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General Meetings in Listed Companies – New Challenges and Opportunities

by

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I. General Remark

The issues that are discussed in the following derive from consultations with Member states of the OECD during the June 2000 preparatory meeting. The structure of the paper follows the recommendations laid down in the "Issues Note" of today´s conference organizers.

II. General Meetings in the Corporate Governance Discussion

Only recently the international corporate governance discussion has turned to general meetings of shareholders[1]. Initially this corporate governance discussion has started from the observation of rationally apathetic investors in companies with widely distributed shareholders[2].Where protection of (minority) shareholders` interests has been thought to be in need of strengthening, the mechanisms discussed and adopted have consisted of developing other means and remedies which work around and outside the general meeting like individual and derivative suits, the threat of takeover bids, strengthening the board´s and the auditor´s role and the like. If shareholder voting and general meetings of shareholders are back on the agenda again today we can identify two main reasons for this:

- First, the emergence of institutional shareholders which promises that the classic problems of shareholders´ collective action could be mitigated[3] and,
- second, the lowering of the costs of shareholder voting, communication among shareholders and collective activities through modern technologies.

Lawmakers in the developed countries around the world have reacted to these developments by encouraging institutional investors to exercise their rights as shareholders and by adapting their regulations to the chances of modern communication technology[4].
There is also however, a third development which seems to work counter intensified shareholder activism and a new role for general meetings in corporate governance: the internationalization of shareholdings. It makes information of and communication with shareholders, casting votes and

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[1] Cf. Theodor Baums, Shareholder Representation and Proxy Voting in the European Union: A Comparative Study, in: K.J. Hopt/ H. Kanda/ M.J. Roe/ E. Wymeersch/ S. Prigge (eds.), Comparative Corporate Governance. The State of the Art and Emerging Research. Oxford 1998, 545 – 564; T. Baums/ E. Wymeersch (eds.), Shareholder Voting Rights and Practices in Europe and the United States. The Hague-London-Boston 1999 (with 20 comparative contributions); Jaap W. Winter, Cross-border Voting in Europe, Working Paper, Rotterdam 2000.

[2] Cf. the seminal work of Adolf A. Berle/ Gardiner C. Means, The Modern Corporation and Private Property, ...1932; rev. edition 1968; cf. also the early famous essay of Walter Rathenau, Vom Aktienwesen. Eine geschäftliche Betrachtung. Leipzig 1918.

[3] The literature is abundant; cf. John C. Coffee, Liquidity versus Control. The Institutional Investor as Corporate Monitor, 91 Columbia Law Review 1991, 1277 ff.; Bernard S. Black, Agents Watching Agents. The Promise of Institutional Investor Voice, 39 U.C.L.A. Law Review (1992), 811 ff.; Mark J. Roe, Strong Managers, Weak Owners, ...1994, at pp. 233 – 253; T. Baums/ R.M. Buxbaum/ K.J. Hopt (eds.), Institutional Investors and Corporate Governance. Berlin-New York 1994 (with 23 comparative studies); most recently Roberta Romano, Less is more: Making Shareholder Activism a Valued Mechanism of Corporate Governance. Yale Law School, Working Paper # 241, 2000, with further references.

[4] Cf. references at..., below.

exercising shareholders´ rights more complicated and costly[5]. We´ll have to get back to that later[6].

III. The Meaning of Voting

Before I turn to the more technical and detailed questions in our "issues note", some general remarks on voting as a principally indispensable right of shareholders should be made. This may also serve as an answer to the first question in our issues note.
Why do shareholders vote, and why should they have the right to vote in corporate affairs?
First of all, voting is a *mode of decision – taking* by a plurality of people. Mostly the majority rule will be applied as requiring unanimity of all (shareholders) may be difficult to organize and unanimity of all voters present could lead to hold-ups by opponents. If we look at voting from the perspective of the division of powers between shareholders and management, shareholders have the right to vote mainly for two reasons:

- First, complete contracts cannot be written. There has to be a *mechanism to adapt the initial "investment contract"* (statutes; articles of incorporation and by-laws) to changing circumstances. Voting is an inevitable supplement to the incomplete statutory rules[7]. There is not always the possibility to exit (via an exchange; a takeover by a major shareholder or an appraisal right against the company). Leaving the adaptation completely to the management could lead to moral hazard problems. Requiring shareholders´ consent for any fundamental change in corporate policy limits managerial discretion and thereby serves as a protection against moral hazard[8].
- The latter is also why shareholders may *vote on certain control matters* (e.g., replacement and election of the members of the board of directors/supervisory board members and of the auditors). Again, there is not always the possibility for each shareholder to exit as an equivalent alternative to voting. And a disinvestment by all shareholders by dissolution of the company would mostly be a last-best solution only.

These general remarks leave, of course, plenty of questions open: Where is the simple majority rule appropriate, when should a supermajority, and when should even unanimity be required? Where should the exact line between the competencies of management and those of the shareholders in corporate affairs be drawn? To what extent can management influence the decision-making process of shareholders, and to what extent does voting in closely-held and in publicly-held companies really matter and contribute to corporate performance? We´ll get back to some of these questions later.

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[5] See International Corporate Governance Network (ICGN), Global Share Voting Principles, adopted July 10, 1998, cited by Stephen M. Davis, Bridging the Accountability Gap: An Agenda for Global Voting Reform, in: Baums/Wymeersch, op. cit.(n.1), at p.386 – 389; Corinna Arnold, Voting Abroad: Practical Experiences, in: Baums /Wymeersch, op. cit. (n.1), 391 ff.; Jaap W. Winter, op. cit. (n.1).
[6] Sub III. 2., below.
[7] Fischel/Easterbrook, The Economic Structure of Corporate Law,...1991, at p.11.
[8] Fischel/Easterbrook, The Corporate Contract, in: L.A. Bebchuk (ed.), Corporate Law and Economic Analysis,...1991, at p. 186.

IV. The Gradual Change of Shareholding Structures

1. Deconcentration

In 1997 the European Corporate Governance Network (ECGN) submitted its empirical findings on “The Separation of Ownership and Control: A Survey of 7 European Countries” to the European Commission[9]. Not astonishingly, the report found that public companies in continental Europe were still to a large extent dominated by large shareholders, groups of companies, families or the state. But the report also found that a fundamental change is under way in Europe today. Stakes of blockholders, especially of corporations and founding family blockholders, are fading, state-owned businesses have been privatized to a large extent, and the share of institutional investors, domestic and foreign, is increasing[10]. What are the main effects of these developments on the shareholders´ meeting? Will these developments change the role and the format of the shareholders´ meeting?[11]

There is no simple answer to this question. At first glance one could assume that the dissolution of blockholdings and the dispersion of shares among “rationally apathetic” investors on the capital market will inevitably result in a shift of power onto management. For shareholders´ meetings that could mean that their formal competencies will be curbed, that shareholders will be less well informed than the former blockholders, and that management will therefore dominate the decision - making process also informally. This conclusion would however, miss at least four essential points.

- First, “blocks” of shares covers a variety of structures which will not always warrant strong influence of shareholders, informed voting and broad competencies of the shareholders´ meetings. This may be the case if the block is held by the founding family or a private investor. In groups of companies with a pyramidal structure however, ultimate power may lie in the hands of the management of the holding company which itself is a widely-held corporation with dispersed owners. The same may be true in companies with mutual or circular capital interlocks. In state-owned businesses effective control by the shareowners will not be always warranted either.
- Second, depending on the structure and dispersion of shareholdings, control in firms with large blockholders will not necessarily be exercised via the formal channel of decisions taken by the shareholders in general meetings. Especially if there is one dominant shareholder alongside with a minority of small shareholders, the informal influence of the dominant shareholder on management will be relevant. The shareholders´ meeting and its competencies may then be reduced to taking few formal decisions.
- Third, as has already been mentioned, refinancing on the capital market rather than through families, a group of companies or the state is not synonymous with relying on small private investors with poor information and no incentives to exercise shareholders´ rights. In both the U.S. and the U.K., for example, the majority of the equities of listed companies are held

[9] The Report can be found at www.ecgn.ulb.ac.be/
[10] Marco Becht, Strong Blockholders, Weak Owners and the Need for European Mandatory Disclosure, 1997, at p. 14 (www.ulb.ac.be/ecgn/docs/pdf/eu.pdf)
[11] Cf. issues note 3.2.

by institutional shareholders, especially by pension funds and insurance companies[12]. Market forces and supporting regulation may press them to become active shareholders[13].

- This observation takes us to our next point: The transformation of a system with large blockholders into a capital market-oriented system with widely distributed shareowners requires the adaptation of the regulatory framework and the development of suitable institutions and remedies in order to cope with the specific problems of a widely distributed shareownership. The provision of standardized and qualified information to investors, the regulation of the proxy voting process and the encouragement of institutional investors to exercise their voting rights are but a few examples for this.

To sum up, if we take the different starting points and the accompanying process of adaptation into account, the transformation of a blockholder-dominated into a market-oriented system with dispersed owners need not result in an ultimate shift of power onto management. Information to shareholders, communication with shareholders, and exercising rights by shareholders will certainly look different. But their influence and the role of the shareholders´meeting in particular may even gain if we compare it with some forms of blockholder-dominated firms.

2. Internationalization

A second development which accompanies this transformation process and affects all markets is the *internationalization of shareholdings.* How will this trend change the role and the format of the shareholders´meeting?[14] Here the actual situation creates specific problems at least for the transitional period. The Washington-based Investor Responsibility Research Center (IRRC) has up to 1995 surveyed its US institutional clients on how many international proxies they have voted. The surveys showed a striking increase in global voting by these investors up to some 70% in 1995[15]. The question, of course, remains whether or not they had received the bulk of their international proxies. The International Corporate Governance Network (ICGN) bemoans that there are barriers in the form of cost, logistics, regulation and law in place which make it difficult for foreign investors and institutions to exercise their rights as shareowners[16]. Foreign investors frequently do not receive proxies in time to make informed voting decisions. Voting proxies by foreign investors is costly in some markets. There is the further problem of volume which will frequently render any effort to exercise shareholders´ rights costly and inefficient. In many markets information to (foreign) shareholders is not sufficient to cast an informed vote. Agendas and notices are not accessible in at least one internationally accepted language. Share blocking long before and during the shareholders´meeting keeps many foreign investors from voting. Companies on new developing markets often do not provide ballots and information on the ordinary and extra-ordinary general meetings at all, as the law may be weak and there is no regulatory agency overseeing disclosure requirements. Many markets restrict foreigners to certain levels of share ownership or to certain levels of voting rights. In some markets beneficial shareholders must have their shares registered in their own name rather than in the name of their custodian (street name); a costly and often time – consuming process[17].

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[12] For the U.S. cf. M.R. Wingerson/ C.H. Dorn, Institutional Investors in the U.S. and the Repeal of Poison Pills, in: Baums/Buxbaum/Hopt, op. cit. (n. 3), at p. 203; for the U.K. P. Davies, in: Baums/ Wymeersch, op. cit. (n. 1), at p. 335.

[13] Cf. for the U.S. R. Romano, op. cit. (n. 3); for the U.K. P. Davies, in: Baums/Wymeersch, op. cit. (n. 1), at p. 335 – 337; for Germany C. Fraune, Der Einfluß institutioneller Anleger in der Hauptversammlung, Köln-Berlin-Bonn-München 1996.

[14] Cf. issues note 3.2.

[15] Arnold, op. cit. (n. 5), at p. 392.

[16] Cf. ICGN Principles, cit. supra (n. 5), at p. 387.

[17] Cf. the list of complaints in Arnold, op. cit. (n.5), at pp. 394 – 398; cf. also Winter, op. cit. (n. 1), and the recommendations of the ICGN in Davis, op. cit. (n. 5), at pp. 387, 388.

Here market pressure will in the long run help to eliminate these regulatory, legal and informal barriers to cross-border investments and their protection through, inter alia, voting. For the transitional period however, as long as these barriers are in place, this means less engagement by foreign shareholders, lower presence in shareholders´meetings, and higher costs of capital for firms from the respective markets. This is certainly an area where recommendations as to the adjustment of the legal and regulatory framework by an international body like the OECD would be very helpful.

V. Information Technology

How may new information technology be used to improve the functioning of the shareholders´ meeting in terms of information dissemination, voting procedures (including proxies), etc.? Have any concrete steps been taken in this direction?[18]

In the *United States*, both Delaware corporate law and the securities laws permit electronic corporate-shareholder communication and proxy-voting[19]. In 1995 the S.E.C. formally recognized that technology has opened important new channels of communication between shareholders and management, and issued an interpretative release promoting electronic corporate-shareholder communication[20]. Although the vast majority of corporations still use paper-based methods of information disclosure and voting, many have begun to use electronic media[21]. ADP (Automatic Data Processing), the biggest proxy service company in the US, has set up a separate website which investors can access by using numerical codes[22]. ADP reports that for 1,000 American publicly listed companies 6% of the proxy votes were cast via the internet or by telephone in 1999. It is expected that this figure will double in 2000[23].

Other legislations have followed suit. *Australian Corporations Law* for instance permits the lodgment of proxies by electronic means[24]. The Australian Companies & Securities Advisory Committee recommends in its final report of June of this year that the Corporations Law should permit the directors of a listed public company to provide for direct absentee voting. This discretion would allow companies to introduce electronic voting[25].

Germany has a couple of weeks ago changed its Stock Corporation Act[26]. Shareholders may be provided with reports, meeting notices etc. via e-mail and cast their votes electronically. This will not be direct absentee voting; rather, the investor´s bank or broker will as his or her proxy

[18] Issues note 3.3.
[19] Del. Gen.Corp.L.§§ 212 (c)(1)-(2) (1996); for the securities laws cf. the following footnote.
[20] S.E.C., Use of Electronic Media for Delivery Purposes, Sec. Act Release 33-7233, Exchange Act Release 34-36345, Rlease No. IC-21399, 1995 WL 588462 (Oct. 6, 1995).
[21] Cf. M.Klausner/J.Elfenbein, The United States (National Report), in: Baums/Wymeersch, op. cit. (n. 1), at p. 362.
[22] www.proxyvote.com
[23] Cf. J.P.Morgan, Internet voting and the delivery of shareholder communications, March 2000, at p. 2.
[24] ss 250B,250BA.
[25] Companies & Securities Advisory Committee, Shareholder participation in the modern listed public company. Final Report, June 2000, at p. 74 f and Appendix 2 (List of Recommendations).
[26] Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung, as of Nov. 16, 2000 (not yet published).

receive electronic instructions which may – if the technology provides for that – still be given during the meeting. For the investor there is no difference compared to direct absentee voting.

Similarly, the Department of Trade and Industry of the *United Kingdom* is about to issue a Statutory Instrument Order which will legitimise the use of electronic communications between shareholders and companies[27]. This means that companies will be allowed to send out company information by e-mail (e.g. meeting notices, reports & accounts, proxy forms, etc), post all this information on their websites for shareholders to read it and take it off the site for personal use. It also allows proxy votes to be returned by shareholders to the company or its registrar.[28]

While this survey is certainly not comprehensive, it still seems correct to assume that the development in many other OECD states has not yet reached that stage. Traditional company law prescribes that the general meeting has to take place at a location where shareholders or their representatives meet physically. Many laws provide that the proxy or, if voting by mail is permitted, the vote has to be in writing. Electronic voting or authorising a proxy electronically is not admitted in most countries[29].

Technology allows for further variations of the traditional shareholders´meeting and opens up completely new perspectives on how shareholders could participate in the future. One model would be one or more "satellite meetings" in other locations. The proceedings at the main site would be displayed on a screen and could be followed by the participants in "satellite meetings" who could then cast their votes electronically. In smaller firms shareholders could like board members communicate and take conclusions in a video conference. We´ll perhaps also see complete shareholders´meetings in the cyberspace in the future.[30] In any event, technology will drive costs of communication with domestic and foreign investors dramatically down, and the hampering requirement of physical presence of either the shareholder personally or his/her proxy can be repealed.

Technology will offer even more. Let me mention only two points. In order to facilitate user friendly access and viewing of the public companies documents, states or even the European Community could evaluate the model that has emerged in the U.S. (EDGAR database), i.e. a central database which could serve not only for regulatory filing requirements but also as a central depository for electronically filed documents that can be used for the electronic delivery of meeting materials and a mechanism to allow for the electronic voting of shares.

Another issue concerns *informed* voting. So far, even with electronic voting, the individual investor gets the management´s (or his bank´s) voting proposal. The key problem of the uninformed and "rationally apathetic" shareholder is only addressed in that he or she need not fill in a proxy in writing, tick the box by hand whether or not he is willing to follow the management´s proposals and send it back by mail. In the future, institutional investors could make their voting recommendations available to individual investors by internet. The investor could see these recommendations alongside with those of the management on his electronic proxy form and take his choice. The incentives for such professional proxy voting advisors and

[27] The draft of "The Companies Act 1995 (Electronic Communications) Order 2000" can be found at www.legislation.hmso.gov.uk/si/si2000/draft/20008674.htm.

[28] Cf. the two consultation documents of the DTI of March 1999 ("Building Confidence in Electronic Commerce-A Consultation Document" and "Electronic Communication: Change to the Companies Act 1985), furthermore ICSA (Institute for Company Secretaries and Administrators), Electronic Communications with Shareholders. A Guide to Recommended Best Practice, 2000.

[29] Cf. the national reports on the legal systems within the European Union in Baums/Wymeersch, op. cit. (n. 1).

[30] Cf. U. Noack, Unternehmensrecht und Internet, Working Paper, Universität Düsseldorf/Germany, with further references.

the preconditions for a competition for shareholder-oriented proxy voting advisory services are discussed in the literature[31].

VI. Competence of the Shareholders´ Meeting

How should the general competence of the shareholders´ meeting be defined? Should it be designated to deal with a limited and defined set of issues or, as a principle, be able to serve as the ultimate decision making body on virtually all company matters? Is it possible to identify any shifts in responsibilities among different company organs, such as the shareholders´ meeting, the board and executive management?[32]

1. Different technical approaches

Internationally we find different approaches to the question how to define the competencies of the shareholders´meeting and delimit them from those of the board. In Sweden, for example, the shareholders´ meeting is – at least in principle – able to serve as the ultimate decision making body on virtually all company matters whereas in Germany there is a designed set of issues on which the shareholders may decide[33]. In the U.S. some competencies of the shareholders´ meeting are indispensable, others depend on the articles of incorporation[34]. For listed companies the respective stock exchange may require that certain important decisions be put before the shareholders[35]. In the U.K., there is a number of situations in which the Companies Act of 1985 or the London Stock Exchange require major transactions to be ratified in general meeting[36]. The general meeting may also curtail the future powers of the directors as to the management of the company by a special resolution, and it has "default powers"[37].

The German example may be particularly interesting as Germany has experimented with different approaches. Under the old Commercial Code (until 1937), the shareholders´ meeting was considered to be – at least in theory – the supreme organ of the company with broad competencies. Practice and statutes however, looked very different also then, of course. Since 1937, the Stock Corporation Code reserves a defined set of competencies to the general meeting. This set is mandatory which means that the statutes must not, even not in smaller companies, deviate. Under this regime, the shareholders´ meeting must not compel the directors to enter or not to enter into a transaction which is clearly a part of the general management of the company´s business except of cases where management has asked for such a decision[38].

Basically, there are two problems with this regulation. First, it applies also to small non-listed stock corporations[39]. Here there are no convincing reasons conceivable why shareholders should not be free to tailor the competencies of the shareholders´ meeting and the board according to their needs. Family-owned businesses as well as start-up companies are therefore forced to

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[31] T.Baums/Ph.v.Randow, Shareholder Voting and Corporate Governance: The German Experience and a New Approach, in: M. Aoki/H.K. Kim (eds.), Corporate Governance in Transitional Economies. EDI Development Studies, The World Bank, Washington D.C. 1995, 435, 451 ff.; M. Latham, The Internet Will Drive Corporate Monitoring, 2000 (www.corpmon.com);with further references.

[32] Issues note 3.4.

[33] Cf. § 119 German Stock Corporation Act.

[34] Cf., e.g., R.C. Clark, Corporate Law, Boston – Toronto 1986, at p. 94.

[35] See N.Y.S.E. Listed Company Manual § 312. 01.

[36] Cf. P. Davies, in: Gower´s Principles of Modern Company Law, 6th ed., London 1997, at pp. 626 et seq.

[37] Davies, op. cit., at p. 186, 187.

[38] Cf. § 119 (2) Stock Corporation Act.

[39] As opposed to limited liability companies (GmbH) where shareholders hold the reins.

develop accompanying shareholder agreements which makes things more complicated than they need be[40].
The second problem with this mandatory catalogue of competencies is that it proved to be incomplete. The Federal Civil Court found that the spinning-off of an essential part of a company´s assets into a subsidiary requires the consent of the shareholders although the wording of the respective paragraph (§ 119 AktG) does not provide for that[41]. There is a lot of literature guessing when exactly this "Holzmüller"-doctrine is applicable and whether it should be extended on other similar important transactions. Accordingly, corporate practice is confused. The Government Commission on Corporate Governance is right now considering whether and how to amend this.

2. *Shifts in responsibilities*

The second part of the question – is it possible to identify any shifts in responsibilities among different company organs, such as the shareholders´ meeting, the board and executive management? - is difficult to answer. A precise and comprehensive answer would not only require a detailed study of the various legal systems including the differences between one-tier and two-tier board systems but also of the actual practice. My general impression is that, for instance, U.S. company *practice* leaves more decisions to management like, e.g., amendments of the by-laws, decisions on mergers up to a certain size, short form mergers, share issuances and share repurchase programs as well as antitakeover measures than traditional continental European company would allow. On the other hand, U.S. company and securities laws and judicial practice provide for an effective protection of investors should the board abuse its powers. More flexibility need not necessarily mean less shareholder protection.

VII. Majority Requirements

Under what circumstances should deviations from the simple majority rule be mandated? What is the underlying reason and guiding principle for such deviations? Is there a real risk that super majority requirements in the case of dispersed ownership and low participation rates may stall the decision making process making it practically impossible to obtain the required majority?[42]

1. Plurality and supermajority requirements

The predominant rule as to the majority legally required for general meeting decisions is the absolute majority of the votes present, equaling voting abstention to negative voting[43]. Some countries however, let the simple majority suffice[44].The articles of incorporation or the bylaws

[40] Cf. T.Baums/M.Möller, Venture Capital: US-amerikanisches Modell und deutsches Aktienrecht, in: T.Baums/K.J.Hopt/N.Horn (eds.), Corporations, Capital Markets and Business in the Law. Liber amicorum Richard M. Buxbaum, London-The Hague-Boston, 2000, 33 – 87.
[41] BGHZ 83, 122 ("Holzmüller"-case). For a description and assessment in English cf. Rosengarten, in: Baums/Hopt/Horn, op. cit. (n.40), 445 –460.
[42] Issues note 3.5.
[43] E.g., Finland, France, Greece, Italy, The Netherlands, Switzerland, U.S.; cf. N. Druey, General Report, in: Baums/Wymeersch, op. cit. (n. 1), at p. 377.
[44] Austria, Belgium, Germany, Luxembourg, Sweden, U.K.; cf. Druey at p. 377 f.

may provide for other "supermajorities" however; or such a supermajority is even required by mandatory law. Such supermajority rules are thought as an instrument of protection of minority interests, but they may also lie in the interest of the management. Take a close corporation under, say, Delaware company law. If the articles of incorporation provide for a supermajority of two thirds of the shares of the company to elect board members, a minority shareholder with 40% of the outstanding stock has a say in who will be elected. In a *public* corporation such a supermajority requirement may serve as one out of several devices to make the acquisition of control by a hostile bidder difficult.

Apart from such voluntary statutory provisions, company laws frequently mandate supermajorities for fundamental changes like, e.g., mergers, dissolutions, sale of all assets of the company and the like[45]. The rationale for these mandatory rules is that investors shall be confident that the initial "investment contract" cannot be altered without their approval. Requiring unanimity in such a case could, of course, lead to inefficient hold-ups. Therefore legal systems frequently provide, beside the supermajority requirement, for appraisal rights for opposing shareholders.

2. *Quorum requirements*

There is no danger that (super-)majority requirements will in the case of dispersed ownership and low participation rates stall the decision making process as long as the (super-) majority refers to the stock voted or the shares present rather at the meeting than to all outstanding shares. This danger exists however, if a legal system requires a quorum of presence. In this point legal systems differ. Many countries do not know any legal minima of shareholders to be present at the meeting[46]. Others have very low statutory provisions[47]. Mediterranean countries however, have substantial limits[48] and respective problems, leading partially to the practice that a second or even third meeting is routinely convened together with the first one. In this second or third meeting, no quora are applicable.

In the U.S., a quorum is also required. Under Delaware law, for example, the certificate of incorporation or bylaws of a corporation may specify the number of voting shares that must be represented at a meeting in order to constitute a quorum. In no event, however, may a quorum consist of less than one-third of the shares outstanding. If the certificate of incorporation or bylaws do not specify how many shares constitute a quorum, then a quorum is a majority of the shares outstanding[49]. It is reported that corporations in the U.S. commonly achieve quorums (through participation of proxy-holders) averaging more than 80 percent of outstanding shares[50].

VIII. **VIII. Nomination and Election of the Board of Directors**

[45] Cf. the detailed report by Druey, op. cit., at p. 378.
[46] Austria, Denmark, Finland, Germany, Luxembourg, The Netherlands, Sweden, Switzerland,; cf. Druey, op. cit., at p. 377.
[47] Ireland, Portugal, U.K.; Druey at p. 377.
[48] France, Greece, Italy, Portugal (for extraordinary meetings), Spain, and Luxembourg (for extraordinary meetings); cf. Druey, at p. 377.
[49] Del. Gen. Corp. L. § 216 (1996).
[50] Klausner/Elfenbein, op. cit. (n. 21), at p. 360.

What is generally law and practice when it comes to the nomination and election of the board of directors? What is the experience from nomination committes, cumulative voting rights and minority representation?[51]

1. Election of directors

Here one has of course to differentiate between one- and two-tier systems. In the predominant one-tier model, shareholders will generally have the right to elect the members of the board. Let us take the English law as an example[52]. The Company Act of 1985 leaves it to the articles of association whether or not all members of the board are elected by all shareholders in a general meeting. There is nothing to prevent articles providing that directors can be appointed by a particular class of shareholders, by debenture holders or, indeed by third parties. In the regular case of appointment by the shareholders´ meeting an ordinary resolution will suffice to elect a director. The articles normally provide for retirement by rotation of a certain proportion and for the filling of the vacancies at each general meeting. However appointed, a director can be removed by ordinary resolution in addition to any other means of removal that may be provided in the articles.

Things look quite different in two-tier systems. In the Dutch model, if a (bigger) company is submitted to the "structure regime", the members of the supervisory board will be supplemented by co-optation[53]. The Dutch government is right now considering whether this co-optation model should be abandoned.

Under the German codetermination model,[54] part of the members of the supervisory board is appointed by (representatives of) the employees and at least - depending on the Act which is applicable – half of the members will be elected by the (plurality of) shareholders. The statutes may provide that a third of the representatives of the shareholders be appointed by a single shareholder or a class of shareholders[55]. Representatives of shareholders can be removed by ordinary resolution without cause with a ¾ majority of the votes; the statutes may provide for an other majority[56]. The representatives of the employees may be removed by their electorate. The supervisory board itself can also ask the court for removal of a member for cause[57].

2. Nomination of directors

Here again one has to differentiate between one-tier and two-tier systems, and board practices have to be taken into account.

In the predominant one-tier system, it is up to the board to make proposals to the shareholders as to the election of board-members. With insider-(management-)dominated boards and rationally apathetic shareholders, this system formerly resulted frequently in factual co-optation by the incumbent management. The discussion during the last two decades or so and the development of codes of best practice in particular seem to have brought about change in this respect. These codes recommend nomination subcommittees of the board with a majority of independent (outside) directors as their members. These committees have to develop proposals how to

[51] Issues note 3.6.

[52] The following is taken from Davies, op. cit. (n. 36), at p. 180, 181.

[53] Cf. H.J.M.N. Honée, Erfahrungen mit der Kooptation von Aufsichtsratsmitgliedern in den Niederlanden, ZGR-Zeitschrift für Unternehmens- und Gesellschaftsrecht 1982, 87 ff.

[54] Fort a description of the different models and their regulation cf. T.Baums/B. Frick, The Market Value of the Codetemined Firm, in: M.Blair/M.J.Roe (eds.), Employees and Corporate Governance, Washington D.C. 1999, at pp. 208 – 210; for a description of the historical development K.Pistor in the same volume at pp. 163 ff.; critical assessment by M.J. Roe, same vol., at pp. 194 ff.

[55] § 101 (2) Stock Corporation Act.

[56] § 103 (1) Stock Corporation Act.

[57] § 103 (2) Stock Corporation Act.

supplement the board[58]. The aim is to appoint truly independent individuals to boards so that they can fulfill their role and objectively oversee company management. Of course it will factually depend to a large extent on the shareholding structure how the composition of the board (and hence the recommendations of the nomination committee) will look like. Dominant or even majority shareholders will quite naturally be represented on boards; board composition will still mirror business relationships; and in companies with widely distributed shares managing directors will play an important if not decisive role.

In the German two-tier system things look different as up to a half of the board seats may be taken by employees´ representatives. As to the other half the board itself will make proposals to the shareholders´ meeting whom to elect.[59]. Nomination committees (with the task of developing proposals for the composition of the supervisory board) are widely unknown in German companies. Boards use to mirror the shareholding structure and composition (representatives of controlling shareholders; bankers as representatives of the proxy –voting banks; representatives of important business partners; leading business figures from other firms; the former CEO). Recently the German Panel on Corporate Governance has in its Code of Best Practice developed recommendations for a more independent composition of boards[60]. The recommendations of the Dutch "Peters Committee" point in the same direction[61].

3. *Cumulative voting rights*

Under cumulative voting, shareholders may vote their shares multiple times up to the number of vacancies to be filled. They can cast all their multiple votes for a single candidate or apportion them among different candidates in any manner[62]. The rationale of cumulative voting is to assist minority shareholders to secure some representation on the board of directors. The greater the number of vacancies, the higher the possibility of minority shareholders securing some representation by focusing their multiple votes on the same one or few candidates. By contrast, under non-cumulative voting, a majority shareholder, or a group of shareholders, could determine all positions of the board.

Cumulative voting is mandatory for public companies in some jurisdictions in the United States[63]. It is permissible in most other U.S. jurisdictions, if authorized by the constitution of the company[64]. There is a continuing debate in the U.S. about whether cumulative voting should be mandatory for public companies. Elsewhere, cumulative voting may be permissible, as in Canada, Australia, and the U.K., but seems not to be in use. To my knowledge continental European legal systems do not provide for cumulative voting, either.

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[58] Cf., e.g., Spain: El Gobierno de las Sociedades, 1998, at 5.1,5.2; Belgium: Belgische Commissie voor Corporate Governance, Verslag 1998, n. 24; France: CNPF/AFEP: Le Conseil dÁdministration des Sociétés Cotées 1995, II.5.; U.K. (Hampel) : Committee on Corporate Governance, Final Report, 1998, A.V.,VI.

[59] § 124 (3)(1) Stock Corporation Act.

[60] German Panel of Corporate Governance, Code of Best Practice for German Corporate Governance, July 2000, at III.1.).

[61] Corporate Governance in the Netherlands. Forty Recommendations, 1997, sub 2.1 – 2.7.

[62] Briefly, the number of votes which each shareholder has is multiplied by the number of directors to be elected and he can "cumulate" his votes on one or some nominees only instead of spreading them over the slate. This is of little benefit to a member with a handful of votes only but it does mean that one who holds one-third of the voting shares should secure one-third representation on the board and that one with 51 percent should secure only one-half and not, as under the majority-rule, be able to elect the whole board (Davies, op. cit. (n. 36), at p. 181). U.S. commentators on cumulative voting have developed formulae to determine the minimum number of shares needed to elect a director if those shares are cumulated in one candidate (R.C. Clark, op. cit. (n. 34), at p. 363). The critical percentage for election as director depends on the number to be elected at a meeting. The higher the number of directors, the lower the percentage shareholding required. Conversely, the lower the number of directors, the higher the percentage shareholding required.

[63] For instance, California.

[64] E.g., Delaware, New York.

As a practical matter, the introduction of cumulative voting requires provisions as to the removal of a director elected through cumulative voting. To a certain extent cumulative voting can also be undermined through changing the size of the board or the introduction of staggered boards[65]. The strongest argument for cumulative voting is that it provides large minority shareholder with a "look-in" at the board. Today, it may also provide access to the boardroom for activist institutions, who will then serve as virtual representatives for other public shareholders[66]. The customary argument against cumulative voting is that it is likely to polarize the board. Practical experience has also shown that big institutionals and shareholder activists or private investors need not necessarily have the mechanism of cumulative voting at hand in order to get a board seat. Critics also point at other devices for keeping minority shareholders interested and informed[67]. Empirical data on the (positive or negative) effect of cumulative voting are inconclusive[68].

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[65] For a more extensive discussion cf. R.C. Clark, op. cit. (n. 34), at pp. 364 ff.; JH. Choper/J.C. Coffee/R.J. Gilson, Cases and Materials on Corporations, 4th ed. 1995, at p. 572 f.; comparative monograph: P. Beyer, Minderheitsvertreter im Aufsichtsrat, Baden-Baden 2001.
[66] Cf. J. Gordon, Institutions As Relational Investors: A New Look at Cumulative Voting, Columbia Law Rev. 94 (1994), 124, 128 f.
[67] Cf. Choper/Coffee/Gilson, op. cit. (n. 65), at p. 574.
[68] Cf. Choper/Coffee/Gilson at p. 575.