisions in which the exercising of voting rights by the shareholders are laid down, will be undertaken. This overview is essentially based on the survey undertaken as the request of the OECD.

1. The role of the general meeting

5. Within the overall framework of the regulatory patterns relating to companies limited by shares, the role of the general meeting is quite similar in most of the jurisdictions compared.

As far as competencies are concerned, there is a striking similarity between all European jurisdictions, which in part is due to the harmonising effects of the EU directives. This observation also includes some non-EU member states, such as Switzerland, Poland, the Czech Republic and Turkey. The furthest away from the common pattern might be the UK, where the situation is open for review.

The regulations give only a limited view of the division of competencies between the board of directors and the general meeting: in some cases, the companies' articles of association may be at variance with the statutory pattern, although this occurs less frequently in listed companies. With respect to these, rules on corporate governance, and other sources of soft law may incite the companies to adhere to a pattern somewhat different from the default rules in the law, e.g. on the reservation of the power to issue additional securities to the general meeting in order to avoid dilution of the shareholders interests[1].

Differences between the European patterns are also due to the existence of a dual board, as is the case in Germany, Austria, Denmark, and Finland (see infra n° 46 e.s.). In these jurisdictions, the powers of the supervisory board include matters that in other jurisdictions would be exercised by the general meeting.

The more one moves away from Europe, the larger the differences appear. Canada and the United States have reduced the role of the general meeting to some essential features. Japan, however, is still very close to the European pattern

6. The fundamental division of powers between the board and the general meeting is in all systems comparable: the board has the residual powers for the management of the company, while the general meeting has mainly the power to supervise the board and decide on the ultimate policy issues affecting the company (including its winding up).

The board therefore is considered the agent of the shareholders, who have in general terms delegated the actual running of the company to the board of directors. Within this agency relationship, one can situate the traditional powers of the principal - i.e. the general meeting - to appoint or dismiss the members of the board, to fix their remuneration, and sometimes their contract, to invite the board to account for its mission (annual reports and accounts, distribution), appreciate their liability and eventually institute liability suits against the board members, or in some systems, give a discharge of liability.

In some jurisdictions the competencies of the board are somewhat broader, mainly as a consequence of specific delegations of powers. Very often the general meeting decides to explicitly delegate certain matters, - such as the issue of additional shares, or share buy backs or the distribution of interim dividends -, to the board for a limited period of time, after which the shareholders can renew the authorisation or not. This delegation would not, it seems, fundamentally alter the relationship between board and shareholders, who ultimately maintain their decision power.

Although it would be compatible with the legal system, the articles of association rarely reduce the powers of the board: flexibility and the need to be able to intervene very rapidly in the markets have refrained the shareholders from retaining some of the powers that according to the statute would pertain to the board. Only in small companies would the shareholders, acting more like partners in a partnership, be more directly involved in the managing of the company.

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[1] See on the role played by the institutional investors on the issue of respecting preferential subscription rights in the UK, E. FERRAN,Legal Capital Rules under the Pressure of the Securities Markets - The Case for Reform, as illustrated by thr UK Equity Markets, in Siena Conference, to be published.

Apart from rules that can be linked to the fundamental agency relationship, the statutes generally reserve for the general meeting those matters that directly affect the legal position of the shareholders. It seems logical, at least in general terms, that the shareholders will be entitled to decide on matters by which they are directly affected. These decisions generally take the form of a change of the articles of association, of the constitution of the company. These essentially govern the relationship between the shareholders and the general functioning of the company. Changes in the articles would therefore have to be submitted to the general meeting, most of the time acting with a supermajority. Some of the matters that have been the subject of the specific delegation mentioned in the preceding paragraph can be analysed as affecting the position of the shareholders: the issue of additional shares may e.g. dilute the position of the present shareholders.

7. What are to be considered changes in the constitution of the company may need further clarification: in some jurisdictions, all changes to the articles, whatever detail they may relate to, must be subject to the decision of the general meeting. In some jurisdictions ancillary rules affecting the functioning of the company may be laid down in the by-laws that can be changed by a decision of the board of directors[2]. In European jurisdictions this approach is seldom found.

Fundamental changes of the company structure would generally also have to be submitted to the shareholders: mergers, split-ups, dissolution or winding up of the company, are part of the exclusive competence of the general meeting, as far as they effect a change in the articles of association. But a de facto merger, by the acquisition of the shares of another company, or the spin-off of significant activities would usually require a decision of the board. The same applies to a de facto cessation of activities leading to a disappearance of the firm.

The change of the nationality of the company will also be mentioned here, although the subject rather exceeds the purpose of the present paper: in several jurisdictions, this change cannot intervene, in others only upon the unanimous decision of the shareholders, while in a third system a qualified majority decision would be sufficient[3]

In Germany, and in somewhat comparable terms, in French case law, it has been decided that the board is not entitled to transfer substantially all the assets of the company to a subsidiary, thereby eliminating any intervention of the shareholders. These significant cases can also be analysed as cases in which the board tries to modify the substance of the company without the shareholders' approval[4]. The comparative overview reveals that this approach is also found in some other jurisdictions, viz. Canada[5], Czech Republic[6], France, Poland, Japan[7] and with additional conditions in Austria and in Switzerland[8] as well.

8. On the basic pattern as outlined in the questionnaire, there is a significant variation if the company has appointed a dual board. As will be explained further, this dual board will normally consist of a supervisory board and a management board. Typically, the members of the supervisory board are appointed by the shareholders, but other patterns have often been made mandatory,

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[2] See CLARK, Corporate Law, 94, Ballantine on Corporations, 64 and 439.

[3] This is the case in France, see Art.154, L. 1966.see for further details : NIBOYET, Traité II, n° 71; BATTIFOL, "Le changement de nationalité des sociétés", *Trav. Com. fr. Dr. Int. Privé*, 1966-69, 65; HAMEL and LAGARDE, *Traité de droit commercial*, I, 429.

[4] See the Holzmüller case, Bundesgerichtshof, Décision, 25 February 1982, II ZR 174/80 (Hamburg[5] S. 189 (3) of the CBCA.

[6] S. 193 Commercial Code; but if the value does not exceed one third of the company's equity, the management board will decide, with the approval of the supervisory board. The general meting must also decide when the company has issues participating securities.

[7] CCJ 245.

[8] According to a draft act on mergers, divisions, transformations and transfers of assets.

especially in the framework of labour co-determination. The management board, where the core power is located, will be appointed by the supervisory board.

Apart from supervision on the management board, the supervisory board will decide in a certain number of matters that in the other patterns have been reserved for the general meeting. The most visible one is the adoption of the annual accounts and the distribution of the dividends. But more refined patterns are followed e.g. in Austria, where the general meeting is invited to approve the annual accounts in case the supervisory board and the management apply for such an approval[9].

Other cases in which the general pattern of competencies is not followed concern the rule found in some jurisdictions according to which contracts in which members of the board have conflicting interests should be submitted to the general meeting. This is e.g. the rule in France[10].

9. The Canadian and the US law define the role of the general meeting in more restrictive terms. Both systems are largely but not entirely similar.

Although the company's charter or its articles of association could stipulate more extensive powers for the general meeting, the default rules would normally provide that its powers are limited to the appointment or dismissal of the members of the board of directors, changes in the companies articles of association (including the reduction of the legal capital), and extraordinary transactions that in effect result in the sale of the company. Changes in the rights of the different classes of stock would require approval of the holders of that class, and of the other classes if involved.

The powers that in the European companies belong to the shareholders would normally be exercised by the board in Canadian and US companies. They include: the issue of additional securities, redemption or repurchases of shares, distribution of profits. Share transactions that would result in a change of control would have to be submitted to the shareholders. Annual accounts are not laid before the general meeting for approval: this preserves the shareholders' right to sue in case the financial statements contain untrue or false information.

Also, changes in secondary rules of functioning of the company are laid down in the by laws which, adopted by the shareholders, often contain a provision that they can be changed by the board.

All in all, the differences between the European model and the North American one are perhaps less substantive than would appear from comparing the statutes: in European statutes and company charters too it is usual that the board is empowered to issue additional shares, to proceed to share buy-backs, and in practice it decides on the dividends and establishes the annual accounts. These legal powers could be delegated to the board for a limited period of time, usually five years and therefore can give rise to shareholder criticism upon renewal.

2. The functioning of the general meeting

10. In all jurisdictions considerable attention is being paid to the guarantees and facilities offered to shareholders to exercise their voting rights. These are partly based on fear: the board and its supporters, the important shareholders, might usurp the rights of the individual shareholders. Also, management boards may look to shareholders for obtaining support for their policies, especially if they need to be re-elected.

In the following analysis the position of the shareholder in the decision making process will be explained in detail. As differences between the national systems are more pronounced than for the subject of the competencies of the general meeting, the more characteristic features of some of

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[9] See § 125 (2) ÖAktG.

[10] Art 101, Companies Act 1966; see further n° 39.

the regulations will be mentioned, referring in the footnotes to the states where these characteristics can be found.

1° - Voting Rights and their exercise

11. In all systems compared, shareholders have voting rights. However, the company can issue classes of shares without voting rights: non-voting shares, preferred shares, etc. Their characteristics should be situated somewhere between shares and bonds. There is a great variation of these intermediate instruments, and the rights attached.

In all jurisdictions voting rights can be suspended in a number of typical circumstances:
- shares held in treasury
- shares for which the significant shareholder has failed to notify
- shares held by a subsidiary of the company
- shares that are in default as to payment of the issue price, or the contribution to the capital.

12. Shareholders can always vote in person. If prevented, there is a general rule that a shareholder can appoint a proxy. More recently, some jurisdictions have introduced mail voting, but apparently this has not been very successful. The latest techniques consist of electronic voting: it is used in all three previously mentioned ways of voting. It is comparable to mail voting, except if the voting takes place during the general meeting.

a) voting in person

13. Shareholders called to the general meeting can vote in person: proof of ownership has to be produced that the person voting is also the owner of the shares. In some jurisdictions, it would be a criminal offence to vote as the holder of shares which one does not own: this rule aims at avoiding vote rigging or trafficking. It does not prevent votes by proxies as there the person voting acts in the name of his principal, disclosed or not.[11]

The shareholder must establish his ownership. If bearer shares are still in circulation under the form of live certificates, the owner should deposit the shares whether at the company's seat, or at a bank, which will then deliver a certificate with which the shareholder can attend the meeting[12]. If the shares have been registered in the company's books under his name (nominative shares - registered shares), this will constitute sufficient proof.

In most companies that have issued shares on the public securities markets, shares will be held in bookkeeping accounts, opened by credit institutions. This applies both to registered and to bearer shares; in the latter case the shares will be deposited with a central depository. In this case, the shareholder could obtain a certificate from the bank attesting that he is registered for the number of shares indicated.

Blocking the shares at the bank for the period preceding the general meeting leads to the shares becoming unfit for trading on the markets: once the shares have been sold, the owner would legally not be entitled to take part in the general meeting. As the institutional investors are claiming an increasingly long preparation period for attending the meeting, this feature may upset the functioning of the markets. In practice, as shares deposited in accounts are fungible, the shares sold can be delivered in an orderly way. As to voting rights, the problem is often solved by determining

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[11] So the banks in Germany and Austria, voting in their own name occurs although on behalf of the shareholder.

[12] See Belgium (Art. 536 Company Code), Finland, France. In the Czech republic the shares are registered in view of the meeting.

a record date, being the date that is taken into account on which voting rights will be determined[13]. Often the record date is a considerable number of days before the meeting (e.g. 30 days).

b) voting by proxy

14. In all compared jurisdictions, it is allowed to vote by proxy. Even in the absence of an express rule in the statute, it is recognised that the shareholder can exercise his rights by appointing a proxy.

Who can be appointed as proxy may further be regulated by the statute, or by the company's articles of association. Often the articles stipulate that only shareholders can be appointed proxy-holders[14]. This limits the professional organisations for the defence of minority shareholders, or professional proxy organisation acting for institutional investors, to take part in the general meeting as proxy holders. Therefore, the French law would allow an organisation for the defence of shareholders to vote as a proxy and to table motion for discussion in the general meeting. In some cases, these organisations will therefore acquire one share in several listed companies to be able to attend the general meeting. However, a modern, widely owned company would allow access even to non-shareholder proxy holders in a policy of communication and openness.

In some cases the articles will contain the rule that the shareholder will not carry more than a limited number of proxies of other shareholders[16]. This rule maintains a certain form of "democratic" decision making, but mainly serves to reduce the influence of opponents, especially as large shareholders would not be prevented from taking part with all the shares they own. It also can be used as a technique to avoid proxy fights. As anti-take-over instrument, it would be rather weak, except if there also existed a restriction on the number of shares a shareholder can acquire, or can vote.

Here again, large open companies would not use this type of technique to reduce the influence of small shareholders.

15. In some European jurisdictions (Germany, Austria, Switzerland), proxy voting is embedded in the general system of depositing bearer shares. Under the applicable banking regulations bearer shares can only be deposited with credit institutions that are subject to prudential control[17]. Most of the shares are therefore held by the bank in open accounts. On the basis of either the applicable statute or the contractual relations, the banks will usually exercise voting rights attached to these shares. These votes are expressed on the basis of instructions given by the shareholder, and if no instructions are given, to the best insights of the bank[18] As a consequence, most large companies are dominated by the large private banks that exercise these voting rights, in addition to the votes they cast in their own name[19]. This institution originally was introduced to ensure that there would be a sufficient number of shareholders at the general meeting so that decisions could be reached by a solid majority, and that haphazard decisions could be avoided[20]. The institution has evolved towards one of the important stabilising factors in the economic systems where it is used.

Increasingly however, as securities markets mature, large shareholders and especially institutionals will prefer to exercise their voting rights themselves.

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[13] See the Canadian rule (Art. 134(2) and 138(2) CBCA), allowing for fixing a record date 50 to 21 days before the meeting. The Belgian draft would also allow the charter to fix a record date.

[14] Only in France would the statute itself provide for this restriction (Art. 161 L 1960). Commercial Code).

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[16] The rule is rarely found in public companies: in France, such restriction would be allowed: art. 161, §2 L 1966.

[17] See the German banking act.

[18] See art. §135(5), D.AktG, comp. § 114(4) ÖAktG.

[21] This is the case in Belgium (art. 550) in France (art. 161-1 L 1966 and art. 131-1 e.s., Décret 1967).

c) voting by mail

16. A few jurisdictions have introduced a system whereby shareholders can also vote by sending a letter, on a prefixed format, to the company[21]. Different from the proxy vote is the absence of a proxy holder: if unforeseen issues arise during the meeting, the shareholder's will not have been expressed and will not be taken into account. The mail vote procedure therefore is suitable especially for large companies, where unforeseen items are very rare, although permissible.

Mail voting requires very strict guidelines as to the procedure, the formulars to be used, and especially the identification of the ownership of the person voting. French law contains precise instructions with respect to the formulars[22]. The identification issue is more complex, as often companies use different types of shares: if only nominative are used, the company can check the number of shares that have been registered in the name of the party voting[23]. With registered shares, or shares deposited with professional depositories, the bank will have to attest the ownership of the shares. There might be questions of reliability of this information. Moreover, signatures whether of the bank or of the shareholder have to be authenticated. If the documents are sent overseas, delays may occur. All this results in the technique of mail vote being rarely used in large companies[24]. In small companies where the parties know each other and are familiar with the signatures, a more ready use will be justified. But often the appointment of a proxy holder will be preferred.

d) electronic voting

17. The issue of electronic voting is still in the embryo stage. Although there are some precedents in the US, it is unclear what part of the voting process has been automated. There is widespread acceptance that electronic voting at the meeting, by those present, raises no specific legal questions: electronic votes are but a technique to cast and count votes.

More difficult is the use of electronic communication to cast votes at a distance. Here the issue of authentication comes in: while relatively easy to solve if the shares are registered in the books of the company, it requires special procedures if the shares are kept under the form of bookkeeping entries with financial institutions, which is most often the case for the most actively traded securities. In that case, the bank must authenticate that the shares are registered in the name of the shareholder, and how many shares he owns. This information should than be transmitted to the company for processing, preferably before the meeting. The company can than check to what extent the shareholder is entitled to vote: voting rights may be suspended for different reasons[25], or the shareholder may enjoy double voting rights.[26] On the basis of these data the quorum, and the applicable majorities can be calculated.

Most difficult is the case in which the votes would be cast during the meeting: the shareholder should first announce that he is taking part in the meeting and must have certified with how many shares he wants to take part. On the basis of these data, corrected for suspended votes or double votes, he should then remain on line and cast his vote as the meeting is progressing. Each time his vote would have to be authenticated by the financial institution where his shares are registered. The voting would have to take place motion by motion. As some shareholders would

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[22] For an overview of the French rules and practices in this respect.

[23] Or can even fill in the number itself, as was proposed for electronic voting procedures: see ANSA, L'utilisation des moyens de télétransmission et les assemblées générales d'actionnaires, Rapport d'un groupe de travail de l'ANSA, January 2000, www.ansa.asso.fr/site/rap1.htm.

[24] According to Belgian law, the company's articles should provide for mail voting. Few listed companies have introduced a provision on mail voting and even less have made use of mail voting.

[25] E.g. they have been acquired contrary to certain regulation or have not yet been notified to the company, although the shareholder owned more than 5%; or further the shareholder has omitted to pay in the capital that was regularly called.

[26] See art. 175 e.s., L 1966.

enter the process and others would leave, this may be a very cumbersome exercise. Therefore, it is advised to limit electronic voting to pre-meeting voting, until further experience is gathered on voting during the meeting.[27]

18. Most states deem that electronic voting at a distance is not possible under present company law rules. Some states envisage to adapt their statute: in France, there would be a general provision stating that when electronic voting takes place, these shareholders will be included in the count for quorum and majority. The rule would be applicable in all companies limited by shares, listed or not.

The German draft law would not allow electronic voting as such, but the use of electronic communication techniques in the transmission of voting instructions between the shareholder and the bank with which the shares have been deposited would be possible.

The UK proposed amendments to the Companies Act do not deal with voting. However, the Company Law Review proposes to further investigate certain issues such as authentication, security, precedence as between votes received electronically and by post[28].

2° Attending the general meeting

a) Calling the meeting: notice and agenda

19. In all systems compared, general meetings take place on an annual basis. These meeting usually approve the accounts and, when necessary, make the necessary appointments (directors, auditors) and decide on the dividend distribution, at least if these are not decided by the supervisory board. The meeting is called the ordinary meeting, as opposed to the meeting that has to be called especially for a particular item, especially when changes to the company's charter have to be made.

Most company acts contain detailed provisions on the minimum and maximum time between calling the meeting and the actual meeting. This issue may look trivial but in practice, it may reduce the risk of manipulation. More important, for the listed companies, there should be sufficient time to enable foreign investors, especially the institutional investors, to be informed, and obtain copies from, analyse and if needed translate the documents laid before the general meeting. There are often complaints that these time spans do not allow institutional investors to take part in the meeting, whether directly or through a fully briefed proxy.

20. The time span to call a general meeting differs substantially between the jurisdictions compared:

- For example: 14 days before the meeting in Austria[29], France; but twice 8 days in Belgium.

The notice is published by the board, and more exceptionally by the auditors. Even when the meeting is called at the demand of the shareholders, as is allowed in most jurisdictions, the board sends out the notice.

The notice is usually sent out by mail if the shares are in nominative or registered form. Publication in the newspapers is mandatory when bearer shares have been issued. In German law, publication in the official gazette for publication should take place one month for the meeting.[30]

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[27] See ANSA document, nt. 23. For an overview, see Wymeersch, The case of ICT in company law matters, in Ferrarini (Ed.); also on website http://www.law.rug.ac.be/fli

[28] Company Law Review, Developing the Framework, vol. 5, March 2000, § 4.49.

[29] § 107 § 1n ÖAktG; idem in France: 15 days (art. 126, Décret 1967); art. 73, Belgian Act.

[30] See § 123 (1), D. AktG.

Some states are planning to change to electronic publication of the notice: this is the case in the United Kingdom, where shareholders who have agreed on electronic communication can receive the notice by e-mail, or may be contacted by e-mail so that they can retrieve the notice and the agenda, and all other documents that are laid before the meeting (annual reports, financial statements, etc.) from the company's website[31]. This is also the case in France[32]; in practice, companies may also voluntary publish these data.

21. In most jurisdictions, a certain percentage of shares, whether owned by one party or by several, will have the right to demand the board to call a general meeting. In that case they also set the agenda. The board could however add additional items to the agenda. If the board resists the demand, the shareholder can apply to the judge who will oblige the board to call the meeting, or will appoint a court representative in charge of calling the meeting. In publicly owned companies this technique is seldom used. It may be useful for exercising pressure on the board.

Share percentages for calling a meeting vary from 5% [33] to 20% [34]

b) attending the meeting by proxy.

22. Invariably all legal systems allow attending the meeting by proxy.

Proxies generally should indicate in which direction the shareholders want to vote: in France, if no proxy holder has been indicated, the vote will be cast in favour of the management by the chairman of the meeting.[35]

Public solicitation of proxies has received little attention in the European jurisdictions: only Belgium has a rarely used statutory provision on the subject, calling for disclosure and approval of the disclosure document by the securities market supervisor[36]. It is well known that public solicitation of proxies is very developed in the United States and in Canada and constitutes one of the alternatives to the control fights by way of tender offers. It also is one of the vectors for shareholder proposals, as mentioned infra.

According to the US securities regulation, companies the shares of which are listed or which have more than 500 shareholders[37] ("public companies") are obliged to follow the comprehensive regulation, essentially on the solicitation of proxies from the public, although similar disclosure requirements apply in case a general meeting has been called, even without solicitation of proxies. This regulation provides for substantive aspects of the proxy (revocability, disclosure of the identify of the persons soliciting, interest of certain persons in the matter to be acted upon in the general meeting) and extensive disclosure as to the background of the proposed motions. In case the annual general meeting calls for the election of directors, the documentation includes audited financial statements for the last three years. Shareholders have the right to request the board to include proposals to be submitted to the general meeting. Although these rarely have a direct effect in the decision making within the company, on the longer term they sometimes have been found to lead to a change of policy by the company.

The company must send to all shareholders of record proxy forms and the said information and a sufficient number is to be distributed to the brokers or nominees for distribution to the

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31 See s. 369 and s. 379A Companies Act 1985 (meetings to pass elective resolutions).

32 ANSA, L'utilisation des moyens de télétransmission et les assemblées générales d'actionnaires, Rapport d'un groupe de travail de l'ANSA, January 2000, www.ansa.asso.fr/site/rap1.htm.

33 Austria § 106 (2) Ö AktG; § 122, D. AktG, France, using a scaled down system (art. 128, Décret).

34 Belgium: art. 73, § 2.

35 Art. 161, § 5 L 1966.

36 Art. 549 Companies Act previously art. 79 § 3, according to which the request for proxy must be presented to the Banking Commission no later than three days before its announcement.

37 300, or 500 if the total assets amount to less than $10 million, Rule 14(a) SEC.

beneficial owner of shares registered in their account. Proxy statements are available at the SEC's Edgar database.

3° Voting procedures at the general meeting

a) voting techniques

23. At the general meeting, voting procedures may vary. All parties present (owners, proxy holders, institutional investors, trustees) vote most of the time by show of hand: as most decisions carry a wide majority, this cannot be objected against. In that case the votes are taken per person, without taking into account the individual holdings of each participant. Therefore this technique cannot be used if the outcome would apparently be different if the votes were counted. In that case a poll will be necessary. The chairperson will call for a poll if there is a considerable minority appearing from the first show of hands. To call a poll is a very cumbersome procedure in a general meeting where numerous shareholders attend: this is the more so as each motion should be submitted to a poll.

Increasingly, in order to facilitate the voting procedure, electronic voting techniques are used whereby the parties present receive an electronic card or device on which a programme is registered that shows on the screen the choices they can make. The votes are then counted mechanically. Although information technology is being used, it merely serves the purpose of counting votes. Therefore it will not be further analysed as a use of ICT in voting procedures.

b) proxy holder

24. Most of the times proxies indicate in which direction the proxy holder has to vote on each of the motions to be acted upon. In the absence of such instructions, the rules according to which votes will be cast differ.

In the US, the proxy holder may exercise discretionary voting authority. However, the proxy rules limit uninstructed proxies. Also, voting is only allowed if the proxy indicates in which sense the shares will be cast in the absence of specific instructions. In French law, the votes without indication of a proxy holder will be cast by the chairman of the meeting, in favour of the proposals of management[38].

In Germany, if the bank voting with the deposited shares has received no specific instructions, and save unforeseen circumstances, it will vote according to its own insights, as has been communicated to the shareholder.[39]

b) Conflicts of interest at the general meeting

25. Shareholders voting at the general meeting may have to decide on issues in which they are themselves directly involved: approval of contracts they have entered into with the company, decisions to start law suits against the director who is also shareholder, or decisions to grant discharge of liability to directors as is usually decided upon in several European jurisdictions. The question arises whether these shareholders can also vote on matters directly affecting themselves.

In general, shareholders can exercise their voting rights in their own interest[40].

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[38] Art. 161 § 5, L 1966.

[39] (1) § 135 (5) D. AktG.

[40] The principle is clearly affirmed in the UK, with the reservation that complex common law principles restrict the application of the rules in certain matters where the shareholder has o act in the interest of the company as a whole.

There are three tendencies: according to the law in certain states, all shareholders can vote, even if directly involved[41]. This rule permits reaching a decision in closely held companies where all shareholders may be in a conflict situation.

In Canada, a restriction flows from a rule introduced by the securities regulator, and dealing with related party transactions[42]. According to UK and Irish stock exchange rules, rules on related party transactions would equally oblige the shareholder to abstain.

In other jurisdictions, voting would be allowed except for specifically designated subjects: in France: contributions in kind by a shareholder, and the acquisition of assets from a shareholder within 2 years from formation; also contracts with directors.[43]

In Germany, Austria[44], Switzerland[45], Denmark[46] and Finland[47] and Sweden[48], there are exceptions for shareholders discharging the shareholder from liability as director, or affecting legal proceedings against himself, and - in the Nordic countries - more generally if to the detriment of the company, the shareholder has a significant interest in the party with whom a transaction is being realised.

In a third system, there is a general prohibition for a shareholder to vote on matters in which they have a direct or indirect interest, especially to discharge their liability, or relating to litigation between the shareholder and the company[49]. This rule was found to apply in Italy, Portugal[50], Turkey, and the Czech republic.

b) Recent issues and trends

26. In several jurisdictions the general meeting has received renewed attention. Several trends can be identified: one could identify these as an “abolitionist trend” and a “restauration trend”.

In some jurisdictions the question is raised whether the general meeting should be maintained as a useful tool in the functioning of the company. Critics point to the high degree of absenteeism, the dependence on the board for decision making and the sensitivity to manipulation. The role of the security markets as instruments for determining company conduct may also support abolitionist thoughts.

However, most of the time this criticism does not lead to full abolition of the general meeting, but more to questioning its role, and to reflections on the remaining functions of the general meeting. In the absence of better solutions, the reflections often lead to the conclusion that new techniques should be developed to render the remaining functions - mostly the disciplining of the management - more effective and more transparent.

The majority trend confirms the continuing usefulness of the general meeting, with perhaps a redefinition of its function. Surveys indicate that business leaders consider the general meeting not as a decision making instrument, but rather as a device for communication with the shareholders, the press and the outside world in general. They plead for reducing the formal legal functions of the

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41 Belgium, Luxembourg, Spain.
42 See R. 61-105 of the OSC, and www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/61-501fr_20000414.html
43 Art. 82 and art. 103 § 4, L. 1966.
44 § 114 (5) Ö AktG; § 136 D. AktG.
45 § 695,§1 CO
46 § 67(4)
47 Ch 9, s.3
48 Ch. 9 § 3, Swedisch Act.
49 Art. 2373 Civil Code.
50 Art. 384.

general meeting, such as the ritual of approval of the annual accounts, but rather for inviting the shareholders to a public relations event, in which not only comprehensive company information is exposed, but also at which the shareholders would develop a certain feeling of solidarity with the company.

27. Several lines of reasoning take root in this philosophy.

Reducing the legal function of the general meeting is relatively easy to identify: one can point to the greatly reduced function of the general meeting in some jurisdictions such as the United States, where the appointment of the directors is de facto the only remaining substantive task. One sees that European legislators have not been very receptive to this trend: they continue to see the general meeting as the traditional principal in the agency relationship. As a consequence, the function of this body has been increasingly hollowed out, leading to a higher degree of absenteeism and decision making by increasingly smaller minorities. In fact, the presence of dominating shareholders has in many companies prevented these developments from being very harmful.

In some states initiatives have been taken to make the general meeting a more lively, appealing event: shareholders are motivated to attend by different techniques, going from a cosy reception - brandy and cigar included - to lunches with the management, and even an attendance fee or a privileged dividend. The latter raises delicate issues of equal treatment.

A softer approach leads to public relation initiatives: many companies have paid large attention to animating their general meeting, inviting guest speakers, making sure the chairman's address really confers interesting information, organising preparatory press conferences, video conferencing the meeting simultaneously in several cities, and so on. This trend most closely corresponds to the perception of business leaders of the general meeting: it is a privileged public relations event.[51] The securities market supervisors, at least in some states, have stimulated this approach. The sensitivity of these issues increases proportionally to the dispersion of the ownership of the company's shares.

Questions relate to the practicability of these meetings, to the fear of disclosing privileged information, and sometimes to the mere expense of running a multi-state, large public relations event.

At the modern general meeting, there should be a dialogue with the shareholders: questions by shareholders should be answered by the board at the meeting. In practice, these questions are either utterly irrelevant, or have been suggested in advance. Few states have taken initiatives to structure this kind of dialogue. As a consequence, general meetings are feared to become quite chaotic, which may lead to the destruction rather than the enforcement of the company's image.

28. In order to better involve shareholders, some look to the voting mechanisms. When shareholders are entitled to vote, they exercise their fundamental rights as members of the company, and act as the principals in the agency relationship towards the board of directors. Psychologically, voting shareholders have the impression that they effectively take part in the company's life, and will feel sympathetic with the company's fortunes. To stimulate the voting process, several ways can be followed: one could facilitate proxy voting, allow for different techniques for distance voting such as mail voting or electronic

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[51] See the survey by Wymeersch and Van der Elst, "De werking van de algemene vergadering in de Belgische beursgenoteerde vennootschappen, een empirisch onderzoek", Tijdschrift voor Belgisch Handelsrecht, 1997, 72-92.

voting. More advanced, and today still largely theoretical, would be “distance” general meetings.

In several jurisdictions there has been some interest for proxy voting, especially as an instrument to ensure sufficient pressure at the general meeting. However, one could doubt whether promoting proxy voting would increase the number of participants, as absenteeism or rather rational apathy in European companies is mainly due to the presence of controlling shareholders. Investors see no point in attending meetings where the decisions have been agreed upon before the meeting takes place.

The leading example for developing proxy voting has been the United States, where the proxy machinery has become an institution in its own right, leading to specific forms - some will say outgrowths- of shareholders’ democracy, especially the right for shareholders to submit motions before the general meeting, and to contested proxy fights. Few European states have dared to follow the American path: a less adversary and less litigious climate, along with the presence of dominant shareholders can help to explain the rather weak development of proxy voting in most of the EU jurisdictions.

29. All jurisdictions know the institution of proxy voting. However, not all have introduced a legal framework ensuring the shareholder to be fully informed before he signs his proxy card. Most of the time the proxy procedures are organised and controlled by the management: so e.g. the conventional rule that proxies without indication of a specific proxy holder are cast by the chairman of the board, who usually chaires the meeting and will therefore be cast for in favour of the incumbent management. To appoint a third party might be difficult: restrictions on proxy voting are still numerous and limit the shareholders’ freedom. Although by law the shareholders have the right in all jurisdictions to introduce specific items for discussion and decision on the agenda, this rarely happens, at least in listed companies. Thresholds for accessing this procedure are high to very high: 5% of the shares in a listed company represent an investment that even most institutional investors would not easily reach.

Public proxy solicitation is not regulated in most jurisdictions: apart from the United States, Canada and Australia, rules were found only in Belgium. They are based on the American disclosure philosophy. In practice, they have only rarely been applied.

More significant are the Dutch rules allowing holders of shares that are deposited by a central share depository to vote in the general meeting, without the full list of shareholders being transmitted to the company. This system is accompanied by pre-meeting disclosure[52].

New techniques of proxy voting are on the programme of the UK company law review. However, at the moment of writing, no specific data are known.

One of the most important proxy voting systems is found in Germany, Switzerland and Austria and is fully embedded in the intervention of the banks in the securities markets. These rules, originally aimed at insuring a sufficient presence at the general meeting, indirectly affect the German corporate governance structure. The rules have become well established: new initiatives related to the electronic dissemination of information, as will be mentioned further.

30. Mail voting is provided for in the legislation of several states and is planned to be introduced in others. Especially in France, there has been experience with this voting procedure. As all French shares are registered in share accounts, the identification issues are

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[52] For details, J. Winter,

probably easier to deal with than in systems with live bearer shares, as still exist in several European states. Mail voting systems are obviously difficult to organise, in terms of identification of the shareholders, of avoiding falsification, of using the right formulas, etc. Therefore the reports on the usefulness of mail-voting are most of the times rather hesitant.

Electronic voting may be considered a variant of mail voting. Both are forms of distance voting. In each case, it is the shareholder directly who casts his vote. If all shareholders would be voting this way, the general meeting would be limited to counting the votes: no presentations, no discussion, in fact no need for a meeting.

With respect to electronic voting, one should distinguish between electronic voting before the meeting and electronic voting during the meeting. While the former does not participate in the dynamics of the general meeting, the interaction is much greater for the second. The difficulties, whether technical or legal, to organise the former are still manageable. These are increased considerably when the voting takes place during the meeting.

In most states it is considered against the present law to organise a meeting where some shareholders would take part by means of electronic voting: the meeting has to take place in a specific physical location where all voters, whether shareholders or their representatives, are convening and where they can interact.[53] This argument is often considered preventing electronic voting, e.g. in Germany. However, under pending German legislation, the use of electronic devices would be rendered possible with respect to some stages of the voting process: preparatory communication of documents to shareholders, communication between the bank, with whom the shares are deposited and the shareholder[54], communication of the data on the motions that have been adopted. But the voting itself should remain a privilege of the persons convening. One easily sees the impact of these limitations: the present actors would be able to continue to control the voting process. Professional organisations representing shareholders would not be prevented from attending the meeting, but would not be able to cast their votes electronically[55]. Even the transmission of the general meeting through Internet seems objectionable as it may jeopardise privacy rights of some attendants[56].

The UK also has a change of the Companies Act on its books: according to the proposed rules the communication with shareholders would largely be done electronically, provided they agree with electronic communication[57]. The voting process itself would not be handled by electronic means. Although there is a wide current of opinion in favour of

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[53] The need for interaction is firmly underlined in German legal writing.

[54] But no electronic voting would be allowed for other proxy holders.

[55] Nor would the electronic sharebook be accessible to them, nor to any other shareholder, except as far as teh information relating to his own shares is concerned.

[56] See NOACK, U., Modern Communication Methods and Company Law, www.jura.uni-duesseldorf.de/dozenten/noack/eblr.htm, who considers this restriction inconsistent with the first directive. However, traditional access remains general. See also Noack, U Modern Kommunikationsformen vor den Toren des Unternehmensrechts, ZGR, 1998, 592-616. SPINDLER, Internet und Corporate Governance - ein neuer vitueller (T)Raum, Zum Entwurf des NaStraG, ZGR, 2000, 420-445, at 429.[57] Both under the form of communication and of posting information on the company's website: this applies to annual reports and accounts, and to notice convening the general meeting. It is also related to the appointment of proxies and to requests for holding a general meeting.

electronically held general meetings, the Company law review indicated that the subject deserved further study and that therefore no proposals were made at this stage.

In France, the company act is planned to be changed to allow for electronic voting. The proposed text merely states that the votes cast electronically should be taken into account for the calculation of both quorum and majority. It does not specify whether these votes are cast before or during the meeting, what conditions should be set for the voting process, etc. These items are left open for the implementation decree.

In France, there has already been paid much attention to the disclosure and voting procedures that are related to the electronic voting process. According to French law, all shares, including bearer shares, are either registered with the company or deposited with a central depository, and circulate under the form of bookkeeping entries. As a consequence, only the bank has the identity of the shareholders that are kept in the banks' registries. Therefore, the voting procedure, once initiated by the shareholders, should pass through the hands of the banks that will verify whether the indicated number of shares is held in the account of that shareholder. Votes would be cast in a separate procedure, before the general meeting starts. An "electronic ballot box" would be organised, where the electronic votes would be deposited.

31. As to the casting of votes by electronic means during the physical meeting, a study made by the French Association Nationale des Sociétés Anonymes (ANSA) concluded that at least as far as present conditions of circulation of shares is concerned, it would not be feasible to organise this type of meeting: for each motion, a new instruction should be given by each shareholder, transiting through the bank, after checking whether the stated number of votes are still registered in his name, which then would be channeled to the company for inclusion with the other votes. Each time, the conditions of quorum and majority would have to be checked. In closely held companies, voting by electronic means seems feasible; in listed ones, one still has to wait for further technical developments.

There is little information available with respect to electronic voting procedure used in other states. Some sources indicate that in the United States, these procedures have been used, but no further details could be obtained.

PART II - THE BOARD OF DIRECTORS

a) Comparative Survey

1. Overall structure of the board

32. In some systems the law does strictly spoken not impose the appointment of a board, but merely of directors [58]. Listed companies are managed by boards[59]. There are several systems applied in the different OECD states.

In several states one finds a unitary board: the directors are elected by the general meeting of shareholders, and are responsible before the general meeting[60]. These boards are, at least in the large

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[58] This is the case in the UK act; also in the Canadian CBCA, calling for at least one director; so also in Italy where the articles have a larger freedom to structure the boards. Idem in Ireland

[59] Canada, Greece.

[60] Greece, unless articles state differently; Luxembourg

companies, composed of executive directors, and of non-executive directors[61]. Under the influence of the corporate governance movement, there is an increasing tendency to appoint at least part of the board as independent directors, a segment of the non-executives.

Unitary boards may delegate the day-to-day running of the business to one or more executive directors, or to a committee, composed of executive directors and officers of the company[62]. De facto this may lead to a structure akin to a dual board system.[63] This delegation often is a revocable one as the full board should always remain in command[64]. The appointment of the executive directors, the supervision of the executives, and the general policies, especially the strategy of the firm are, along with legal duties, the traditional fields the board will keep to itself.

The French board structure is based on the unitary pattern: it is, at least before the proposed changes in the law, based on strong concentration of power in the hands of the chairman of the board, who is also the chief executive. The président-directeur général is assisted by one or more, but not more than 5 directeurs généraux. It has now been proposed to split the two functions.

33. A second pattern is based on a dual or two tier board structure: there are two organs, the supervisory board and the management board. The first is appointed by the shareholders, or by other constituencies, especially the employees, while the members of the second board are designated by the supervisory board. The management board is in charge of the day-to-day management of the business, while the supervisory board may either play an essentially internal role of supervision on the management body, or be a supervisory body with in addition limited powers of action.

In some states, it is mandatory for public companies limited to have a supervisory board, while in others the choice is left to the articles. Also, labour co-determination, although more frequently met in the two tier board structure, is not necessary linked to the existence of a two tier board, as will be shown later.

2. Characteristics of the unitary board

2.1. Appointment, position and removal of the members of the unitary board

34. Both in one and in two tier boards, the rule is that the members of the board are elected by the general meeting[65]. In some systems there may be special nomination rights granted to specific classes of shareholders[66], especially also state representatives[67]. Cumulative voting, allowing for better representation of the minorities is still the exception[68]: usually directors are elected by the majority in the general meeting, with no minority representation[69]. According to corporate governance recommendations, directors should be appointed on the nomination of a special committee of the board, selecting the appropriate persons, according to pre-established rules or profiles. If the company has a dominant shareholder, this party will in fact have to approve the nomination.

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61 This is recommended by the Combined Code, applicable in the UK and in Ireland, to ensure that no single individual can dominate the board.

62 Japan

63 See Belgium, also in Italy.

64 Italy (comitato esecutivo)

65 See Australia, Canada, France, Luxembourg, Ireland (unless the articles provide otherwise)

66 Or as in Japan, to shareholders who hold 1% of the shares over the last 6 months, or not less than 300 shares. See art. 143, Dutch NBW.

67 See in Italy for the former state owned companies.

68 Allowed in Italy; discussed in Belgium (art. 55), art. 89 L 1966; but in Dutch Law, the supervisory board can be composed of one member (art. 140 NBW).

69 So in Finland, Greece, in Italy, Japan.

Boards decide in college and will therefore usually be composed of at least three directors[70]. There are in most cases no requirements as to the nationality of the directors: in Australia, Canada[71] and in Switzerland a majority should be nationals. This also applies to half the members of the supervisory boards in Sweden, Finland and in Denmark[72].

There are usually no limits on the number of members a board can be composed of[73]. In France, this is however a much debated subject, the number being fixed under present regulation to 24, to be reduced to 18 under the future law. In Ireland, this figure is put at 25.[74] Corporate governance recommendations often limit the number of directors to 8 to 12 members.

Directors often serve on several boards: in most jurisdictions there is no limitation on the number of boards on which directors can serve[75]. In France, directors may not serve on more than 8 boards of French companies, not including group companies. It is proposed to reduce this number. A director may not be appointed as chairman to more than 2 companies. Corporate governance recommendations indicate that directors should be sufficiently available for the company's interest: a maximum of four boards is therefore recommended.

As to the age limit, the law sometimes provides for a minimum requirement[76], sometimes a maximum [77]. The articles of association may contain provisions in that respect.

Directors serve on boards for limited periods of time: these periods vary between 1, 3[78] and 6 years[79], notwithstanding re-election. There is tendency in governance rules to limit the period for which directors are appointed, to enable the general meeting to keep a better control on the composition of the board. Also, it is often stated that directors may be re-appointed one or two terms, but not systematically. Staggered boards are often allowed by the law but it is unclear how frequently this technique is used.[80] As members can be dismissed at will its usefulness often is not clear.

Whether moral persons can be director is a subject on which a diversity of opinion exists: some jurisdictions refuse[81], while others accept it.

The same applies to whether directors should be shareholders: this old requirement has received new attention as it aligns the interests of the directors to those of shareholders. The requirement was only found in France[82]. It is de facto being revived under the form of stock options.

In some jurisdictions, the majority of the board should be composed of outside directors: in some jurisdictions the law itself provides for this requirement[83], although in most, it is the consequence of corporate governance guidelines[84]

The removal of directors is a privilege of the general meeting[85]: any clause or technique to the contrary is often held void[86]. In most systems removal can take place without cause: the board

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70 E.g. Japan, Belgium.

71 The majority of the directors and the managing director as well; it is proposed to reduce this number to 25%, and to abolish it for board committees. But it will continue to apply to certain sectors that restrict foreign ownership, and in the financial sector as well.

72 Which should be members of the EEA. For Denmark, members of the management board, and at least half the members of the supervisory board shall be residents of Denmark, or nationals of the EEA. According to Ch. 8, 53 of the Swedish Act, the Government can grant an exemption.

73 Japan.

74 Companies (Amendment) n°2 Act, 1999, s.45.

75 Finland, Italy, Luxembourg, Denmark (but the list of a candidate's directorships will be published)

76 18 in Australia; comp. in Sweden (no minors).

77 72 in Australia, s. in France: art. 90-1 (not more than 1/3 above 70).

78 Australia ASX rule 14.3, Ireland

79 Belgium, France, Greece, Luxembourg.

80 France; but as directors are revocable without cause, this does not lead to any protection of directors against their immediate removal; so also in Greece, Denmark, Japan. It is usually the case in Ireland

81 See Canada

82 See art. 95 L 1966, these shares serving as an asset guaranteeing possible liability; but not in Canada; not in Italy.

83 See e.g. Canada: 2 out of 3 directors must by others than officers or employees.

84 This is recommended in the US.

should be the expression of the will of the general meeting[87]. But in case of removal, rules of due process or of orderly decision-making should be followed.

In Italy, unless the articles provide otherwise, all directors step down at the same time and then the whole board is up for election[88]

2. 2. The Internal structure of the board.

35. Under this heading some of the points that have recently attracted substantial attention in the corporate governance debate will be dealt with: the separation of the roles of the chairman and of the CEO, the functioning of internal board committees, but remuneration of the board members can also be placed under this heading.

a) The chairman of the board as CEO

36. In most jurisdictions, the statute does not mention the chairman of the board, and even less his functions[89]. The appointment of a chairman is usually provided for in the articles, or by decision of the board, and his activities are largely determined by custom. Often, in case of a tie, the articles may entitle him to the casting vote[90]

The question whether the chairman of the board can also be involved in the operational management of the company, especially by being part of the management board, mainly concerns the unitary board structure. In the dual board structure, there is a clear separation between membership of the supervisory board and membership of the management board. Although both boards often hold joint meetings, there should be a clear division of tasks and responsibilities.

In the jurisdictions with a unitary structure, the legislation rarely deals with this issue: Paragraph 8 of chapter 8 of the Swedish company code expressly states that the managing director of a larger company shall not be chairman of the board.[91] A comparable rule applies in Danish listed companies: the chairman should not get involved in operational issues which are the task of the management, unless the law or the board has expressly ordered him to do so.[92] In the Finnish Act, it is provided that the managing director may be the chairman of the board of directors, but in larger companies (with a capital of 0,5 million Finnish Marks) only if there is a supervisory board.[93]

In France the law requires the chairman to be the chief executive officer, the all powerful "president directeur-général". However, legislation is under consideration making the system optional, thereby opening the way for a separation of the two functions.[94] The chairman would be in charge of the organisation and the functioning of the board, and the representation of the company.

In the United States, and in the absence of any statute on this point, it would seem that the majority of the boards are still headed by the CEO. However, his preponderant influence would then have to be balanced by a larger number of independent directors.

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85 See Canada, by simple majority; but directors elected by a single class of shares, cannot be removed except by that class. Also in Italy, but damages may be allowed in case the director is removed without cause; idem for Luxembourg; Japan, where he can also be removed for cause by the court upon the application of the holders of at least 3% of the shares.

86 Australia, Ireland.

87 In Greece by 10% of the shareholders.

88 Staggering clauses are allowed, also in Luxembourg.

89 This is the case in Australia, Canada, the Czech republic, Japan; but it is mentioned in Greece (art 20) and in Italy (art 2380 (4) Civil C: but the chairman can be appointed by the general meeting.

90 E.g. in Finland.

91 I.e. with more than one million kronor; comp. D. 56, Danish Act.

92 § 51 (3) of the Danish Act.

93 Ch. 8, sect. 18, Finnish Act.

94 See “la loi relatif aux nouvelles régulations économiques”.

In the United Kingdom too, there is a strong trend to appoint separate chairmen and CEO's. The Corporate Governance recommendations read in this sense: "there should be a clear division of responsibilities at the head of the company which will ensure balance of power and authority, such that no one individual has unfettered powers of decision"[95].

In the other states, the factual situation is mixed: in Belgium, one finds a wide variety of factual situations, with a tendency towards the UK approach. The governance codes recommend however to separate the two functions[96]

In the other states, there is no specific rule applicable to this issue: it means that the managing director may be appointed chairman of the board[97]. The practise has been documented in a Korn/ Ferry study[98] and indicates that in Southern European States, in 57% of the companies analysed, both functions were separated, another 7% considering to introduce such a separation, while the remainder 36% declared not to consider such a change.

b) Board Committees

36. Most corporate governance recommendations contain a statement about the usefulness of having committees of the board to advise the board on specific issues. These committees are either voluntarily instituted by the board[99], imposed by stock exchange listing conditions or by corporate governance recommendations.[100]. Statutory provisions on committees are still very rare and framed in very broad terms[101]. In some non-statutory provisions, the types and functions of these committees are described in more detail[102]. As the committee practice is still relatively recent in most jurisdictions, one should not so much pay attention to the prescriptions on committees, but rather check how widespread this practice has become. It seems that today most listed companies have at least an audit committee.

Usually three committees are provided for. The audit committee is the most important one: it keeps under review the scope and results of the audit and the independence and objectivity of the auditors.

Usually committees are composed - by majority or exclusively - of directors that are not involved in actual management, whether independent or outside[103] directors. This applies especially to the audit committee, preferably composed of independent directors only.

The remuneration committee proposes, within the framework determined by the board, the remuneration of the managing directors, and some of the higher officers of the company. The members should be independent directors, free from any relationship that could materially interfere with the exercise of their independent judgement.

The nomination committee prepares the nomination of new board members, and most importantly considers the issues of the replacement of key management functions, including the

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95 See the Combined Code, §§

96 This is the case for the Belgian (for empirical data: see Wymeersch, Comparative governance after the Investment Services Directive, European Financial Services Law, 1996, nr. 4, p. 98-102, nr. 5, p. 130-141) and the Spanish codes.

97 This is the case in Greece, in Japan, Luxembourg, Portugal, Spain, Turkey; also in Italy, except in large listed companies

98 Korn/Ferry Report, nt. 161, p. 17.

99 Hence there is no statutory basis: Austria, Belgium (recommendation by the stock exchange but a proposal to be submitted to parliament would expressly allow advisory committees to be formed) Denmark, Finland (Stock exchange recommendations). Committees are not mentioned in: Czech Republic; Germany (increasing practice), Greece, Italy Japan, Ireland (but Combined Code applies) Luxembourg, Poland, Portugal, Spain (but corporate governance codes recommend), Switzerland (widespread practice), Turkey.

100 E.g. in Canada, TSE.

101 The law mentions committees in: Canada (mandatory audit committees); France (art.90, Décret 1967, but no specific in the regulation)

102

103 e.g. Canada, s. 171(1)

CEO. In some cases this committee evaluates the board members and the corporate governance practices followed by the board[104]. It is composed of a majority of non-executives, and may chaired by the chairman of the board.

In European companies, one sometimes finds other committees: strategic committees are often formed as an instrument of dialogue between the controlling shareholder and the management. Recently, "corporate governance" committees, or ethical committees have been found, seeking adherence to better governance or more ethical behaviour.

At least with respect to listed companies, it is customary to mention in the annual report the existence of the committees of the board, their composition, and sometimes also some information on their functioning.

c) Remuneration of directors

37. On the subject of the remuneration of the directors, one should recall the distinction between the position of members of the supervisory board, and that of the directors effectively managing the company.

1° - non-executive members of the board

In principle, the remuneration of the board members, including the members of the supervisory board, is fixed by the general meeting of shareholders[105]. This corresponds to the agency relationship. However, in some jurisdictions, directors are fixing their own remuneration.[106] Restrictions would flow from general principles of fiduciary duties, and rules on abusive self-dealing by directors.

Usually board members receive a fixed remuneration, in France linked to their attendance of the board meetings[107]. In many legal systems, directors may also be entitled to part of the company's profits, creating conflicts of interest. Therefore this practice is often frowned upon.

More recently, it has been discussed whether board members should be entitled to stock options, usually reserved for the executives. Positions are divided: some argue that granting options would motivate the directors to perform better, others underline the conflicting interests that may emerge by allowing directors to be dependent on the company's share price. The latter has become apparent in share buyback programmes, where alleged by company funds were used to increase the share price.

Disclosure of directors' remuneration is also a topic that is differently looked upon according to the legal system concerned: in the US, Canada[108] and in the UK remunerations[109] are published on an individual basis, especially for the executives. This is not the tradition on the European continent, and remunerations are disclosed anonymously, on an aggregate basis for the entire board and management[110]. However, in France the employers' organisation has accepted to disclose the remuneration of the highest officers of the company[111]. Corporate governance codes would invite companies to disclose their remuneration rules and guidelines, but not the individual figures.

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[104] See the TSE listing conditions

[105] Belgium; Czech Republic; Denmark; Finland, France; Germany (for the supervisory board) Greece; Italy (art 2389 C.Civ; also for the collegio sindacale.), Japan (lump sum, to be divided by the board) Poland (for the supervisory board) : Portugal; Spain, Turkey

[106] See in several US state laws, e.g. Delaware; also s. 125, Canadian CBA; Also in Switzerland 677-678 Code of obligations verdacht

[107] Art.107 a.s., L. The general meeting allows a lump sum, further to be divided by the board (art. 93,(1) Décret).

[108] Also detail are published in the proxy circulars Reg. s.35 (t)

[109] Also in Ireland according to the listing rules

[110] This would be mandated in the future also in Switzerland, but it is unclear whether it will take on an aggregate than on an individual basis.

[111] To be checked: CNPF

It is controversial to what extent non-executive members are eligible for stock options[112].

2° - remuneration of the executives

38. The remuneration of the managing board members, or of the operational managers is fixed by the board of directors[113], or the supervisory board[114], more rarely by the general meeting[115].

Often remunerations are determined on the proposition of the remuneration committee, acting within the framework of general guidelines fixed by the board. Individual negotiations are the rule for the members of the management.

Remuneration packages usually include a fixed fee portion, including perks, pension benefits, stock grants[116] while an increasingly large part of the remuneration is determined as performance related. In addition stock options are often included in the package[117]. In several jurisdictions the granting of stock options is subject to a decision of the general meeting[118].

Most of the time there are no limits to the remuneration[119] apart from the deterrent effect of disclosure. In some jurisdictions however, general principles such as fiduciary duties, or general principles on "fair and reasonable" behaviour may restrict the board's unlimited freedom to fix remuneration of executive directors[120] Also criminal law provisions such as on "abus de biens sociaux" may help to temper over-greedy directors. In Poland, there is an explicit ceiling: in the state controlled sector, the director's salary shall not exceed 6 times the average in the sector[121]

to be added UK + US

2.3. Conflicts of interests at the level of the board of directors.

39. In most legal systems compared, there are express rules on conflicts of interests involving directors. These rules either establish a general standard of honest and fair behaviour, enforced by general principles of fiduciary law, or establish specific procedures and disclosure obligations, which, if complied with, would protect the directors against liability. In some legislation all three approaches are found. This is the case in Part X of the United Kingdom Companies Act 1985 entitled "enforcement of fair dealing by directors", where certain transactions fall under an outright prohibition[122], others being subject to prior approval of the general meeting[123], while additional disclosures apply to a third group[124].

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112 See for the negative art. 208-1, L 1966; but see projet de loi relatif aux nouvelles régulations économiques, except if the directors also is an employee, including the pdg. Idem in Germany; allowed in Switzerland

113 See Belgium (also according to the draft law)

114 Austria, France L.; Germany; Italy (after consultation of the supervisory board) Poland

115 Czech republic

116 Preferred to stock option in Italy

117 See Austria; also Belgium, Denmark; Finland; Italy; Japan

118 e.g. in Japan; Spain

119 So e.g. in Italy; Luxembourg

120 See e.g. in Austria, § 78(1) AktG; comp. the rule in the Czech Republic no benefit would be granted a director who has "obviously contributed to adverse financial results of the company, or who has acted in violation of a legal duty in connection with his directorship". Idem in Denmark, s.64, according to which the remuneration must be normal in view of the nature of the duties or the scope of the work, and reasonable in relation to the companies and the group's financial position. See art 339 of the Portuguese Act

121 While for the members of the supervisory board, the relationship is one to the average wage in the enterprise's sector.

122 s311 of the UK Companies Act prohibiting to pay remuneration free of income tax.

123 E.g. in France

124 Belgium.

However, in such a complex field, compliance with the company law may not be sufficient, as other rules, especially criminal law provisions, may impinge on the matter. This is especially the case with the rules on "abus de biens sociaux" as exist in France and Belgium.

Conflict of interests matters are dealt with differently in company systems with a supervisory board: if conflicts arise at the level of the management board, these can be dealt with by submitting the matter to the supervisory board[125]. If the conflict arises at the level of the supervisory board, identical procedures apply[126]

a) Conflict of interest defined

40. Conflicts of interests may be of very diverse nature.

In most cases conflicts are limited to personal direct interests of the directors, including interests through other companies in which the director has substantial interests[127]. These interests are usually of a financial nature, excluding conflict situations based on general family interest, or moral or political interests[128]. In some statutes, the conflict is defined as relating to agreements or legal proceedings between the director and the company[129], including contracts with third parties, in which the director has a material interest[130].

A further distinction relates to personal v. functional conflicts: the second arise out of other functions the director exercises, e.g. as a director in other companies. This subject is of special importance in groups of companies.

In French law the rules on conflicts apply to all contracts between a company and its directors, or its directeurs-généraux, including contracts between companies with interlocking directorship, at least if the director is managing partner or executive director of the other company.[131] But relationship with group companies without interlocking directors in the position as mentioned would not be governed by that provision.

b) procedural techniques

41. The most frequently found procedural technique consists in having the directors with a conflicting interest give notice of the conflict to his fellow directors[132] and abstain from taking part in the discussion and from voting at the board[133]. However this is not found everywhere: in several systems, the director may take part in the vote, provided he has disclosed his interest. This allows the board of small companies to reach decisions, even if conflicting interests are at stake. Typically the directors of listed companies would not have the right to take part in the vote: here the interest of investors is at stake and a stricter fiduciary standard is applicable.[134] French law requires, apart from the above mentioned obligations, a special report of the auditors and an approval by the

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125 See Austria §§ 79 and 80, Ö AktG, § 89, D. AktG; also the future Belgian draft law;

126 Denmark; Germany §114 and 115 AktG; for the supervisory board members

127 Greece

128 This was the case in Belgian law; also CBCA 120(1)

129 Denmark

130 Finland Ch.8,s.10

131 Art. 101, L. 1966

132 So e.g.; in Australia ; Belgium 524; Canada, including the case of a company in which a director is later appointed while the director was a party to a material contract with the company: s. 120(2) CBCA. Italy, art 2391 CC. See s. 317(1) Companies Act 1985 as to the duty to declare interest, irrespective of a specific transaction.

133 Australia, s.191; also in Belgium; CBCAs.120(5) unless the decision relates to his remuneration; art 2391 Italian CC, Portugal, comp. Poland. In the UK, where there are numerous explicit prohibitions on conflict of interest transactions, there is no general rule preventing a director with a conflicting interest to take part in the board meeting deciding on the contract.

134 Australia, S.195, but the other directors may approved the director with conflicting interest to take part. Also the Australian Securities Investment Commission may derogate;

general meeting.[135] In the UK, prior approval of the general meeting applies to substantial property transactions [136]

In the US too there is an overall prohibition on self-dealing. Conflicts of interests should be disclosed, and the decision taken by the disinterested board, or by the shareholders. The transaction should in any case remain fair to the company.

Sanctions and remedies are diverse: the court may set aside the contract entered into without complying with said rules[137] In French law, approved transactions protect the directors against liability, except in case of fraud[138] More generally, directors would be liable in case the procedures have not been followed[139], and may in some jurisdictions even be held criminally liable[140].

c) Reporting and disclosure

42. In many jurisdictions, the auditors have to be informed and presented a report on the effect of the transactions[141]. The general meeting is informed about transactions with conflicting interests. In some cases, special mention in the director's report has to be made.[142] In the UK, service agreements of directors are open for inspection by the shareholders[143]. The stock exchange listing conditions sometimes impose stricter disclosure rules, including rules on parent-subsidiary conflicts of interest[144].

d) Explicit prohibitions

43. Some jurisdictions have in their statute explicit prohibitions on certain types of contracts or transactions between the company and its directors. This is especially the case for loans and credits, including security to the directors.[145] Competing with the company is also restricted and cannot be undertaken except with the company's consent[146].

e) General fiduciary standards

44. In the Anglo-Saxon systems, director's liability is measured at the yardstick of their fiduciary duties towards the shareholders[147]. Normally, the compliance with the strict procedures that have been outlined before would not protect them if their behaviour falls short of the fiduciary standard that is held applicable[148]. This obligation to act in the best interest of the shareholder

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135 Art. 103 L.1966; also in Turkey, the general meeting should first authorise the transactions.

136 s.320 -322 companies act 1985

137 See s.120§8) CBCA

138 Art. 104, L.1966

139 Belgium where directors could be held liable, even if the procedures were followed and the transaction was "grossly prejudicial" to the company (art. 60 § 2), Italy, art 2391 CC.

140 Italy art 2631 CC; compare rules on "abus de biens sociaux".

141 E.g. Belgium art. 524; France, art 103, L. 1966.

142 Belgium, art. 524, Luxembourg

143 s.318 Companies Act,

144 This is the case with the UK listing conditions; also in Belgium; see art. 60 bis of the companies Act.

145 See CBCA, 120(5); France, including guarantee, but excluding normal transactions at market conditions ; s.332-338 of the Companies Act 1985

146 See Poland, also Czech Republic, Turkey; Portugal: see ¤ 88, D. AktG.

147 This is also the case under state law in the US, where notwithstanding the above mentioned procedures, directors may not take advantage of their position through unfair or fraudulent transactions. The question of corporate opportunities has received much attention.

148 So in Belgium, under art. 60, § 2; comp. the Greek rule according to which the board may not pass any resolution likely to give an undue advantage to a shareholder or a third party to the detriment of the company or other shareholders.

guides the directors in their behaviour: either to be absent from the meeting, to simply abstain from voting, or even to resign their directorship[149]

In Swiss law, in the absence of a specific prohibition, directors are held by a general duty to act in the interest of the company. Conflicts of interest must be notified in due time[150].

In the other systems, liability would be barred by the procedures having been complied with, except in case of fraud[151].

3. The Dual board structure

3.1. General rules and status of dual boards

45. Several states in the EU adhere to a dual board structure, mostly as an obligatory structure[152], sometimes as an optional form[153] But intermediate structures exist: in Denmark, e.g. or in Italy, where the College sindacale, or board of auditors is comparable to a supervisory board, but with less powers than the usual supervisory board: it exercises no surveillance on the board of directors who are not accountable to this board, but to the general meeting. The recent reform of the law has more clearly defined the tasks of each of these bodies.[154] The Danish system is reported to be in between as there is a board of directors, in fact a supervisory board, which appoints the management board, which may be composed of one single person. He may be a member of the board of directors.

The number of members of the supervisory board varies widely: at least 1 in the Netherlands[155], and at most 7 in France[156]. They must be physical persons.[157] Often, supervisory board members must be independent; therefore one cannot be simultaneously member of the supervisory board and of the management board, nor officer of the company[158]. Even when some member can sit on both boards, as is the case in Denmark, the chairman of the supervisory board may not be an executive director.

The rules of appointment of supervisory board members are regularly the same as for the members of the unitary board[159].

The management board is usually appointed by the supervisory board[160], although here too special presentation rights may have been stipulated.[161] Members are appointed with better

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149 According to the Australian law. Also in German law for members of the Aufsichtsrat.

150 Art 717 CO, but misuse of business secret for own purpose is a criminal offence.

151 This seems to be the French position.

152 Germany, Czech Republic; Poland, in the Netherlands, it is obligatory for larger companies with own funds of at least 25m. DFL and at least hundred employees in the Netherlands.

153 E.g. France, where an increasing number (22 %) of stock exchange listed companies have chosen for a dual board. In Finland, for companies with 80.000 Euro share capital. It is reported that their number is decreasing, also in the banking sector where it previously was compulsory.

154 In listed companies, auditing will be entrusted to the external auditors, while the collegio sindacale will be in charge of supervising the legal duties of the company and the internal organisation and controls an the disclosure as well.

155 See art. 140 NBW but 3 in the large company; in the Czech republic, both boards should have at least three members. In Poland, there should be at least one manager, and the supervisory board should be composed of at least three persons;

156 5 in Finland, one to three in Denmark; three in Germany: § 95, D. AktG; § 86 (1) Ö AktG.

157 See Finland

158 Except in, Denmark where the rule applies that the majority of the members of the board of management shall not be members of the supervisory board. In Germany, the prohibition extend to members of the management of subsidiaries, nor of other companies in which a member of the management board is part of that company's supervisory board (§ 100, D. AktG). Comparable rules exist in art. 160, Dutch NBW.

159 See France.

160 Finland, e.g. although the articles may stipulate that the general meeting will appoint both. Idem in Denmark, where public authorities or third parties may have received the right to appoint a minority of the supervisory board.

161 See Netherlands

protection against removal: in France the protection lasts for 2 to 6 years at least[162]. Removal can only take place by decision of the general meeting, on proposition of the supervisory board.[163] In some systems, there may also be direct election by the general meeting[164]

The Italian system is somewhat different as members of both the board of directors and the board of auditors are elected by the general meeting. There should be at least three members. However, there is a minority representation : at least one member must be elected by the minority of shareholders.

Removal of management board members is generally effectuated by the constituency that has elected those members. The shareholder representatives can be removed by the general meeting without notice[165] Often the same applies to the employee representatives. The Dutch system is different: members of the supervisory board cannot be removed except for cause[166].

3.2. Co-determined boards

46. In several European states[167], boards are subject to rules of co-determination, according to which employees or their representatives are involved in the board's decision making. Most systems are based on the existence of a dual board system.

Co-determination in the supervisory board is found in Denmark, Finland and Sweden. The most famous examples are Germany and Holland. More recently Poland and the Czech Republic joined the list.

a) The Nordic States

47. In Denmark co-determination is mandatory as soon as 35 employees[168] are employed: they will elect their representatives, up to 50% the number of the directors elected at the general meeting, but not less than two. Under the said threshold, co-determination is left to the articles of association, providing for 2 or more employee members.

In Finland, large companies with over 150 employees should have representatives of employees, whether at the level of the supervisory board, the management board, or in an ad hoc body covering all the divisions of the company.

In Sweden the representation of employees is governed by an act of 1987 [169].

b) The German system

48. The German and Dutch systems of co-determination are complex.

Two tier boards with employee representation are compulsory in Germany; the obligation also applies to larger firms in the Netherlands[170]. The two systems are quite different, conceptually, in structure and in composition.

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162 Four years in Denmark.

163 The future law would permit removal both by the supervisory board and by the general meeting.

164 Czech Republic

165 Denmark

166 Art. 144 NBW: members of the supervisory board can always be removed by the persons who appointed them. In the larger Dutch companies (see nte 146). They can also be suspended by the supervisory board or by the judge if there is cause (art. 161 §2 and 3 NBW).

167 There are no rules on co-determination in: Belgium, Italy, Portugal, Spain, Switzerland, Turkey, United Kingdom, United States,

168 Calculated on a consolidated basis; special rules apply to groups

169 To be further researched.

170 It applies only to the large NV: art. 153 and 158, Book 2, NBW.

The German system is based on compulsory representation of both shareholders and employees on the supervisory board. There are three systems of co-determination:

1°) In the steel and coal sector (Montanmitbestimmug), the supervisory board is composed of two times five members, each representing capital and labour, while an eleventh member is added with a neutral position, who is elected by the general meeting on proposition of the majority of the members of the supervisory board in each section. In addition, an “Arbeitsdirektor” is appointed as member of the managing board, elected on the proposition of the majority of the board, but also of the majority of the representatives of the employees. The rule applies to all AG and GmbH in the steel and coal sector employing more than 1000 employees.

2°) In the other sectors of the economy, co-determination is mandatory, either according to the scheme applicable to smaller firms, in accordance with a 1952 law (Betriebsverfassunsggesetz) or, for larger firms, according to the 1976 Mitbestimmungsgesetz.

According to the 1952 law, one third of the members of the supervisory board are employees of the firm. It applies to all firms, with more than 500 employees, except firms belonging to a single physical person, or to a partnership of physical persons.

3°) The 1976 system is based on a modified system of equal representation, and is applicable to all larger companies, whatever their legal form, with 2000 or more employees in the group. This is the most frequently applied system, and will be analysed hereunder.

49. The German system of labour participation is based on a complex system of direct or indirect representation on the supervisory board. In the largest companies, counting 20.000 or more employees the board is composed of two times 10 members, each elected by the shareholders or by the employees. The employee representatives are in part direct employees of the enterprise,- seven in the largest enterprises, elected by the employee delegates[171] - and three representatives of the unions, represented in the group[172]. The chairman of the board is elected by the representatives of the shareholders: he has a casting vote in case of a tie, but this is seldom used[173].

Representatives of the shareholders are elected for a period of four years[174]. These are elected by the general meeting, in which the banks play a leading role. They cannot be revoked except with a 3/4ths majority. Supervisory board members are appointed for a 5-year term. They can be members of other supervisory boards, but not more than ten, except within groups, where they can take up an additional 5 seats. Members of this board cannot be managers of subsidiaries of these same company, nor managers of a company in the board of which the manager of the company has been elected[175].

The managing board is composed of mostly five members, one of which is the labour director. The board is appointed by the supervisory board, and cannot be dismissed except for causes independent of office results.

Under German law, the members of the managing board are appointed by the supervisory board for a definite period of time[176] and cannot be dismissed except on serious

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[171] See § 9, MitbestG. Direct election is optional for the larger enterprises.

[172] See for details § 7 (2) to (4) of the MitbestG.

[173] See HOPT, K.J., indicating that "it would alienate good relations with labor and well beyond" in The German two-tier board, Comparative Corporate Governance, Comparative Corporate Governance, Berlin, 1997, p. 67-118.

[174] § 102 AktG. This rule results in practise in a 4 to 5 year term: HOPT, K.J.,

[175] § 100, 2) (3) Both rules serve to avoid supervised to be supervisors.

[176] Five years in Germany, § 84 (1)(1) AktG. comp. art. 272 NBW.

grounds[177].independent of office results. These guarantees for independence are not present under Dutch law[178].

According to this dual structure, members of the management board are not part of the supervisory board. As a consequence both bodies have different chairpersons.

50. The German system has inspired some of the regulations in the neighbouring states.

Luxembourg has mandatory employee representation for large companies, i.e. those employing 1000 or more employees. One third of the board of nine must then be composed of employees. The regime is applicable to a handful companies: Arbed, RTL,

In Poland the law provides that for large enterprises (i.e. with more than 500 employees) 2/5th of the supervisory board should be employee representatives, but this applies only as long as the state remains sole shareholder. The regime continues to be applicable after privatisation of the company.

The Czech Republic has followed a scheme inspired on one of the German systems: at least 1/3 of the supervisory board is elected by the employees, if the company employs more than 50 persons. They can only be removed by their employee constituency.

c) The Dutch system

51. The Dutch system is quite different from the German one, as not being based on the proportional, - according to some "adversarial" - representation of both components of the enterprise, but rather on the consensus between the two traditional production factors, capital and labour[179].

The system, known as the “structuurvennootschap” is based on the mandatory structure of the supervisory board, the law imposing a number of statutory requirements and fixing competencies. Labour representation at the level of the supervisory board is indirect and based on co-optation of members of the board who, without being labour representatives, enjoy the confidence of the employees. Therefore, members of the supervisory board are in a specific position of independence: they do not represent labour interests but have to take care of “the interest of the company and its related enterprise” as a whole.

The “structuur”-regime is applicable to all larger companies, both of the nv- and of the bv-type. Are considered “large” companies: companies that have own funds exceeding 25m. DFL, have an “enterprise council”, and employ more than 100 persons within the Netherlands.

There are important exceptions to the rule, especially designed to take into account the international group structure of some of the major Dutch firms: Dutch parent companies of international groups such as Royal Dutch, Unilever, Philips, Akzo and Heineken, are fully exempted as being mere holding companies of groups, the majority of their employees being located outside the Netherlands[180]. Further full exemptions relate to subsidiaries, including joint ventures, of groups that are subject to the co-determination rules at the parent company level.

Besides, there is also a “scaled down” regime, according to which two essential competencies of the board would not apply: these are the rules on appointment or dismissal of managing directors and the rules on approval of the annual accounts, both privileges being exercised at the parent company level. But the rules on co-optation of members of the supervisory board, and their supervisory powers on the management board remain fully applicable. This regime

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[177] See § 84(3) AktG. comp.

[178] Comp. art. 272 NBW.

[179] This difference of approach has been underlined by Unilever’s chairman TABAKSBLAT, Corporate Governance in internationaal perspectief, Naamloze Vennootschap, 1995, at. 245.

[180] This criterion leads to distortions, as distortions, as many Dutch firms would qualify under the exemption. See: VAN DEN HOEK, P.C., Dient het structuurregime te worden aangepast aan gewijzigde omstandigheden of inzichten, in: Knelpunten in de vennootschapswetgeving, Kluwer, 1995, 42.

has been provided for certain group entities that are subject to the “structuur” regime, but being dominated by Dutch or foreign parents that are not subject to the co-determination rules, would result in these parents not to effectively exercise control over their Dutch subsidiaries. This regime can be invoked by parents if the majority of its employees are active outside Holland, or by joint ventures when none of the participants is a Dutch parent subject to the co-determination rules[181]. Foreign parents sometimes maintain the co-determination regime upon acquisition of Dutch subsidiaries.

Finally there have been some cases in which the minister of Justice has granted exemption of the” structuur” regime[182].

52. According to the Dutch “structuur” regime, the companies subject to its rules have to introduce a two tier board[183]. The typical “structuur” regime implies that the members of the supervisory board - at least three- are co-opted by this board, acting on proposals submitted by the general meeting, by the enterprise council or by the management board. For that purpose the shareholders may institute shareholder committees. The appointment by the board may be opposed by the general meeting or by the enterprise council, i.e. by capital or by labour. Objections may be based on the grounds mentioned in the law, especially that "the expectation that the nominee will be unfit for the function as a board member or that the board will not be correctly composed"[184]. If the board maintains its appointment notwithstanding the objections, the matter may be brought by the “enterprise council” - i.e. mainly the employees of the firm- before the "Enterprise Chamber", a specialised Chamber of the Amsterdam Court of Appeals. In practice, conflicting views are settled either by the nomination being refused by the candidate, or by the board preferring to propose a new candidate. In about 25 years, only 11 cases have been brought before the courts.

There is some case law dealing with objections against the appointment of board members, mostly based on the third ground, i.e. the board has not been composed in a balanced way. Among the cases that have been commented on, the objection was upheld based on the finding that the board would be exclusively composed of persons with economic-financial and technical expertise, without anyone having knowledge and experience in the field of social relations[185]. In another case, objections were upheld as two out of three members were group officers, who had no experience in the Netherlands, having never lived nor worked there[186]. It has been suggested that a board composed exclusively of officers of the parent company, would not be composed in a balanced way. In another case it was considered that the supervisory board should be composed of members that are sufficiently independent v.à.v. the parent company. The mere fact that officers of the parent were appointed to the board would not prevent the board from acting independently. As three out of five would have been officers of the parent, their nomination was considered not justified on that ground.[187] In practice however, most conflicts are settled, in accordance with the underlying purpose of the legislature, i.e. to promote harmonious relations between labour and capital[188].

The number of members of this board is determined by the charter, and if not provided for, by the board itself. Also the same rules apply as to the age limit in non co-determined companies.

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181 Art. 155 NBW.

182 27 cases had been published in 1992: see VAN DER HEIJDEN-VAN DER GRINTEN, Handboek van de naamloze en de besloten vennootschap, 12e Ed., 1992, p. 65.

183 See art. 150 comp. art. 158, and VAN DER HEIJDEN-VAN DER GRINTEN, Handboek van de naamloze en de besloten vennootschap, 12e Ed., 1992, 272, p. 473.

184 As this is stated in art. 158 (6) of the Companies Act, Civil Code, Book 2.

185 Nederlandse Standard Electric Maatschappij, Decision of 16 march 1979, N.V., 1979, 94, nt. VAN SCHILFGAARDE.

186 In the case of Cyanamid, NV, 1983, 233, nt. VAN SCHILFGAARDE; for an overview of these cases see VAN SCHILLFGAARDE, nt. 362, 370 e.s.; also: SLAGTER, Ondernemingsrecht, 262.

187 Kodak Nederland, OK, 2 February 1989, NJ, 1989, 86, nt. MAEIJER; NV, 1989, 20, nt. VAN SCHILFGAARDE.

188 See in this sense, SANDERS and WESTBROEK, BV en NV, 5th Ed., 6, p. 326; SLAGTER, Ondernemingsrecht, 262.

In principle, the supervisory board has the same competencies as in the common “non structure” system. However, the law contains a list of subject matters which have to be submitted to the supervisory board, either for decision of for advise, before being submitted to the general meeting[189].

53. As has been made clear from the preceding description, the Dutch system is not based on employee representation, but on the presence of board members that enjoy the confidence of both shareholders and personnel and adhere to a large vision of the business's purpose incorporating the "interest of the firm" rather than that of the shareholders or the employees. The role of the supervisory council has therefore been defined by the law as the "surveillance of the policies pursued by the management board and of the general state of affairs of the companies, and of its related enterprise"[190].

In the “structuur regime”, the appointment of the management board members must be decided by the supervisory board; the charter could not provide nomination rights for any other body. However, the supervisory board will inform the general meeting or the shareholders commission of its intended nomination. The enterprise council is entitled to give its opinion on the intended appointment. Unless otherwise provided for in the charter, the supervisory board will determine the duration of the directors’ employment contract.

54. The Dutch “structure regime” has been criticised in legal and other writings. Some have argued that, as presently organised, the regime results in insufficient external scrutiny on management, the supervisory board members being all too dependant on the management board. Cronyism is considered one of the main reasons why some long established Dutch companies - DAF, OGEM - collapsed, or were greatly endangered (Philips). Increased shareholder influence is argued[191].

According to recent reports[192] the law is likely to be changed to allow for a 1/3rd direct representation of the employees, putting an end to the co-optation system.

d) France

55. The French co-determination regime is voluntary[193], except for state enterprises. In general employees may be appointed to the board, but their number should not exceed 1/3rd of the board's members[194] The regime exists at the level of the unitary board, and also in the supervisory board; the law forbids employees to take part in the management board, or "directoire"[195]

In private companies, the articles may provide that up to five[196]representatives of the employees may take part in the board. In addition, if the employees hold at least 5% of the shares, the question of employee representation should be submitted to the general meeting [197]. These

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189 Art. 164 NBW, providing for a right of approval of the management board’s decision.

190 Art. 140(2) NBW.

191 See e.g. WILDENBERG and ZWETSLOOT (Ed). Naar een nieuwe machtsdeling in de Nederlandse Vennootschap, Kluwer, 1994, for a more balanced opinion: VAN DEN HOEK, P.C., Dient het structuurregime te worden aangepast aan gewijzigde omstandigheden of inzichten, in:Knelpunten in de vennootschapswetgeving, Kluwer, 1995.

192 See FT, 14 november 2000, referring to a preliminary report of the Social Economic Council

193 See Le Fèvre, La partipation, Rev. Sociétés 1987, 189.

194 Art. 93, L. 1966.

195 Art. 142, L. 1966.

196 In listed companies, L 5 Januari 1988; in unlisted companies, the number is fixed at maximum 4. However, in any case, it should not exceed 1/3 of of the board.

197 Art.5, L 25 July 1994

representatives are elected by the employees, not by the general meeting and are added to the board. The employee representatives cannot be revoked except by a decision of the tribunal[198]. With respect to all other aspects, including liability, they are subject to the same rules as all other directors.[199]

e) Other states

56. In the Czech Republic at least one third of the members of the supervisory board is elected by the employees of the firm, if the company has more than 50 employees. They cannot be removed by their constituency.

b) Recent issues and trends

57. From the preceding overview of the statutes dealing with the board of directors it would seem that there is little discussion and controversy in this field. This impression is highly misleading. The corporate governance discussion is going on in almost all of the economically developed states but has not yet found an expression in the different statutory instruments. Therefore much of the reforms take place without outside the legal framework, this is in selfregulatory instruments, or have only reached the level of draft laws, some of which are being discussed in the parliaments concerned.

There have been several stages in the corporate governance discussion. In the first stage, the dissuasion turned mainly around the functioning of the boards, the relationship between chairman and CEO, the presence of independent or non-executive directors, the necessity to install audit and other committees, and the issues involving orderly decision making. In that perspective one has to view the recommendations that were put into place in the UK and in several European systems, mainly inspired by the UK Cadbury rules of best practice (Belgium, Italy Spain, Portugal). Most of these recommendation were imposed on listed companies only, and maintained by a mechanism which is known as “comply or explain”. In other states studies were initiated, leading to detailed recommendations or actions, but without a specific mechanism of enforcement (France, Netherlands). In Germany, studies are still under way.

Developments in the United States call for a special mention,. First, they precede the European developments by at least a decade: already in the seventies, and probably before, the SEC took interest in governance issues as part of its action of supervision of the securities markets and required e.g. the appointment of independent directors, and the installation of audit committees. At the normative level this lead to the impressive and at that time highly controversial Restatement of the Law on Corporate Governance, prepared by the leading company law specialists in the US and published by the American Law Institute. Even for non US analysis and practice, this publication is a useful source of information as it outlines in clear terms the policies and legal questions that are worth to be considered. It furthermore establishes links with other fields of the corporate system, such as the duties of the board members, and the rights of action of the shareholders.

58. The corporate governance discussion has since reached all fields of the corporate world, and even beyond. It is striking how frequently he term corporate governance, which was unknown ten yeas ago is being used, even in the regular newspapers. This points to a keen interest in the issues of governance and the perception that a company’s continuing success in part hinges upon the adoption of solid governance structures. Companies themselves, under the pressure of the

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[198] Art. 97-6

[199]

markets pay increasing attention to their governance: if the number of pages in their annual reports can be used as a yardstick, corporate governance is certainly at the heart of their endeavours.

What stands for better governance may vary from state to state: in large part of Europe it stands for more balanced, objective decision making, less influence of the controlling shareholder, better surveillance of the corporate processes, including the auditing and inetrnal controls, more attention for the investors and the markets, including better relations and more disclosure. In other systems, it will focus on a rebalancing of the board, reducing the influence of the CEO, who is also chairman, with directors appointed on an objective basis. Greater attention for the interests of the shareholders, including the institutional investors. To sum up: corporate governance in the first series of systems - the so-called insider systems - covers a wider range of issues than in the second.

59. It is striking that almost the entire governance revolution has taken place outside the regulatory apparatus: selfregulation in its different appearances has been able to deal with them, thereby preventing the choices to be definitely chiseled into marble. By choosing for soft law, experiments have been made possible, and they still are numerous. The market forces have been able to come into play, penalising the laggards, without necessarily offering a premium for those who tried to excel.
In some cases this soft approach was insufficient. One now sees the legislators slowly moving in: in several jurisdictions, initiatives are being developed, still rather timid. France will do away with the authoritarian regime of the CEO, Belgium has a draft law on Corporate governance, Italy has introducing some measures in the Draghi Reform, while in Germany, in the KonTraG, some of the take-over protections were abolished.
It is striking that *the* governance issue that was occupying the best minds in Europe for the last 25 years has almost entirely been left unmentioned: co-determination is not frequently discussed these days, at least in those states that have not made it mandatory in the 60s and 70s, while in the other states its abolition has been considered here and there.

The phenomenon may be attributed to the introduction in several legal systems of better protections for the workforce, and better consultation techniques outside the ultimate decision making process at the head of the company. By freeing the board from the obligation negotiate with the labour representatives as part of its decision making, the board has been able to focus on the interests for which it has been appointed. The interests of the stakeholders, mainly the employees has been adequately secured in other organs, especially the Workers Council.

PART III - LEGAL CAPITAL

a) Comparative Survey

60. The rules on legal capital differ considerably: in the EU, the Second Company law directive has largely harmonised the applicable provisions, as far as the public companies limited are concerned. Hence in the EU member states, and in some jurisdictions that follow EU regulation in this respect, the applicable regulations have been largely harmonised[201].

In the non-EU jurisdictions, more specifically in the US and in Australia, legal capital has lost its significance: the initial obligation to form a capital has been abandoned, and the other rules

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[201] For a thorough comparative overview of the implementation of the Second directive in the national company law statutes, see J.N. Schutte-Veenstra, Harmonisatie van het kapitaalbeschermingsrecht in de E.E.G. Kluwer, 1991, 348 p.

that are linked to the notion of capital have been largely abandoned, or were framed in different terms.

Some of the rules on legal capital are not applicable in some EU states as far as private companies limited is concerned. This is especially the case in the United Kingdom, both for present regulation and more clearly, after the proposed reform of company law rules will have been enacted. The observation also applies to other matters: financial assistance is not forbidden but regulated e.g. in the Netherlands[202].

61. The prominence of legal capital in the EU states is largely the result of the second company law directive, which was very much inspired by legal thinking of the early 1960s. The function of the legal capital is twofold: in the relationship to the creditors, it indicates which amounts are reserved to satisfy the creditors' claims, and are beyond the reach of the shareholders for distribution. In that sense the legal capital is supposed to protect the claim of creditors.

In the relationship with the shareholders the capital contains the key to determine the relative position of the shareholders, at least as far as the shares are concerned that have contributed to the capital. Voting rights, but also dividend rights and subscription rights are determined as a fraction of the overall rights within the company: for determining the relative position of each shareholder, the legal capital used as the denominator.

62. The following overview will summarise the rules on legal capital as are in force in the EU states, and in some other jurisdictions as well. As these mainly derive from the implementation of the second EU directive, this instrument will serve as a guidance. With respect to several of the rules of the directive, critical notes will be added[203]. However, not all sections of the directive will be reviewed for lack of time and space. In another section, the arguments that are usually raised against the usefulness of the notion of "capital" as a company law instrument will be summarised.

§ 1 The legal capital and its relationship to the creditors

63. The Second Company Law Directive imposes a certain number of rules on public companies limited. These are not applicable to private companies limited although many member states have rendered a largely identical, or sometimes a similar set of rules applicable. However some member states have limited the ambit of the rules on legal capital to the public companies, leaving the private companies largely out of the scope of the capital rules. The United Kingdom and Ireland have not introduced a minimum capital requirement for private companies limited, but some of the other rules that the directive links to the notion of capital are applicable to both types[204].

This difference in the directive's ambit according to the status of the company as public or as private company limited has a substantial impact depending on the jurisdiction in which the rule is applied: where in some member states the number of public companies is about 30 to 40% of the total of companies limited, in other it is less than 10%. The practical consequence is an uneven playing field, leading to regulatory arbitrage. One example of this type of arbitrage was recently

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[202] Art. 207 c NBW; but no similar rule is found in the German GmbHG. Differences in the applicable regime also concern share buy backs: in the Netherlands the regime is identical in both types of companies (art 209 NBW), while German law(§ 33, GmbHG) restricts the buy back under less onerous conditions than for the AG. In France a less restrictive regime applies for the (art 63, L. 1966). But there is no pre-emptive rights for new shares in German the GmbHG, nor in the French law of 1966, but may be stipulated in the articles of association.

[203] Since several years there has been increasing criticism addressed to the Second directive, in part based on the overly restrictive attitude of the directive, in part putting into question the need for a legal capital. To what extent the rules of the directive are relating to the notion of legal capital should be clearly identified.

[204] See s. 155 limiting the application of the rules on financial assistance to distributable net profits

discussed before the European Court of Justice, in the so-called Centros case[205]. As far as the present issue is concerned, the court held that the Treaty rules on freedom of establishment prevent a member state from barring access to its territory to a foreign (in casu: English) company on the mere ground that it has been formed in a jurisdiction where no minimum legal capital applies. The holding applied to a company with a mere registered office in the UK, and a principal establishment in Denmark.

64. Upon formation of the company the directive obliges all public companies limited to form a minimum legal capital, fixed in the directive at 25.000 Euro. The amount has not been adapted since 1978 notwithstanding inflation. Most member states fix the minimum requirement at present at a higher minimum amount, sometimes up to 100.000 Euro[206].

The minimum capital requirement was intended i.a. to incite starting companies to pay attention to the importance of creating a company with limited liability. Some member states have added a requirement that the initial capital should be adequate to sustain the projected business venture. In that sense, the minimum capital requirement, especially when reinforced by an requirement to provide for adequate capital has contributed to reduce the number of early insolvencies of business that were set up without sufficient consideration being given to the business risks. Also, as competing company forms with limited liability were on offer, especially the private company limited, parties often preferred to choose for these less regulated forms.

In writing, the function of the initial capital has also been analysed as the price the shareholder pays for obtaining the licence to trade without unlimited liability. This type of a franchise tax is however fixed without taking into account the amount of the risk involved. It is fixed at such a low level that it barely bears any relationship to the purported function of the rule.

65. The capital must be formed exclusively out of cash contributions, or out of fixed assets, but undertakings to perform work or supply services may not form part of these assets[207]. This rule has prevented companies to recognise value, in terms of contribution to the capital, of contractual promises to perform research or innovation services for the company, and can be considered as a burden on the formation of high tech companies that mainly consist of non-material assets. In some jurisdictions, the problem has been solved by allowing the company to issue shares “not representing the capital”, whereby the shareholder receives comparable voting and or dividend rights, other shareholder privileges as provided for in the articles of association. However, his position is less well protected than those of the holders of shares that protect the capital.

66. In exchange for their contribution to the capital the shareholders receive shares: these are necessarily shares with a nominal value, or with an “accountable par” being the division of the capital by the number of shares issued[208]. These figures express a relation to the nominal capital, not to the value of the shares. It is not allowed to subscribe shares for less that their nominal value as then the capital would not be fully subscribed. The rule also applies to shares with an accountable par. Although most member states still adhere to a system of shares with nominal value, some states have recently adopted other systems, also to enable companies more flexibility for the adaptation of their capital to the introduction of the Euro. Germany in particular has introduced a system that allows the issue of shares without reference to the nominal legal capital[209].

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[205] ECJ, March 9, 1999, C.21/297

[206] Comp. Belgium (2500000 Bef or 62500 Euro), Italy (200.000.000 lire or xxx Euro) Germany (100.000 DEMxxx) against Netehrlands (100.000DFL or Euro.xx ..) or £50.000 in the UK

[207] Art. 7 Second Company Directive, December 13, 1976, 77/091/EEC, OJL26, 31.1.1977, 1-13.

[208] According to art.8 Of the directive, these are the only acceptable forms. However the directive fixes no minimum amount: so also in Belgium, (both for the SA and the Sprl.) or in the Netherlands.The members states sometimes fix a minimum: in France, 10 FFR (Décret 30 October 1948)

[209] See Namensaktiengesetz.

The issuance of shares without any expressed value, as is usual in some of the American states, has not been introduced in the EU: in the UK, where the Company law review paid attention to this issue, the directive was deemed to stand in the way of adopting this more flexible solution.

67. In all jurisdictions, the amount of the capital is an element of the company's articles of association. Hence changes to the capital are not allowed, except by changing the articles. These changes have to be voted on by a supermajority, of 2/3rd or 3/4th of the shareholders, even if the increase of the capital by no means affects the position of the shareholders, e.g. in case existing reserves are added to the capital.

However, the directive - and most member states - make allowances for a system of "authorised capital "whereby the board of directors is empowered, for a limited period of time, and often within certain limits, to issue additional shares and increase the capital. The regime usually only applies to the public company limited[210]. This authorisation adds considerable flexibility to the use of shares for financing the company, especially in case shares are being issued for acquiring other businesses, or for issuing shares to employees. Shareholder keep control on the board's authorisation by several devices: the authority to issue shares normally is granted by a supermajority; the general meeting sets certain limits to the authorisation, and may grant limited derogation to the right to issue shares to other parties than the existing shareholder[211]. This issue of the preferential subscription rights will be dealt with later.

The power to issue additional shares may also be given to be board only for specific purposes, often to acquire another business in a share for share exchange**.** This delegation can also be used as allowing to issue shares in order to resist an unfriendly take-over bid: this can be countered by issuing shares to specific friendly parties[212]: the rule is found in several jurisdictions[213]

68. Once the company has been formed, the legal capital serves as the yardstick for the undistributable net assets: the rational is that creditors should have the certainty that the company will not wilfully reduce its net assets under the level indicated by the legal capital, "plus the reserves that may not be distributed under the law or the statutes", the so-called undistributable reserves.[214] The capital represents the hard core of the own funds that the company is deemed to reserve for the creditors.

The rule has been criticised as offering little security to creditors, especially at the moment insolvency threatens, which is the point at which it is most needed. The significance of the rule as a creditor protection device very much hinges upon the assumptions on which the accounts are being kept. In case of insolvency it usually appears that the capital and the rest of the reserves are swallowed up by the value restatements that takes place as a consequence of re-basing the account to a non-going concern basis. Are these creditors worse off: with some cynism, one could say that without legal capital, their sitiuation would be even more hopeless.

The information which creditors can derive from the accounts, provided these are reliable, are often of little use, as the accounts will be available only after a long period of time, and do not reflect the present state of solvency of the company. Therefore, the ex ante protective function of the legal

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[210] So e.g. in Belgium

[211] See art 34 bis § 4 bis Belgium

[212] The rule is found and applied in several jurisdictions: e.g. in Belgium, on the basis of art. 34 bis, § 4 bis; for an example see also the Gucci case under Dutch law: Ondernemingskamer 3 and 4 March 1999, *TWS* 1999, 246-250, note S.M. BARTMAN, 246-250, and CA Amsterdam 27 May 1999, *Bull. Joly Bourse* 1999, 375-392, nt. D. SCHMIDT, *Bull. Joly Sociétés* 1999, 874-878, nte. SCHMIDT, and comments S.M. BARTMAN, "De rol van de ondernemingskamer by overnamegeschillen", *TVVS* 1999, 138-141

[213] e.g. in the Belgian law

[214] Art. 15 Directive

capital is also relatively limited. It is often said that creditors have more information about the solvency of the debtor from rumours in the markets, especially also from competitors of the debtor.

For large companies the information the creditors can obtain from the accounts may be more significant: however, solvency criteria of large businesses are based on the return on invested capital, rather than on legal capital.

In addition, it is often argued that the legal capital may only serve to protect unvoluntary creditors (out of negligence or tort) and small creditors. Lare creditors would not need capital, as they have other instruments and techniques to protect themselves. This contention is true, but only in part: banks often insist on a larger capital basis, or on subordination of certain debt, especially debt to shareholders, to avoid opportunistic behaviour.

69. Once the capital, and the other undistributable reserves have been identified, their aggregate amount serves as a yardstick to restrict several distributions to shareholders. This rule applies to the distribution of dividends[215], to the repurchase of own shares[216], to financial assistance to employees [217], and to other transactions [218]. In all these cases the rules serve the protection of the creditors: in case of insolvency the creditors will not have to suffer harm as a consequence of distributions that have reduced the net asset value under the level of the said yardstick.

Criticism is based on the observation that dividend distributions are decided on the light of a broader set of factors than the level of undistributable own funds balance sheet data are but a minor factor. Restrictions on distribution will flow from conditions imposed by large creditors. Distributions may take the form of transactions with shareholders[219].

More convincing is the idea that excessive distributions should be judged not only on the basic of said balance sheet data, but also taking into account the prudence to which directors are held towards creditors. However, as these prudence rules are less generally accepted than the fiduciary standards directors should respect v.à.v. shareholders, the practical result is that these rude restrictions on distributions may play a minimal protective role, especially in the period preceding insolvency.

70. Pursuant to the provisions of the Second directive most company laws in Europe contain rules restricting the companies repurchasing their own shares. These rules serve on the one hand the protection of creditors and shareholders as well. Share buybacks may not be entered into except with the approval of a supermajority of shareholders, and with due respect to the equal treatment of the shareholders. One of the motives on which these restrictions are based relate to the protection of the legal capital: therefore the amount has to be restricted[220], and once the share have been acquired, an undistributable reserve has to be formed[221]. The rule directly serves to protect the capital: if the shares were acquired in contravention to the legal provisions, and have not been disposed off within one year, the shares shall be cancelled, with or without a corresponding reduction of the capital[222]. These rules have been introduced in the statutes in all EU States.

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[215] Art 15,(1)(d) Directive

[216] art. 19(1)(c) Directive

[217] art. 23(2) Directive

[218] See Directive art. 35, relating to redemption of the subscribed capital without reduction of the capital; also art 36 relating to the compulsory withdrawal of shares. Idem for redemption of redeemable shares, art 39.

[219] See for the argument: Luca Enriques, As simple as it may be: The case against the Second Company Law Directive Provisions on legal capital, Bologna 2000. But these transactions may fall under other prohibitions, including criminal ones.

[220] This is to 10% of the of the subscribed capital: art 19 (1)(c) of the Second directive, and the maximum value involved is the amount of own funds, exceeding the undistributable own funds.

[221] art.21(1)(b) of the Directive

[222] And s. 20.(3) adds; such a reduction must be prescribed where the acquisition of shares to be cancelled results in the net assets having fallen below the amount specified in art.15(1) (a), i.e. the capital plus the undistributable reserves.

A 1992 amendment to the Directive has extended some of these rules to shares acquired by a subsidiary company: with respect to these cross holdings, apart for motives of capital maintenance, the leading motive has been to avoid control being held in the hands of the member of the board of the parent company (autocontrol devices)[223]. The rule is - at least in some member states - applicable to shares that do not represent the capital, i.e. have been issued against contributions that were not accounted for by an increase of the capital. Here as in the case of the company subscribing to its own share[224], the rule has no direct relationship to the legal capital: it merely leads to a suspension of voting rights, not to compulsory reductions of the capital.

to the extent that it deals with voting rights, it should be solved by rules relating to the directors' fiduciary duties.

71. In practice, one of the most difficult prohibitions in the capital maintenance provisions concern the rules on financial assistance. These rules prohibit a public company to grant loans to third parties when these funds are designed to finance the acquisition by that party of shares of the company, whether these shares are being subscribed or have been issued before. The rule is supposed to protect the capital: if the shares acquired would be worthless, the loan might be irrecoverable. Also it is feared that the acquirer of a controlling block will pay his acquisition out of the funds of the company. The fundament on which this rule is based, is very controversial, if not flawed[225]. The rule has been a considerable handicap in the implementation of management buy-out transactions and other similar deals. It has lead to complicated systems of evasion. Some member states have proposed to have the prohibition either abandoned, or at least reduced, e.g. to the amount of the capital and the undistributable reserves[226].

§ 2. The capital as a yardstick for the relationship among shareholders

72. The notion of capital also serves as the central criterion for determining the rights of the shareholders vis à.vis each other. These rights are described in terms of voting rights, rights to profits, (dividends, winding up), subscription rights, right to equal treatment in case of share buy backs, information rights, and so on.

The main application of the rule relates to the voting rights. In several jurisdictions the "one share one vote" rule is found[227]. This rule usually is expressed in term of legal capital: all shares that represent the same amount of the stated legal capital are entitled to the same voting rights. If shares have been issued that represent different fractions - e.g. different nominal values - their relative position will be determined in reference to the par value of the legal capital they represent.

The "one share, one vote" rule, although highly controversial in legal and economic literature[228], is often advocated as one of the essential privileges of the shareholders. It is not part of the present system of European directives: the fifth directive, where it was stipulated, can be considered as abandoned.

Whether companies are actually governed by a one share, one vote system requires further investigation. Often the rule is only applicable to common shares, "representing the capital", but can be easily evaded by issuing other classes of shares. In other system, all shares are equal, but some

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223 see also n° ..

224 art. 24 a..pf the Second directive.

225 This was our analysis of the rule in : Article 23 of the second company law directive: the prohibition on financial assistance to acquire shares of the company Fs. Drobnig**.** the rule may be analysed as forbidding certain transactions with conflicting interest, or as a specific technique for preventing directors taking undue risks. Under both angles - duty of care or duty of loyalty - the rule of the directive addresses a possible problem with the wrong remedies.

226 See Company Law review, vol.3,. Company Formation and Capital maijtenance, § 3.41 e.s

227 See e.g. in Belgium, art.74 bis, §2; Also under art. 118 and 228 of the Dutch Code (for the NV or the BV). Idem in French law: art. 174, L. 1966; and in German law, § 134, AktG

228 See on the subject in the United States[229] This is the case in France: art. 175, L.1966

shareholders can obtain double voting rights[229]. In the economic literature, the frequently found system of pyramiding, whereby a shareholder obtains considerable influence in a company by taking up a controlling stake in another company, that holds a controlling stake in the third one, and so on, leads to the exercise of powers that bear little relationship to the amount of funds invested.

In the absence of a uniform rule, it is not surprising that several jurisdictions allow companies to issues shares with multiple voting rights, one share bearing 10, 100 or even 1000 times more votes than other in all other respects identical shares.

73. The notion of capital is also considered to play an important role as far as pre-emptive subscription rights are concerned. According to the directive the new shares must be offered to the existing shareholders "in proportion to the capital represented by their shares"[230]. This relationship to the notion of capital has nothing obligatory: pre-emption rights for the issue of new shares may be equally applicable in case no reference is made to the company's legal capital, but merely serves to avoid diluting the existing shareholders' voting rights, or financial position. This observation is more striking as the restrictions or the withdrawal of pre-emptive subscription rights is appreciated in function of the market price of the shares, and not of their capital value.

All European statutes contain extensive regulations of pre-emptive rights and of the rules to set these aside, which in practice are more important than the rules actually putting into play the pre-emptive mechanism.

As to the usefulness of pre-emptive subscription rights, one can refer to studies that illustrate their usefulness as far as institutional investors are concerned. The restrictions that have been applied in some member states have in the meantime been limited, allowing the management to issue shares more or less at the market price, without having to offer these shares first to the existing shareholders. There have been studies stating that, in some cases at least, the costs and expenses involved in a rights issue exceeded the price difference that the company would grant institutional investors on a non pre-emptive basis.[231]

b) Issues and Trends

The debate about the usefulness of the legal capital

74. The rules on legal capital are increasingly criticised in legal writing, for being inefficient, counterproductive and unduly burdensome. This criticism is to some extent inspired by the observation that in some jurisdictions companies function as well without any requirement of legal capital. This does not mean that these companies do not have own funds, whether capital or other components of own funds. But these items are not the object of regulatory provisions, nor is the capital itself used as a criterion for applying specific rules. As a consequence some legal writers have defended the opinion that one could as well do away will the notion of legal capital itself. [232] Other writers have been less radical and criticized some the rules that the Second directive links to the notion of capital. This was also the opinion of the SLIM working party dealing with the Second directive: without abandoning the concept as such, the application of some of its rules should be relaxed.

In the preceding comparative overview, some of the rules of the Second directive have been criticised. As a conseqeunce of being laid down in the Second directive, these rules should be considered part of the conceptual technique of the legal capital. With respect to some of these rules,

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[230] Art. 29 Directive.

[231] On the subject see E. Ferran,

[232] See in that sense: L. Enriques, As simple as it may be: the case against the Second Company law directive Provisions on legal Capital, Bologna 2000.

we have pointed out that they may be applicable, whether or not one adheres to the idea that a legal capital is necessary. This is the case for the rules on the pre-emptive subscription rights.

75. A second type of criticism relates to the observation that creditors really do not care much for the legal capital: most creditors do not check the capital before contracting with the company. The argument is fallacious Some creditors do: the company will not obtain any credit from the bank if its capital is insignificant, and the bank will insist on the shareholders guaranteeing the loan it grants thereby piercing not the veil of incorporation but the limited liability which the shareholders had contracted for. If professional creditors did not care for the company's liabilities, it would never insist on looking at the financial statements, nor request subordination from shareholders. Legal capital is the erga omnes declaration of full subordination. But it is true that the legal capital is only a part of the bank's assessment for obtaining insight in the financial capacity of the company s a debtor: the bank will analyse more the cash flows, than look at the balance sheet.

76. It has also been reproached to the Second directive to have been inconsistent: being only applicable to public companies, and not to private companies, it is odd that the protective measures do not apply where the need for protection is the highest, this is for the small companies, more precisely for priuvate companies limited. National regulators have often declared the same rules applicable, although with less rigour.

This difference in the directive's ambit according to the status of the company as public or as private company limited has a substantial impact depending on the jurisdiction in which the rule is applied: where in some member states the number of public companies is about 30 to 40% of the total population, in other it is less than 10%[233].

In practical terms, the resulting consequence of this disparity is an uneven playing field, leading to regulatory arbitrage. One striking example of this type of arbitrage recently was discussed before the European Court of Justice, in the so-called Centros case[234]. As far as the present issue is concerned, the court held that the Treaty rules on freedom of establishment prevent a member state from barring access to its territory to a foreign (in casu: English) company on the mere ground that it has been formed in a jurisdiction where no minimum legal capital applies. The holding applied to a company with a mere registered office in the UK, and a principal establishment in Denmark. With respect to argument of the Danish government that it was necessary to protect creditors of the branch by imposing a legal capital the Court made the following sweeping statement. The practice in question (i.e. requiring a minimum capital) is not such as to attain the objective of protecting creditors which it purports to pursue since, if the company concerned had conducted business in the United Kingdom, its branch would have been registered in Denmark, even though Danish creditors might have been equally exposed to risk.

77. The usefulness of the legal capital is different for small as compared to large companies. Where for the latter, the notion of capital

For small companies one could argue that there is a relationship between the requirement to form a minimum capital and the propensity to use company forms for staring up new business. The minimum capital is then the price the shareholders will have to pay for enjoying protection against the shareholders.

Is this technique efficient? One could argue that it might be efficient is there was a higher propensity to become insolvent for lowly capitalised companies in contract to those with a higher capital. There is little empirical research undertaken. We could only point to a comparison, relating to Belgian SA, Sprl and Co-operative companies; the first with a minimum capital that was almost

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[233] See for comparative figures Wymeersch, A Status Report in Hopt a.o., Comparative Corportae Goevcrnence

[234] Centros ECJ, Case C-212/97, § 35, 9 March 1999.

twice as much[235] as that of the Sprl type. The company type with the lower minimum capital showed an insolvency ratio - being the ratio of insolvencies to total number of existing companies that was clearly less than that of the lower capitalised companies.[236] At that time these company types were competing with the co-operative company, that required no minimum capital at all. Here the insolvency ration was 84% of that of the companies with the highest minimum capital requirement (the SA), in one year topping at 185%. From these figures one could conclude that if minimum capital does not matter so much for the largest companies, it does at the lower end of the scale.

The price shareholders pay for limited liability and therefor to shift risks to creditors is clearly too low: here a trade off is made between the protection of creditors and the needs not to restrict access to business. If the motive may look convincing from an ex ante standpoint, it often is less convincing ex post: case law often refuse to consider the legal capital as a bar to refuse recourse against the shareholders. Different techniques are used, sometimes confusing the role of the shareholders with that of the directors: group liability[237], lifting the veil, but also rules on wrongful trading[238], rules on director liability for insolvent trading[239].

78. This analysis leads to the conclusion that the rules on legal capital are up for being reconsidered. On the one hand one should clearly differentiate between the rules that are directly linked to the notion of capital, such as capital on formation, capital reduction, and those that have no such necessary links, the rule being applied even in the absence of a legal capital requirement.

The second series of rules should than be reviewed in the light of their own merits. The rules on preferential or pre-emptive subscription rights have a justification that varies from case to case.

The rules on share buyback can perfectly function outside any legal capital environment: but to avoid abuses one will probably have to reinforce the duties of directors repurchasing shares from friendly parties, or using this technique to influence the markets, possibly to their own profit.

In both cases, the strict rules of the directive are an alternative solution to the absence of equally effective and as easily enforceable rules on fiduciary duties.

With respect to minimum capital, the abolitionist doctrine seems less convincing: one shareholders want to shift the risk of doing business to the creditors, they should give creditors adequate means to protect themselves, The present accounting and disclosure system is not effective, as far as that is concerned. If the legal system would be moving to annual accounts that are published in a short time frame, e.g. weekly, or monthly account, the need for a initial capital might diminish. In the meantime, this is the only brake on overoptimistic businessmen. The level may be too low but some states impose additional liability if the is manifest undercapitalisation for the initial period[240]. The fact the many legal systems do not impose that type of sanction indicate that their belief in the legal capital requirement is rather weak.

D. Corporate Ownership and Control

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[235] At that time: 1.250.000 for the SA and 750.000 for the Sprl. For the period between October 1985 tot November 1989, the percentage difference was on average 43%. These

[236] See for the research, Wymeersch, Kritische benadering en synthese van de besproken vennootschappen, in Miskende vennootschapsvormen, Kluwer, 1991; at 170.

[237] See the comparative reports in Wymeersch (ed) Groups of Companies, de Gruyter,1993; Lutter (Ed) Konzernrecht om Ausland, ZGR Sonderheft, 1993; see further the proposals of Forum Europaeum, in ZGR, 1998, 672.

[238] s. 214 of the Insolvency Act 1986

[239] See art. 63 ter Belgian Companies Act; art.180 - 182, French L. 25 January 1985 (action en comblement de passif)

[240] This rule is found in Belgian law. There is no equivalent French rule: liability is directed to the directors that have "contributed to the insolvency", art 180, L. 25 January 1985

79. The issues dealing with ownership and control belong to the most actively debated ones in the international corporate governance discussion. It is therefore interesting to give an introductory overview of the regulations of most of the OECD States. In this field, even more strikingly perhaps than for the other subjects, one can see how much convergence towards a common system of regulation is underway.

1. Ownership restrictions

80. Very few jurisdictions have maintained restrictions relating to the ownership of shares. This abolition is a direct consequence of the liberalisation of capital transfers. Within the EU the Treaty has abolished all restrictions, and no restrictions can be re-introduced except in case of gross unbalance.[241] Some states maintain restrictions with respect to particularly sensitive firms, such as defence contractors[242], telecommunications, press and media firms[243], or the ownership of real estate[244]. In Australia there is a general authorisation requirement for acquisition of a substantial interest in listed companies[245]. Most other states have not maintained state-imposed restrictions[246].

With regard to previously state-owned companies, some states have set limits on the percentage an individual shareholder can hold after privatisation: such provisions apply in Italy[247] and in Portugal, at a 5% level[248]. In the Czech republic, an authorisation by the Securities Commission is required before acquiring a 10% block of shares[249]. Also, special prudential rules are applicable to the acquisition of shares in credit institutions[250].

In general, there are no restrictions on the number of shares an individual shareholder may hold[251].

2. Voting restrictions and cross holdings

81. Voting rights may be suspended for a whole series of reasons: some have been mentioned**.**

A specific case is that of cross holdings, which previously were frequently used by company boards to exercise influence on the voting in the company's own general meeting. The mechanisms of autocontrol are at present out of favour: the power should go to the shareholders, i.e. to the investors. This evolution is largely driven by market requirements.

Ownership of shares usually also confers the right to participate in the decision making mechanisms, essentially by taking part in and vote at the general meeting. In listed companies, voting rights have a considerable value, best apparent in case of a take-over. However, in many jurisdictions, not all shares have the same voting rights.

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241 Art G.15 Maastricht treaty, art. 73 B and 73 F EU Treaty.

242 E.g. in the US. In Canada there is list of restrictions relating to book publishing, broadcasting, domestic transportation, financial services.

243 In France

244 Switzerland

245 Foreign Acquisitions and Take-over Act 1975, application to 15% acquisitions by one party or aggregate control of 40% of the issued shares.

246 Turkey, Finland, Germany, Ireland, UK.

247 Decree >332/94; special rules apply to the banking sector

248 Decree-Law n° 380/93 of 15 November. In the Czech Republic, a comparable rule applies, but stated in different terms: an investment fund may not be formed by an issuer contributing more than 11% of the assets of the fund.

249 And for subsequent acquisitions of 5%.

250 E.g. prior consent by the Czech central bank for acquisitions of 10% or more.

251 E.g. in Austria. But if these have to be included in the articles of association later on, very strict provisions may apply: so in Denmark, where a 90% vote would be necessary.

The concept of non-voting shares is regulated in many legal systems, but it is unclear how frequently this type of shares is issued, at least in listed companies. As to voting shares, voting rights can be evenly spread, all shares being entitled to one vote. But other systems exist: voting caps at one end and multiple voting rights at the other end of the spectrum.

Most statutes have no rules on voting caps: they are usually allowed and left to the articles of association[252]. In Finland, there is a 10% cap in insurance companies, probably for protecting these companies against a take-over. In some states, voting caps are considered incompatible with the rights of each shareholder to vote[253]. Different rules apply in co-operative companies where the one-man-one-vote rule is sometimes followed[254]. Only in the Czech Republic a rule exists limiting the number of votes cast by a single shareholder in a listed company (to 20%).

82. Cross holdings of shares have been regulated by an amendment to the Second European directive: the directive puts the acquisition of shares by a subsidiary on the same footing as the acquisition by the company itself[255]. Indirect holdings, especially through the subsidiary of a subsidiary, are less strictly regulated: it suffices that voting rights be suspended[256].

As a consequence member states either have forbidden cross holdings, or have imposed strict conditions equivalent to those applicable in case of direct purchases by the parent of its own shares[257]. But some member states impose stricter requirements: France expressly imposes the sale of the cross-held shares that exceed 10%[258]. With respect to indirect purchases most member states have chosen for the suspension of the voting rights[259].

As to non-EU states there is a wide variety of solutions, some states abstaining from any restriction[260], others allowing such acquisitions provided sufficient disclosure is made[261], imposing a suspension of voting rights[262], or stipulating a strict prohibition[263]. In Australia, the subject would be dealt with under the heading of “related party transactions” and directors’ fiduciary duties.

3. Restrictions on the transfer of shares

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252 E.g. in Austria, Czech Republic, the UK, Turkey, Switzerland, Spain (art 105), Portugal (384 2b and 3);.in France (art. 225, provided the cap applies to all shares). But to introduce a voting cap in an existing Danish company would require a vote by 90% of the votes. Canada, s.140, (1)

253 Germany; Japan; Luxembourg, adhering to a one-share one-vote rule, does not allow voting caps.

254 See in Italy

255 In that sense: Belgium art. 627 Company Code; Switzerland art 659 b(1), CO; Portugal art 325 A Companies Act; Luxembourg. Italy has a stricter system: between listed companies a 2% limit applies; shares that exceed the limit must be sold. France forbids any voting rights to be exercised between companies that control each other (art 233 Code comm). There seem to be no restrictions in Austria, Finland, and in Denmark: **to be checked**

256 Art. 24 a Second directive.

257 See Belgium: art. 631 Company Code; comp. UK

258 Art. L. 233-29 Commercial Code; in other Member States, a different sanction may apply, 259 See e.g. Belgium art. 631 Company Code; in Germany, for 25%+ cross holding, the second acquired company cannot cast votes for the election of the supervisory board of the first.

260 Turkey, Poland

261 For US companies subject to SEC regulations, 5% beneficial owners have to be disclosed. For Poland, disclosure of parent -subsidiary cross holding

262 Japan CCJ 241

263 Japan CCJ 211; Canada s. 30 CBCA, imposing disposal in case a subsidiary was later acquired that held shares in the parent.

83. Usually shares in public companies limited are freely transferable, although the articles may subject the transfer of shares to certain authorisations[264]. Some statutes expressly provide that it is forbidden to exclude transferability of the shares in companies limited[265]. In Canada, the transfer may be restricted in connection with public policy objectives[266]. Only in Australia are the articles of association entitled to restrict ownership to a specific percentage. However, the Stock exchange must agree to this provision[267]. The articles may provide for a suspension of voting rights or even forced disposal in case the stated limitation is crossed.

Stock exchanges would normally frown upon transfer restrictions, but according to the 1979 EU directive, restrictions are allowed provided they would not disturb the functioning of the market[268]. In France, the regulation of the Stock Exchange forbids clauses restricting transfer of listed shares[269]. Swiss law allows for the enforcement of restrictions if the acquisition would lead to a shareholder holding more than a given percentage[270]. Stock exchanges often require lock-up arrangements during the period immediately following an IPO[271].

The American UCC was recently modified to require restrictions on the transfer of shares to be mentioned expressly on the share certificate. Also, transfer restrictions could result from an exemption from the federal securities laws: e.g. in case of a private placement exemption, the shares may not be transferred except 12 months after the placement has been completed[272]. An appropriate legend on the share certificate would be necessary.

Private contractual arrangements restricting the transfer of shares are generally allowed, in some statutes, the party refusing the transfer should be willing to purchase the shares himself. In Italy and Portugal these agreements have to be disclosed[273].

4. Ownership declarations

84. In a few states there is a general regime of disclosure of the share register: any shareholder or creditor of the company can examine the list of registered shareholders[274].

In all analysed systems, owners of significant blocks of shares in listed companies are obliged to inform the supervisory authorities and the markets about the blocks of shares they own,

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264 So e.g. in Canada, for privately-held companies: s.6(1)CBCA; in the Czech Republic ; only Turkey; also Japan where only board authorisations are allowed.

265 See Belgium art. 510, which forbids restrictions on the transferability that are unlimited in time; art 328 Portugal

266 s. 174 CBCA

267 Listing Rules 3.19

268 According the Admission directive of 1979: in that sense: Germany, Luxembourg; Italy; Ireland. Restrictions must be disclosed to the markets: e.g. the restriction not to sell the shares to US residents. No restrictions are allowed in Turkey. A substantially similar rule applies in Australia: based on the stock exchange listing rules the company may not prevent the transfer of shares. In certain circumstances however, e.g. as a consequence of a court order, the company may apply to prevent the transfer from occurring.

269 Art. 3.1.8. Règlement SBF. The same is found in Finland

270 Art 685 d(1) CO

271 Germany.

272 Rule 144, 17 CFR § 230.144. Rule 144 is complex and not exclusive, so resales in some circumstances within the one year period may be consistent with the original non-public offering exemption even though they do not comply with Rule 144

273 After having been scrutinised by the CNMV, who decides what will be disclosed. Also in Italy, where they are without effect in case of a take-over bid. (Art 112 TU) The Belgium Corporate Governance recommendations issued by the Banking and Finance Commission stated a similar rule. Also in France: art. L. 233-11. So in Japan. In Austria, restrictions are reported to arise from special arrangements such as the right to send a member to the board, or shares regulated by special acts.

274 However Canada s.21(3) adds that the list may only be used for an effort to influence voting, or an offer to acquire shares, or any other matter relating to the company. As few shareholders are registered, the securities supervisors plan to extend this disclosure to the list of the beneficial shareholders.

provided these exceed a certain threshold. The 1988 European directive puts the initial threshold at 10%, but most member states, with some exceptions[275], have stipulated a much lower threshold, usually 5% or even 2%[276]. In Portugal, this regulation also applies to closely held companies[277]

Other systems are used outside the EU: in Japan, companies have to disclose the identity of the 100 largest shareholders. Australia has a continuous reporting system for shareholders holding more than 5%; the Stock Exchange rules require companies to disclose the names of their 20 largest shareholders[278]. In Canada a 10% threshold applies under the insider trading rules[279].

In the Czech republic, the commercial code imposes comparable disclosure rules: significant shareholders - defined according to the percentages stipulated in the EU directive - have to report their voting rights to the company, the securities commission and the securities centre that will make them public. Anybody can obtain access to the list of 10 % or more shareholders, as far as registered shares are concerned.

85. Especially in systems where ownership of shares is concentrated, it is very important that the markets can have a precise insight in the ownership structure of large block-holders. This information also matters for supervisory purposes, e.g. to detect secret control acquisitions. In practice, several factors stand in the way of this objective. Theoretically it should be possible to map out the full ownership situation in listed companies. In practise, the difficulty is considerable. Ownership usually relates not only to direct ownership, but also to beneficial ownership through nominees, trustees, related companies, and similar constructions. Special difficulties arise with respect to identifying concert action. Sanctions for not declaring shareholders are very difficult to enforce.

In practice however, one sees that the data published are rather difficult to interpret, while no information is available as to the upstream ownership, i.e. in companies that hold the block of shares. As a consequence, transparency as to the ownership situation is very diverse in the different jurisdictions. Moreover, only in a few states information is available with respect to the amount of shares held by the directors and officers of the company[280].

A variety of instruments can be used to oblige unwilling shareholders to declare their holdings[281]. In the UK, the company may serve a notice to anyone believing to be interested in shares, requiring the addressee to confirm whether this information is correct[282]. In Portugal, the company should inform the supervisor[283]. In Poland, a shareholder may be invited by the other shareholders or by the board to declare whether he exercises dominant influence: until the answer is furnished, the voting rights of the addressee are suspended. In the Czech republic, there will be a ban on further acquisitions, and a suspension of voting rights. Sanctions vary between the suspension of voting rights to the compulsory sale of the not declared shares.[284]

86. Considerable diversity also exists with respect to the accessibility of the above-mentioned information. In some jurisdictions, the company itself restates the information it has

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275 Applying the thresholds as stated in the directive: Denmark, Greece, Finland, Luxembourg, Ireland, Portugal, where a 2% and a 5% also apply; and Turkey. No restrictions were reported about Austria: to be checked.

276 In Italy; 3% in the UK and in Ireland, if the company became aware of the holding.

277 Art. 448, Companies Act, also calling for disclosure in the annual report.

278 s. 617 b. ; ASX listing rule 4.10.9.

279 s. 127 CBCA

280 E.g. Ireland, including rights to subscribe to shares. Turkey, at a 1% level, once the holding exceeds 10%; Spain, all transactions, including options.

281 Fines in Italy. In Belgium, the judge can suspend the voting rights for a maximum period of one year (art. 516 Company Code).

282 S. 212. If the person fails to give the information, the company may apply to the court for an order directing that the shares in question be subject to freezing and disenfranchisement (s.216 juncto Part XV of the Company Act)

283 Art. 17.2 of the securities code.

284 E.g. according to the draft Belgian law.

received in its annual report[285]: This is by far the most accessible technique of dissemination of this type of information. In other states, the information is made available at the stock exchange website, or at the supervisor's office, whether or not in a consolidated form, this is: including the updates. In some states the information is made available in a private publication, while privacy discussions have prevented at least in one state to have the information released to the public at large[286]. This state of affairs could be improved.

Take-over bids

87. Apart from a few jurisdictions, most regulatory systems have more or less extensive regulation on take-over bids, or tender offers as these transactions are called in some states. The trend to introduce regulation has increased considerably in the wake of the enactment of the 13th Company law directive: some states that had been traditionally very hesitant if not hostile towards take-overs, such as Germany and the Netherlands, are now in the process of drafting extensive regulation.

It is impossible to deal with all issues involving take-overs. Only some of the issues that were mentioned in the enquiry will be briefly summarized.

88. The regulation of take-overs generally covers three types of transaction: take-overs in general, mandatory bids, and certain types of squeeze-outs.

The general take-over regulation deals with take-overs - whether agreed upon or not - of listed companies. It describes the procedures, disclosures, and conduct rules for the parties involved. It contains principles that can be found in several regulations:

- rules on the announcement of the bid
- rules on disclosure by the bidder
- rules on disclosure of the position of the target's board
- rules on higher and competing bids
- rules on parallel transactions by the parties involved
- rules on defence actions undertaken by the target board
- the neutrality rule for the board of directors

Company law rules are generally not directly involved. Take-overs are mainly regulated by capital market rules, either statutory or stipulated by the stock exchanges or other market authorities. In the UK and Ireland, Australia and these rules are frequently of a non-statutory nature, or applied by a body with a non-statutory status.

89. A second set of rules relates to mandatory bids. These rules oblige the acquirer of a controlling block in a listed company to bring a bid for all remaining shares, at a price ranging, depending on the regulation involved, from the highest price for the controlling shares[287] to the market price determined over a period of several months[288]. Other intermediary formulas are used.

In all systems compared, the bidder should seek to acquire all the shares tendered: by not allowing partial bids, regulators may not only have attempted to avoid the minority's prisoner's dilemma, but also have deterred prospective bidders that will have to put up the money for 100% of the company.

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[285] Belgium art. 4§2 s.2 of the Transparency Act; Ireland. Switzerland, including shareholders that should be known to the board, Spain, France art 233 Commercial Code.

[286] In the Netherlands: the Tribunal in Amsterdam, 15 september 1994, Kort Geding, 1994, 354 decided that the rules on public disclosure of public documents is not applicable to this type of information, the purpose of the rule being confirmed to the verification of the disclosure by the shareholders. Privacy motives were also discussed.

[287] OK, B.

[288]

Although it has been the subject of extensive discussion, it is now widely settled that control is acquired once the bidder buys or acquires, directly or indirectly, himself or through his allies or concert parties, voting shares as a consequence of which he will hold a percentage of voting rights that exceeds, depending on the jurisdiction, 30%[289], 1/3[290], or even fifty %[291]. Some more complicated systems persist in Spain[292], and in Belgium[293].

The transaction is further structured as an uncontested take-over but sometimes changes into a regular take-over fight, especially when the threshold triggering the obligation to offer has been fixed at a relatively low level, leaving room for other parties to launch a competing bid. In practice most mandatory bids are the result of a full change of control: the bid for the remaining shares leaves no room for competing bids. In order to avoid this lack of competition, some legal systems have declared the initial transfer of the controlling block non-binding: the seller of the control block can still tender his shares in a subsequent higher bid[294]. This restores the public auction philosophy on which the take-over bid is based.

Mandatory bids are considered a powerful minority protection instrument: depending on the factual setting, especially the presence of strong controlling shareholders, it mainly protects the control position of these shareholders[295]. Mandatory bids are scheduled to be introduced as a mandatory rule by the 13th company law directive; only a few EU states will have to introduce the technique[296]. In the US and in Canada, mandatory bids are not known, and in Australia, although the usefulness of the rule had been discussed, the parliament finally declined to introduce it as a legal device.

90. A third set of rules relates to the going private technique that often constitutes the third step on the way to de-list the target company. If the public bid has yielded a percentage of shares of more than 90%, the bidder may be obliged to launch a bid for the remainder of the shares at the same price. In some jurisdictions, minority shareholders can oblige the bidder to launch the bid, either before or after the bid period[297]. This remedy is often supplemented by squeeze-out remedies, whereby 90% or more of the shareholders can oblige the minority to transfer its shares to this controlling shareholder[298].

91. In the take-over procedure, there are two further points that have called for extensive comments: anti-take-over defences and the role of the target board.

With respect to defences, there is a great difference of philosophy between the US, Canada and Australia and the EU states. In the former group, the board of directors has a strict duty to act in the interests of the shareholders. Therefore it can call on defences, such as poison pills, to enhance the price the bidder will have to pay for the target shares. Once the target board has decided for the sale of the company's business, it is its duty to maximise the shareholder's wealth. However, it was decided in Delaware case law that the board can also use defences to abort the bid if, after due consideration, it is of the opinion that secured the future of the company in the interest of the

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292 In Spain, the bid should aim at acquiring an additional ... % once the ... % threshold is crossed, and ... % upon crossing in 50% threshold.

293 In Belgium, "control" is defined on a case by case basis, often at less than 33%, provided the bidder acquires the shares at more than the market price.

294 OCP.

295 See for the reasoning: E. Wymeersch, in K.J. Hopt and E. Wymeersch, European takeovers, law and practice,

296 Germany, Netherlands, Sweden, Luxembourg

297 ... France

298 See Forum Europaeum

investors[299]. In both cases the fiduciary duties to which the board is held are the ultimate touchstone for the board's action.

The European philosophy is substantially different: in systems with dispersed ownership, as well as in systems with controlling shareholders, the board of the target company should abstain from any action that is likely to "frustrate" the bid. This duty to abstain enters into fore once the bid has been announced or, according to regulation in the U.K., once the bid is "imminent". During the bid, the target board is held to "neutrality": the target may not undertake any action other than day-to-day management[300]. Additional shares may not be issued except with pre-emptive subscription rights, and with the approval of the general meeting. Such approval should be given during the bid period. In several EU States, similar provisions are already applicable.

This strict attitude to post-bid defences contrasts sharply with the greater leeway that is left to companies to organise what is called pre-bid defences, provided these can be put at work before the bid is launched and do not call for any intervention of the board. Here, one finds a wider variety of techniques[301]. However, legislators, and companies on a voluntary basis, are increasingly forbidding or abandoning the defences as these have a negative impact on the pricing of the shares in the market. Significant changes can be mentioned in France, in Germany, while Dutch companies, famous for their defensive structures, increasingly abandon their defences voluntarily.

92. Another much debated issue concerns the attitude the board can adopt with respect to a take-over: most regulations provide that the board should take a stand as to the effects of the proposed take-over, in some regulations including the effect on the interests of the stakeholders. The board's opinion is then published in the take-over prospectus. Specific questions arise under the heading of conflicts of interest, especially when the board members also hold shares in the company, or when they also sit on the board of the bidder, which happens frequently when a holding company bids for the shares of its subsidiary. As to personal holdings, it is required that board members declare whether they will tender their shares or not. In some jurisdictions, it has been decided that the board's opinion should be rendered by the independent directors, excluding the directors that hold interlocking directorships with other group companies, especially the bidding parent.

b) Recent trends and issues

93. Issues dealing with ownership and control have come to the forefront these last decades. Academic studies have been undertaken mapping the ownership relations, leading to increased insight in the differences between economic systems and between dispersed and concentrated ownership[302]. The origin of these differences has been the subject of much debate[303].

In most systems control is essentially based on ownership of voting shares. Most systems impose no restriction, neither on acquisition of shares, or on the exercise of voting rights attached to shares. Exceptions are noticed in politically sensitive areas such as defence contracts, or media firms. But the overall scheme is one of freedom, and equation of control to investment. Voting caps, although allowed by statute, are infrequent in listed firms.

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299 This is the Time- paramount case

300 See on the subject in general: K.J. Hopt, as to the directive: E. Wymeersch,

301 For an overview of anti-takeover defences, see Maeijer and Geens, Protective measures against takeovers.

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Regulations have imposed declarations of major holdings leading to a better insight in the ownership and especially the control relations. Transparency has been enhanced, although it is still far from perfect, and considerable differences between systems still subsist.

94. The market for corporate control in its strongest form is represented by public take-overs, which have become one of the major instruments for restructuring business firms and disciplining management. Their number has increased considerably, mainly in systems where they were previously unknown or a rather marginal occurrence. As a consequence almost all systems contain extensive regulations on take-overs.

There are significant differences between the systems with respect to the functions attributed to take-overs. These differences relate in part to differences in ownership structure.

Mandatory take-overs are found in the EU, but not in the large Anglo-Saxon economic systems. The explanation for this difference can in part be found in the observation that bids are mandated as a technique of protecting minority shareholders, specifically if the bid is the mechanism of entry of a company into a group of companies. In that sense it has been identified as a powerful alternative to rules of group law. The mandatory bid rule has a profound effect on the economic structure of a given system: its political side effects, e.g. on concentrations, going private transactions, etc. have been identified, but would need further empirical study.

In the UK, the mandatory take-overs serves a different function, it prevents the listed companies from being dominated by one or a few dominant shareholders, and therefore prevents group relations from being established. At the same time, it helps to maintain the liquidity in the markets by preventing the concentration of important blocks in the hands of a few.

In systems without mandatory bids, one can expect stronger reliance on fiduciary duties and market transparency for the purpose of minority protection. Some of the situations mandatory bids attempt to prevent will then be solved by other instruments: German law on groups of companies, rules on conflicts of interest in company groups, stronger fiduciary duties, specific rules on related party transactions, including criminal rules on “abus de biens sociaux” can be considered curative instruments.

The economic justification of the mandatory bid rule has been discussed in economic literature: it was correctly pointed out that the rule may prevent some necessary deals from taking place[304]. In the meantime the rule has been incorporated in the behaviour of investors to such an extent that it would be impossible to do away with it.

95. A second dividing line between systems concerns anti-take-over defences. Here opposing views are defended: in the US, boards are entitled to combat a take-over in order to enhance the value of the shares of the company’s shareholders. Under specific circumstances, boards can even engage in outright blocking of a bid that is considered contrary to the boards previously determined policies.

In Europe, the opposite rule has been adopted, as it is laid down in the UK’s City Code on take-over and mergers. Once a take-over has been announced, the board is bound by a strict neutrality rule. The only technique to oppose a bid would be to influence shareholder conduct, or to invite a white knight. This setting leads to additional power of the dominant shareholders who can negotiate with prospective bidders. Hence the need for a bid on the remaining shares: in some systems, investors enjoy the full benefit of the control premium, in others not.

The strict prohibition of post-bid defences does not prevent companies to seek refuge in strong pre-bid defensive techniques. There is however increasing pressure from the market to abolish these restrictions. Recently, labour co-determination has been identified as an interesting

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[304] L. BEBCHUK, “Efficient and inefficient sales of corporate control”, *The Quarterly Journal of Economics* 1994, 957-993; also M. KAHAN, “Sales of corporate control”, *The Journal of Law, Economics and Organization*, 1993, 369-379.

defence tool, as it would prevent a bidder to fully take control of a target company. Other structural techniques like banks' intervention in the proxy machinery may also play a role in stabilising control.

96. Ownership of listed companies is likely to change significantly over the next decades: investors, both individuals and institutionals will probably increase their holdings, while the percentage owned by large shareholders will correspondingly decrease. Simultaneously, one sees numerous companies going private, investors being offered to exchange their shares in the listed subsidiary for shares of the parent. These evolutions point to changes in ownership patterns, on the one hand towards more dispersed ownership, on the other towards fully concentrated ownership. In addition, newly listed companies usually have concentrated ownership. All this indicate that both patterns will probably continue to co-exist. Regulations will have to take account of both hypothesis.

These developments also point to the importance of the take-over regulations, both for markets with dispersed and markets with concentrated ownership. Regulation in several states has achieved a high degree of perfection. In the EU, future developments will very much depend on the outcome of the discussion about the 13th directive. Further efforts are needed to achieve a more level playing field.