are somewhere in between a systematic admission of the shareholders' claim and a court review of the reasons for the claim and perhaps the claim's compliance with certain formal or substantive requirements. The difficulty of drawing a line renders a choice between zero and one necessarily inaccurate and somewhat discretionary. Once more, the interrelation and interdependence of even technical provisions is manifested. As will be shown in Part III, fundamental provisions and economic background play an even weightier role.

Table 6: Scores on the Sixth Anti-Director Right

<table>
<thead>
<tr>
<th></th>
<th>LLSV score</th>
<th>Revised score</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>France</td>
<td>1</td>
<td>1?</td>
</tr>
<tr>
<td>Belgium</td>
<td>0</td>
<td>0 (but not less protective)</td>
</tr>
</tbody>
</table>

H. Conclusion

The above investigation shows that the difference between common law and civil law with regard to shareholder protection is not as straightforward as the numbers in *Law and Finance* suggest—at least not with regard to the corporate law of these traditions. The LLSV scores should be amended such that the United States and Belgium receive four points and France probably even five. This conclusion confirms that Vagts and Berndt's challenges to the LLSV scores are not limited to Germany. For France and Belgium as well, the quality of investor protection has been seriously underestimated. That is a pity, given the large number of studies that draw upon the findings of *Law and Finance*. Scholars sometimes debate whether the complexity of law can be reduced to numbers. If one does so, one sacred tenet of comparative law should not be violated: a functional approach should be used, since a particular goal may be obtained through another legal rule or through an extra-legal phenomenon. In

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199 This article does not go into the question of whether investor protection is of a different quality in securities laws.

itself, the anti-director index does leave some room for such an approach, and by using this approach this article amends the scores as follows.

Table 7: Overview of the Scores on the Anti-Director Index

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>Belgium</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>LLSV</td>
<td>Revised</td>
</tr>
<tr>
<td>Proxy by Mail to Firm</td>
<td>1</td>
<td>1 (but not protective)</td>
</tr>
<tr>
<td>Shares Not Blocked</td>
<td>0</td>
<td>1 (as of now)</td>
</tr>
<tr>
<td>Cumul Voting/Prop Repres</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Oppressed Min Mechanism</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Preemptive Rights</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>% Extraordinary Meeting</td>
<td>1</td>
<td>1?</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3</td>
<td>4 or 5 at time of LLSV paper/ 5 or 6 now</td>
</tr>
</tbody>
</table>

Still, even with the scores revised, the index does not reflect all the protective mechanisms that a legal system offers. The existence of a slight differentiation in a seemingly identical or similar mechanism, or even a different context gives an identical or similar rule a totally or slightly different meaning. "Cross-reference," as it is called, is not always possible.²⁰¹ Bradley wrote:

We are tempted to think that we understand what the rules are in another legal culture because we think they are like our own, or we think we understand how they are different. But the reality is usually more complex than we could ever imagine. . . . It is not enough to read the foreign rules, because even when the rules appear to be written in our own language they are not.202

A look at law in practice often produces a different outcome than an analysis of the law on the books. Some of these complicating mechanisms have been described above. The more fundamental factors are dealt with below.

III. FUNDAMENTAL DIFFERENCES IN THE DISTRIBUTION OF POWERS

A. Introduction

In addition to the technical rules described in the previous part, there is one more important factor that shapes the effect of the six anti-director rights in a particular country. This factor is the typical distribution of power within a corporation. The difference in the distribution of power is a distinguishing characteristic between corporate law in the United States and in Continental Europe, one that is more fundamental than investor protection.203 Because it is of such great importance, Parts III and IV are dedicated to it. The distribution of power not only affects the bearing of anti-director rights in different jurisdictions, but also other legal provisions and economic realities. To use the different distribution of powers as a starting point in comparative corporate law is to open new perspectives. It leads to a better understanding of legal, economic and methodological factors, including factors that have so far been related to investor protection.

The difference in the distribution of power among corporations has two facets. The first—the difference between dispersed and concentrated ownership—has received ample attention in previous scholarship and will therefore be dealt with only briefly under Section B. The second aspect—


203 See La Porta et al., supra note 11, at 24. "Using investor protection as the starting point appears to be a more fruitful way to describe differences in corporate governance regimes across countries than some of the more customary classifications such as bank- or market-centeredness." Id.
the distribution of power as it ensues from corporate law provisions—is frequently unobserved. 204 This is the subject of section C.

B. Economic Distribution of Power

It is well-known that in common law countries, ownership is commonly dispersed among many shareholders, whereas in civil law countries, it is mainly concentrated in the hands of a few shareholders. In the United States, shareholders do not have large stakes. 205 Also, voting blocks, consisting of several stockholders voting in concert, are small. The largest voting block typically represents between five and nine percent of the stock, with the remaining blocks being insignificantly small. 206 Numerically, share ownership of the French SA is less concentrated than is often assumed. 207 This is due to the use of techniques to maintain control without owning majority stakes. 208 When looking at voting blocks instead of direct shareholdings, one finds that the three largest voting blocks are about twenty percent, six percent, and three percent, respectively. The remaining blocks are negligible. 209 Similarly, in Belgium, the possibility of pyramidal structures and other techniques to separate cash flow and voting rights makes it more interesting to look at voting blocks than at shareholdings. The largest voting block represents typically fifty-six percent, while the second to the tenth largest voting blocks typically represent around five percent of the company's stock. 210 In terms of the

204 A rare publication where the distribution of legal powers has received full attention, although without coverage of all relevant aspects and only with respect to common law countries, is Bebchuk, The Case for Increasing Shareholder Power, supra note 26, at 836. The author formulates the independence of the distribution of legal powers from the economic allocation of powers as follows: "even [with dispersed ownership], introducing shareholder power to intervene would considerably change the balance of power between shareholders and management." Id. at 842.

205 See supra Part I.

206 See Marco Becht, Beneficial Ownership in the United States, in THE CONTROL OF CORPORATE EUROPE 289 (Fabrizio Barca & Marco Becht eds., 2001). Other strong empirical research can be found in CHRISTOPH VAN DER ELST, AANDEELHOUDERSCHAP VAN BEURSGENOTEERDE VENNOOT SCHAPPEN, ECONOMISCH-JURIDISCHE ANALYSE IN BELGIÉ EN EUROPA [STOCK OWNERSHIP OF LISTED COMPANIES. ECONOMIC AND LEGAL ANALYSIS IN BELGIUM AND EUROPE] (2001).


209 Becht, supra note 206, at 318.

210 Id.
amount of stock the largest shareholder owns, percentages are, of course, lower. Where they do not exceed fifty percent, the term "majority shareholder" is not accurate, and therefore, the term "reference shareholder" is often used as a generic term.

These different ownership structures have often been identified as the cause of shareholders' weak power in the United States and their stronger power in Continental Europe. The following section shows that ownership structure is definitely not the only cause, and probably not even the primary cause, of differences in the degree of shareholder power. It remains, however, an important element, as it affects the anti-director rights and is one aspect of the distribution of power, the latter of which is dealt with in the next section.

C. Legal Distribution of Power

1. Introduction

The fundamental legal difference between the U.S. system of corporate governance and the Continental European corporate law system is the way they distribute powers within a corporation. One aspect is the allocation of decision-making powers—who gets to decide what (subsection 2). Another aspect is who can initiate the proceeding that leads to decision making (subsection 3). In both respects, the lion's share of power in the United States is in the hands of the board and management, whereas in Continental Europe, the shareholders hold the greater part. This discrepancy is buttressed by the enabling character of the DGCL and the mandatory character of most Continental European corporate legislation. Because of the DGCL's enabling character, the board has a greater say over the relative distribution of powers than in Europe where the allocation of powers is largely statutorily fixed (subsection 4). This section will end with a salient example, namely, the election and removal of directors (subsection 5).

The following explanation of this difference (Part III) and of its consequences (Part IV) is a simplification in several respects. First, not all of these differences can be generalized to a distinction between common law and civil law. Within both legal traditions, there are some variations that require more explanation and nuance, without invalidating the theory presented hereafter. For instance, with regard to the allocation of decision-making powers, including the dismissal of directors, the United Kingdom and Australia are closer to the civil law tradition. Regarding other points, such as the mandatory or enabling character of the distribution of powers, they fit with the U.S. configuration. There are also some important
divergencies within the civil law tradition. For some, but not all, countries of the German law tradition (e.g., Germany and Austria), the situation with regard to board dismissal and election is not as straightforwardly a shareholder's power as it might appear.\textsuperscript{211} Second, in considering the legal distribution of powers as set out below, one should make abstraction of the economic reality, i.e., the stock ownership structure prevailing in a particular country. For the purpose of Part IV, which explains how closely both factors are intertwined, it is necessary first to consider them separately.

2. The Allocation of Decision-Making Power

The common law principle that the holder of primary management power\textsuperscript{212} is well embodied in the DGCL.\textsuperscript{213} DGCL section 141(a) stipulates that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."\textsuperscript{214} In some Continental European countries the default powers reside with the board;\textsuperscript{215} in others the opposite is the case: the shareholders' meeting has all powers that are not by statute given to the board.\textsuperscript{216} In both cases, the shareholders' meeting generally has considerably broader powers than in the United States. In the United States, shareholders' substantive powers "are essentially limited to the election of directors and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolution."\textsuperscript{217} Apart from the election of directors and amendment of the

\textsuperscript{211}For Germany: § 84 Nr. 3, § 103 Nr. 1 AktG. For Austria: § 75 Abs. 4, § 87 Abs. 3 AktG.

\textsuperscript{212}Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cuninghame, 2 Ch. 34 (Eng. C.A. 1906).

\textsuperscript{213}In practice, the board delegates much of its power to managers. That does not change the validity of the hereafter presented theory. It is sufficient that the power appertains to directors and management (de facto with the managers dominating), but certainly not to the shareholders.

\textsuperscript{214}DELCODE ANN. tit.8, § 141(a) (2001).

\textsuperscript{215}This is the case in Belgium, Luxembourg, Ireland, and Italy. Trans-European Law Firms Alliance, Shareholder's Rights: A Legal Comparison, at http://www.apcims.co.uk/publications/discussions/pdf/Shareholders%20Rights%20-%20Preface.pdf (last visited Apr. 9, 2004).

\textsuperscript{216}Id.; see also Commercial Code, art. L. 225-98 (French statute granting all powers not given to board to shareholders).

\textsuperscript{217}Stephen M. Bainbridge, Director v. Shareholder Primacy in the Convergence Debate, 16 TRANSNAT'L LAW. 45, 48 (2002).
bylaws, all these decisions need approval by the board. Therefore, these two exceptions can be and are generally considered the most important powers of shareholders in a Delaware corporation. Startlingly, it is exactly with regard to these two powers that the discrepancy between the United States and Continental Europe is greatest. Many times in practice even the outcome of the board election is predetermined by the incumbent board.

For this part of the argument, the critical difference lies in the power to amend the company's constitutional documents. Under Delaware law, provisions in the certificate of incorporation can be amended only upon the board's proposition and with approval of the shareholders' meeting. As a result, the board effectively has a veto over any changes to provisions in the charter. This power is far-reaching, given the wide range of issues that can be addressed in the charter, such as the rights and powers of stockholders, directors and officers, and the veto power it holds over the bylaws. Indeed, bylaw provisions may not be inconsistent with the provisions of the certificate of incorporation. In addition, the board has the authority to amend the bylaws if the certificate of incorporation so stipulates, which it generally does. Shareholders have an inalienable right to amend the bylaws too, but the board is in a better position to do so because of the collective action problem shareholders face. Conversely, in Europe, charter and bylaws usually are one single document, and a shareholders' vote is required for any change in any of its provisions. The board does not even need to agree with an amendment, let alone propose the amendment, even when the amendment modifies a provision that would be a typical charter provision in the United States.

A shareholders' meeting, of course, makes numerous decisions that do not concern charter or bylaw amendments or elections. The number of such decisions is larger in Continental Europe than in Delaware. As

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219See infra Part III.C.5.
221Id. § 102(b).
222Id. § 109(b).
223Id. § 109(a) (after the corporation has received any payment for any of its stock).
224David A. Drexler et al., Delaware Corporation Law and Practice § 9.02 (2004).
225Del. Code Ann. tit. 8, § 109(a) (2001) (after the corporation has received any payment for any of its stock).
226E.g., § 145 Abs. 1 AktG (Austria); Companies Code, art. 558 (Belgium); Commercial Code, art. L. 225-96 (France). The required percentage of favorable votes depends on the nature of the amendment, but is never below fifty percent (except in some extreme circumstances) Companies Code, art. 535, al 3 (Belgium); § 119 Nr. 1(5) AktG (Germany).
mentioned above, in Delaware, the remaining powers of the shareholders' meeting are votes on major structural changes, such as mergers and consolidations\textsuperscript{227} or sales, leases, or exchanges of all or substantially all of the corporation's property and assets.\textsuperscript{228} Stockholders in Europe not only vote on business combinations\textsuperscript{229} and sales of all or substantially all of the corporation's assets,\textsuperscript{230} but they also vote on various other decisions, such as spin-offs and divisions,\textsuperscript{231} an increase or decrease in the company's capital,\textsuperscript{232} and the waiver of preemptive rights thereby.\textsuperscript{233} A typical power of the shareholders' meeting in Europe is the approval of the dividend,\textsuperscript{234} which in Delaware is the exclusive authority of the board.\textsuperscript{235} As a consequence of their limited powers, stockholders in Delaware often use bylaw amendments as a means of having input in corporate decisions, a situation that has been labeled "a malfunction in the corporate mechanism."\textsuperscript{236}

3. The Allocation of Agenda-Setting Power

It seems evident that if a shareholder cannot raise an issue, the right to vote on that issue has less value. Therefore, one should consider not only the distribution of substantive powers, but also how much initiative shareholders are able to take to exercise these powers. The question thus becomes how easy or difficult it is for shareholders to have their proposals included in the company's proxy or to solicit proxies themselves. Or, in civil law countries, how smoothly they can put their proposals on the

\textsuperscript{228}\textsuperscript{228}Id. § 271(a).
\textsuperscript{229}\textsuperscript{229}Companies Code, arts. 699, 712, & 722 (Belgium); Commercial Code, art. L. 236-9 (France); §§ 319-320 AktG; §§ 65, 73 UmwG (Germany).
\textsuperscript{230}\textsuperscript{230}Companies Code, art. 761 (Belgium); § 179a AktG (Germany).
\textsuperscript{231}\textsuperscript{231}Companies Code, art. 733 (Belgium); Commercial Code, art. L. 236-9, rendered applicable by art. L. 236-16 (France); §§ 65, 125 UmwG (Germany).
\textsuperscript{232}\textsuperscript{232}Companies Code, arts. 581 & 612, respectively (Belgium); Commercial Code, arts. L. 225-129 & 225-204, respectively (France); §§ 182, 192, 202, 207, 222, 229, & 237 AktG (Germany).
\textsuperscript{233}\textsuperscript{233}Companies Code, art. 596 (Belgium); Commercial Code, art. L. 225-135 (France); § 186 AktG (Germany).
\textsuperscript{234}\textsuperscript{234}Commercial Code, art. L. 232-11 (France); AktG § 174 (Germany); the power is implicitly but incontrovertibly granted in Companies Code, art. 554 (Belgium).
\textsuperscript{235}\textsuperscript{235}Del. Code Ann. tit. 8, § 170 (absent any restrictions contained in the certificate of incorporation).
meeting's "agenda." This is an important question because the proxy forms and the agenda are the only means in the respective legal traditions for informing other shareholders as to which issues will be decided. Because of the success of proxy voting in the United States, it is de facto the last moment at which a new issue can be put forward with a reasonable chance of obtaining enough votes. In civil law countries, it is even a rule de jure that, except in some limited circumstances such as urgency, the shareholders' meeting cannot decide upon issues other than those included in the agenda of the meeting.

Here again, a fundamental difference is visible between the United States and Continental Europe. In the United States, running a proxy contest is so costly that it is used only in egregious situations where the contestant aims at taking control. Holders of at least $2,000 in market value or of one percent of the company's securities for at least one year by the date the proposal is submitted are entitled to include certain proposals in the company's proxy materials under the town meeting rule. The board, however, has a broad variety of permissible grounds for excluding the proposals from the company's proxy materials. This includes cases where the proposal relates to the company's ordinary business operation or to an election of directors, or where the proposal is improper under state law. In order to avoid the latter objection, the SEC recommends that shareholders frame their resolutions in a precatory form. In that case, however, the board can, and routinely does, ignore the shareholder proposal, regardless of the percentage of shareholders who support it.

The situation is different in Continental Europe. When shareholders convene a meeting or have a meeting convened, they generally also set the

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237 This part does not deal with the decisions for which the statute designs a specific procedure, such as for the above-mentioned structural changes.

238 Section 108 Abs. 2 AktG (Austria); Commercial Code, art. L. 225-105, al 3 (France); § 124 Abs. 4 AktG (Germany). In Belgium it is a generally accepted principle that is not explicitly in the statute. BERNARD TILLEMAN, DE GELDIGHEID VAN BESLUITEN VAN DE ALGEMENE VERGADERING [THE VALIDITY OF RESOLUTIONS OF THE GENERAL MEETING] 226-27 (1994).


240 17 C.F.R. § 240.14a-8 (2004). Contrary to what is the case in Continental Europe, a brief supporting statement is also included. Id.

241 Id. § 240.14a-8(i)(1)-(13).

242 Id. § 240.14a-8(i)(1) note.

agenda. In Belgium, the board\textsuperscript{244} in such a case is obliged to set the proposed issues on the agenda.\textsuperscript{245} It is only in exceptional circumstances, such as with a proposal that is illegal or could otherwise harm the corporation, that the board can modify the shareholder proposal.\textsuperscript{246} In France, the situation is somewhat different. The agenda of an extraordinary meeting is set by the president of the commercial tribunal when designating the representative who will convene the meeting.\textsuperscript{247} Stockholders in France, however, can easily include a proposal in the agenda of a meeting convened by the board. Thus, for submitting a proposal to the shareholders' meeting, they do not even have to convene a meeting themselves. One or more shareholders representing a percentage of the share capital ranging from 0.5 percent to five percent, depending on the size of the company's capital,\textsuperscript{248} or an association of shareholders, can demand the inclusion of draft resolutions in the agenda.\textsuperscript{249} The statutory schedule for the calling of a shareholders' meeting is actually designed to allow shareholders to have their draft resolutions entered in the meeting's agenda. After the board of directors or the managing board has published a "notice of meeting," the shareholders can submit additional draft resolutions and/or amendments to the management's resolutions.\textsuperscript{250} These will be included in the final agenda as contained in the second notice, the "notice of call." Thus, shareholder proposals are presented to shareholders to the same extent as the proposals from the board.\textsuperscript{251}

In Belgium, it is assumed that shareholders who meet the ownership threshold for convening a meeting can also have items included in the agenda for a meeting called by the board. The threshold is twenty percent

\textsuperscript{244}Sometimes, other bodies are competent, e.g., the statutory auditor (Companies Code, art. 532) or a liquidator (HELLEMANS, supra note 63, at 396-98).

\textsuperscript{245}This is important, since as a rule the shareholders' meeting can generally decide only issues on the agenda (and unforeseen urgent matters). § 124 Abs 4 Akt.G. (Germany); Commercial Code, art. L. 225-105, al 3 & art. L. 225-121 (France). The Belgian Companies Code does not explicitly state the principle, but it is generally accepted. See HELLEMANS, supra note 63, at 399.

\textsuperscript{246}HELLEMANS, supra note 63, at 398-99.


\textsuperscript{248}Decree No. 67-236, art. 128.


\textsuperscript{250}Decree No. 67-236, arts. 123-126; ANSA, Calling the Shareholders, at http://www.ansa.asso.fr/site/acv_uk_3.asp (last visited Apr. 9, 2004).

\textsuperscript{251}ANSA, Calling the Shareholders, at http://www.ansa.asso.fr/site/acv_uk_3.asp (last visited Jan. 26, 2005). In practice, however, dissenting proposals are rare.
of the company's capital. Given the typical stock ownership structure of a Belgian corporation, this is not as high as it seems to be at first sight.

4. Enabling versus Mandatory Corporate Law as a Supporting Factor

The difference in the internal distribution of decision-making and agenda-setting powers is strongly supported by the difference between an enabling and a mandatory approach in the investigated countries' corporations acts. Contrary to what is the case for the allocation of powers, this distinction correlates well with the division between common law and civil law. What is said about the United States in this section essentially also holds true for other common law countries. Roman Tomasic's observation that in Australia "the distribution of decision-making power within the corporation is a contractual matter" aptly characterizes the enabling approach in common law jurisdictions in general. The Australian Corporations Act only requires a few decisions to be made by the general meeting of members and leaves the distribution of powers up to the corporation. Most companies follow the replaceable rule that confers on the board of directors all powers that have not been attributed to the general meeting by the company's constitution. Tomasic concludes that "[w]hilst the law does not prescribe any general division of power within a corporation it does, however, have more to say about relations between the board and the general meeting once their respective powers have been specified by the corporate constitution."

Legislators in common law jurisdictions adopt a more flexible approach to corporate governance than those in civil law countries, and leave room for the reallocation of rights. A reading of the DGCL leaves no room for doubt that this also holds true for Delaware law. The DGCL explicitly mentions that the certificate of incorporation may contain "any

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252 SHAREHOLDER VOTING RIGHTS, supra note 56, at 27.
253 In Germany, shareholders must represent five percent of the share capital or a nominal amount of EUR 500,000: AktG § 122(1)-(2).
254 François & Delvoie, supra note 22, at 31-32 (noting the difference between enabling and mandatory law, but stressing its importance only with regard to investor protection rules).
255 ROMAN TOMASIC ET AL., CORPORATIONS LAW IN AUSTRALIA 263 (2d ed. 2002).
256 Corporations Act, sec. 198A.
257 TOMASIC ET AL., supra note 255, at 264; with reference to Corporations Act, sec. 140.
258 Katharina Pistor et al., The Evolution of Corporate Law: A Cross-Country Comparison, 23 U. PA. J. INT'L ECON. L. 791, 828 (2002). In Delaware, this situation was reached by the late 1920s. In the United Kingdom, this liberalization occurred even earlier. It should be noted that federal securities law in the United States is mandatory. Id.
provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the shareholders.\textsuperscript{259} This flexibility is the case not only for decisions that strictly concern the corporation itself, but also the removal of directors. The charter can provide that the removal of directors from a classified board not be limited to cases where there is cause.\textsuperscript{260} De facto, this means that the Delaware legislature has left it up to the board to reduce its own authority, because it has absolute veto power over charter amendments. The statute assigns most powers to the board and "any alternative provision is hostage to the consent of the board of directors to that alternative."\textsuperscript{261} Not surprisingly, the result is that the board effectively has all powers that are not mandatorily attributed to the stockholders.

In contrast, Continental European statutes mandatorily define the division of power between shareholders and directors. The company's constitution, or even a shareholders' resolution, cannot assign to the board powers that are statutorily reserved to the shareholders' meeting except in the few cases where the statute authorizes such a delegation.\textsuperscript{262} Thus, in civil law countries the legislature deems it necessary to determine itself how powers should be allocated in a corporation. It has given power to the shareholders' meeting, with no possibility for the board to appropriate that power.

5. Election and Removal of Directors as a Special Example

The weak power of shareholders in the United States is often justified by reference to a different type of decision-making power, namely, the shareholders' authority to elect and remove directors.\textsuperscript{263} Stockholders who do not agree with the board and management, the argument traditionally goes, can replace the board with a new team. Nonetheless, it has become obvious not only that replacement is a very crude device for resolving disagreement on a particular action,\textsuperscript{264} but also that shareholders

\textsuperscript{260}\textit{Id.} § 141(k).
\textsuperscript{262}Pistor et al., \textit{supra} note 258, at 818-19; \textsc{Hellemans}, \textit{supra} note 63, at 555-611 (arguing that in Belgium this is a "public order" rule, which is even stricter than a "mandatory" rule). \textit{See also} § 23(5) AktG (Germany) (the charter may deviate from the provisions of the AktG only if expressly allowed).
\textsuperscript{263}\textsc{Del. Code Ann.} tit. 8, §§ 141(k), 211(b) (2001).
\textsuperscript{264}Bebchuk, \textit{The Case for Increasing Shareholder Power}, \textit{supra} note 26, at 18-23 (discussing the problem of bundling).
really do not have much power to replace directors. A comparison with Continental Europe shows that this weakness is still underestimated. Election and removal of directors is one of the best examples of shareholder weakness in the United States compared to Continental Europe. This is the case for the annual board election and even more so, though less often noticed, for removal during a director's term.

In the annual election of directors in the United States, shareholders' powers of initiative are weaker than they already are under the general regime regarding shareholder proposals described above. As mentioned above, in certain situations, election of director proposals may be excluded by the board from the company's proxy. Insurgent stockholders are thus obliged to solicit proxies themselves. This, however, is prohibitively costly for them. Under the "Froessel rule," incumbents are almost systematically reimbursed for their expenses, win or lose, whereas insurgents have to win in order to be reimbursed. The problem is made even worse by the collective-action problem shareholders face.

Yet, proposing an alternative candidate at the yearly elections is extremely important, since mere abstention or a vote against a proposed candidate will not be sufficient to prevent her election. Indeed, in the absence of a different provision in the charter or the bylaws, directors are elected not by majority but by plurality. In the words of Joseph Grundfest, this means that if "a million shares count as a quorum, and if 999,999 ballots strike your name out and say no, you, as the director, owning only one share, and you vote for yourself, congratulations, you win. You have the plurality." Insurgent stockholders must therefore be prepared to bear the costs of the proxy contest. Theoretically, they could also nominate candidates at the meeting. It would be too late, however, since the vast majority of shareholder votes is normally already cast by proxy, on the basis of the proxy materials that are distributed before the meeting.

As a result of these difficulties for insurgents, incumbents usually are re-elected, or to state the case more strongly, they re-elect themselves by

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263 Allen & Kraakman, supra note 132, at 182-85.
266 Donald, supra note 236, at 9-10.
merely proposing themselves.\textsuperscript{271} The recent SEC proposal to require companies to include shareholder nominees in their proxy materials\textsuperscript{272} will certainly make shareholder participation in the proxy process more meaningful. Yet its impact will be seriously limited because of some important requirements. Most importantly, in order to gain access to the company's ballot, shareholders or groups of shareholders must satisfy a five percent ownership requirement for the previous two years. Additionally, a triggering event must have occurred in the preceding year, i.e., a majority vote in favor of a proposal to have shareholder access or a thirty-five percent vote to withhold support from one of the directors.\textsuperscript{273} If these requirements are met, one shareholder or a group with the largest two-year beneficial ownership at the time of delivery of the notice of nomination would have limited access to the ballot. It would be limited because the shareholder or shareholders would be allowed to nominate only a few directors\textsuperscript{274} and would still have to bear their own campaign costs.

Although in Continental Europe directors are generally not up for re-election every year, as in Delaware, shareholders can more easily elect their own candidates. They do so by application of the rules described above concerning the meeting's agenda.\textsuperscript{275} The big difference, however, is not in the annual election of the board. The main difference is probably the degree to which it is possible to remove directors without cause outside the takeover context. The biggest stick for a board that does not act according to the stockholders' wishes is the power to remove the board without cause. Therefore, it is important to know how broad this power is.

At common law, directors could be removed only for cause.\textsuperscript{276} As James Cox and Thomas Hazen note, "[A] director who is serving the corporation faithfully is privileged to continue in office until the end of the term despite the opposition of a majority of the shareholders."\textsuperscript{277} Today,

\begin{itemize}
\item \textsuperscript{271}Margaret M. Blair & Lynn A. Stout, \textit{A Team Production Theory of Corporate Law}, 85 VA. L. REV. 247, 311 (1999).
\item \textsuperscript{273}\textit{Id.} at 60,789-92.
\item \textsuperscript{274}Only one nominee in a board of up to eight members, two nominees in a board of between nine and nineteen members, and three nominees in a board of twenty or more members. \textit{Id.} at 60,797.
\item \textsuperscript{275}At the end of a director's term, the issue of (re-)election is on the agenda, usually without mention of the names of the candidates. Candidates, both incumbents and insurgents, are proposed at the meeting itself. As mentioned above, because of the infrequent use of proxies, the outcome of such a meeting is not determined beforehand, so that at least theoretically insurgents have as equal a chance as incumbents. See supra notes 244-53 and accompanying text.
\item \textsuperscript{276}Campbell v. Loew's Inc., 134 A.2d 852, 857-58 (Del. Ch. 1957).
\item \textsuperscript{277}COX & HAZEN, \textit{supra} note 60, at 446-47.
\end{itemize}
Delaware law provides that outside the election at the end of directors' terms, shareholders can remove members of a staggered board only for cause.\textsuperscript{278} Even at the time of the election, shareholders' possibilities of replacing directors are seriously limited because only one third of the directors are up for re-election. Indeed, boards are staggered in the majority of corporations.\textsuperscript{279} Consequently, the only alternative is often a hostile bid, a proxy contest or a hybrid of both.\textsuperscript{280}

Even the effectiveness of these techniques is questionable because Delaware law is fairly liberal in allowing takeover defenses. \textit{Unocal Corp. v. Mesa Petroleum Co.} set out the general rule that such defenses must pass a two-prong test. First, the board must have had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed."\textsuperscript{281} Second, the measure "must be reasonable in relation to the threat posed."\textsuperscript{282} In \textit{Paramount v. Time} it was held that such a threat can even consist of the possibility that shareholders elect to tender their stock to the bidder "in ignorance or a mistaken belief,"\textsuperscript{283} which led some commentators to conclude that the board could "just say no" to acquisition attempts.\textsuperscript{284} It is only when the company is put up for sale or breakup—in "\textit{Revlon} mode"—that courts apply more stringent standards.\textsuperscript{285} Also, the board may not use its power for inequitable purposes, even when legally possible,\textsuperscript{286} or interfere with the effectiveness of the shareholders' franchise.\textsuperscript{287}

Outside the context of an existing bid, the Delaware Supreme Court in \textit{Moran v. Household} validated the "poison pill" and considered its adoption\textsuperscript{288} by the board to pass the \textit{Unocal/Unitrin} test. Boards can adopt this pill without a shareholder vote and at any time, even after a hostile bid has been launched (the "shadow pill" or "morning after pill") if they do not

\textsuperscript{280}Allen & KRAAKMAN, supra note 132, at 497-98.
\textsuperscript{281}Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).
\textsuperscript{282}Id.
\textsuperscript{283}Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989).
\textsuperscript{284}Allen & KRAAKMAN, supra note 132, at 530.
\textsuperscript{287}Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).
\textsuperscript{288}Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985). According to the court, its use in response to an actual takeover bid must be judged separately. Id.
already have one at that time.\textsuperscript{289} Thus, the company does not have to put a pill into place beforehand and can avoid the costs that a pill implies.

By the time of Moran v. Household most companies had staggered their boards.\textsuperscript{290} Most companies still do nowadays,\textsuperscript{291} allowing boards to easily and safely protect themselves against hostile bids. The combination of an effective staggered board and a poison pill ensures that a hostile bidder has to wait a long time—two elections—before there is a chance to gain a majority of the board seats. In addition, success is not guaranteed: the hostile bidder has to win those two elections. The most difficult problem here is that the bid must be open during this entire period. As a consequence, the takeover threat is only nominal in these circumstances.\textsuperscript{292}

In addition to these strong anti-takeover devices, there are other impediments to running a proxy contest. Most importantly, as explained above, insurgents face the risk of bearing all costs of the procedure if they lose. Bebchuk recently concluded that "[a]lthough shareholder power to replace directors is supposed to be an important element of our corporate governance system, it is largely a myth."\textsuperscript{293}

In conclusion, boards can safely rely on a variety of techniques and case law and do not have to retain a large participation in the company's equity to secure their position. Ironically, it is often said that because tender offers must be negotiated with the board, "devices that enable boards to protect small shareholders from large shareholders become devices that are used to protect boards (and management) from takeover bids."\textsuperscript{294}

In Continental European countries the law rarely provides such strong entrenchment opportunities against hostile takeovers as in the United States.\textsuperscript{295} More importantly, however, the shareholder right to remove


\textsuperscript{290}Lucian A. Bebchuk, et al., The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy, 54 STAN. L. REV. 887, 895 (2002); recent shareholder attempts to de-stagger the board have not been very successful. Id. at 890-91.

\textsuperscript{291}See IRRC, CORPORATE TAKEOVER DEFENSES 2004. This study tracks 2000 firms and finds that the majority of them has classified boards, poison pills and other takeover defenses. It also finds, however, that the prevalence of classified boards and poison pills appears to have peaked. See also the considerations in the conclusion of this article.

\textsuperscript{292}Bebchuk et al, supra note 290, at 890.


\textsuperscript{294}Bech, \textit{supra} note 206, at 13.

\textsuperscript{295}Entrenchment is \textit{de facto} obtained by the large block of stock of the reference shareholder, not as a consequence of legal provisions. On the relationship between both, see Part IV.
directors has considerably more significance. Directors can generally be removed from office at will (ad nutum), which means at any time, at the mere discretion of the majority of the shareholders. Combined with strong shareholder agenda-setting rights, this means that in most Continental European countries, a shareholder or group of shareholders can convene a meeting and then dismiss all directors by a mere majority vote. Not surprisingly, staggered boards are almost unknown—because of at-will director revocability, staggering the board would not entrench it. The only hurdle is to get director removal on the agenda of the shareholders' meeting. As explained above, the thresholds for doing this are not prohibitively high. In France, the shareholders' assembly can revoke and replace directors or members of the conseil de surveillance even if that issue was not on the agenda. This situation implies that a board that wants to lock in its seats must be able to rely continuously on the trust of a majority stockholder. To formulate it the other way around, only a majority shareholder can be sure that the appointed directors will not be removed the next day. As a consequence, of all possible board compositions, only that approved by the majority shareholder will produce a stable board.

As mentioned above, anti-takeover techniques are not the main point of difference between the United States and Continental Europe. Still, there is a difference and Belgian law is a good illustration thereof. Because of statutory restrictions, poison pills are not a potent defense against a hostile bid. In principle, capital can only be increased by the shareholders' meeting. The board's ability to increase capital, if authorized to do so in the constitution, becomes much smaller than it already is once the company is notified by the Banking Finance and Insurance Commission that a public takeover bid has been made. In that case, the board can increase capital by ten percent at most, and cannot exclude preemptive ("preferential") rights. Obviously, these conditions cancel out much of the potential power of a poison pill. France is similar to Belgium as to the extent that entrenchment is permissible.

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296 This mechanism is less direct in Germany and Austria, where shareholders elect and dismiss the supervisory board (except the employee representatives), which in turn elects and dismisses the management board. § 103 Nr. 1 AktG (Germany); § 87 Abs. 3 AktG (Austria).

297 Commercial Code, art. L. 225-105, al 3. This is one of the few departures from the general rule mentioned in Part III.C.3.

298 Companies Code, art. 581.

299 Id., arts. 604, 607.

300 Two-tier regimes, such as the Netherlands and Germany, tend to provide for more entrenchment.
IV. A NEW PERSPECTIVE FOR COMPARATIVE CORPORATE LAW

A. Introduction

The amended scores in the anti-director index show that investor protection—at least as measured by the anti-director index—is not an effective way to distinguish between the U.S. system of corporate governance and the Continental European corporate legal system. Part III has revealed a critical difference in the way powers are typically distributed within corporations. The impact of a country’s typical legal distribution of corporate powers is sweeping and therefore needs to be given more attention. This is the task of Part IV. First, it illustrates how most of the anti-director rights take on a different dimension depending on the allocation of legal powers and the ownership structure (section B). Next, this part demonstrates that the distribution of powers explains to a large extent the observations that have been explained to date as a consequence of differences in investor protection as measured by the index.301 The argument of this article is that the allocation of legal powers is fundamental to understanding many key economic differences between the United States and Continental Europe, such as ownership structures, firm growth and size, the value of control, the success of stock options as an incentive mechanism, and the division between common law and civil law as far as corporate law is concerned (section C). Part IV ends by briefly situating the distribution of powers theory in the context of the underlying principles of a corporate law system (section D).

B. Consequences for the Anti-Director Rights

The difference in allocation of legal powers outlined above sheds a new light on most of the anti-director rights.302 This is particularly so for the proxy mechanism, cumulative voting, the right of appraisal, the existence of preemptive rights, and the required represented shareholder percentage to call a special meeting.

301 See the introduction for a list of studies that attributed some findings to differences in investor protection.

302 Although LLSV consider the divergence between diffuse and concentrated ownership to be a consequence of the presence or absence of anti-director rights—through legal origin, this divergence also influences the effect the anti-director rights have. The argument here is not that increased shareholder power rules out the need for the protection of small shareholders. In a concentrated ownership structure, shareholder(s) with a large stake can relatively independently exercise the powers that are assigned to them by statute. In extreme cases, the minority will depend on shareholder protection in the same way as dispersed stockholders in the United States.
The substantive stockholder powers and their agenda-setting rights deeply affect the relevance of the proxy mechanism. This mechanism may be an important device for management to gather the necessary quorum in a dispersed ownership structure, but shareholder meetings are not only about quorums but also the actual vote. In that respect, the proxy mechanism may facilitate the exercise of a shareholder's voting right, but if the shareholder does not have a voting right in the first place, it loses much of its value. Accordingly, from the stockholder point of view, the proxy mechanism has the least value in the jurisdiction where it is best developed, namely, the United States. In the countries where it would have the most value, it is used less frequently.

From the point of view of the board and management, however, the proxy mechanism has the most value in the U.S. legal framework. This becomes clear if one considers the extent of the stockholder agenda-setting rights, which have an even more severe effect on the value of the proxy mechanism than the level of substantive rights. Where stockholders do not have much power of initiative, the proxy mechanism in fact works to their disadvantage. As explained above, stockholders in the United States are in a much weaker position than management to propose alternative candidates in a board election or to make other proposals. The proxy mechanism as it exists today, with management being reimbursed automatically and insurgents only when successful, renders it intolerably costly for insurgents. Management thus has a huge and even decisive competitive advantage.

The linking of these characteristics to the distribution of powers in Delaware corporations has been well described by Justice Jack B. Jacobs, Vice Chancellor Leo Strine, and former Chancellor William T. Allen: "The notion that stockholders should have the power to disrupt the functioning of the republic whenever they see fit is viewed as fundamentally inconsistent with the Delaware model of the corporation. . . . [T]he election of directors is the one area in which stockholders may act affirmatively."

With reference to the Froessell Rule, however, the authors note that "[o]ne fundamental reality is that the annual election process is tilted heavily towards management and does not operate in a way that encourages genuine choice or debate."

The lack of shareholders' agenda-setting power also affects the utility of cumulative voting. Cumulative voting makes sense only where stockholders have a real choice between candidates. If the only candidates are those proposed by the incumbents, shareholders will only be able to cast

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304 Id.
their votes in favor of one or more incumbents. This is not the only problem arising out of the legal rules with regard to board elections. The staggered board is a serious threat to the existence of any effect of cumulative voting. When the board is classified, only a few directors are put up for election every year. A minority will therefore need a larger stake in order to be able to appoint a director. Staggering the board has indeed been used as a way to hamper minority representation. On the other hand, the inefficiency of the cumulative voting mechanism is not a primary concern in a typical U.S. corporation. Where stockholdings are scattered, the votes are not dominated by one stockholder or group or stockholders anyway, and there is no other stockholder or group that would have enough votes to effectively appoint a director by voting cumulatively. The practical utility of cumulative voting exists where a few individuals or groups hold stakes that represent a substantial portion of the shares outstanding.

The different distribution of legal powers can also be associated with the existence—or non-existence—of appraisal rights. Katharina Pistor et al. present this relationship as a choice between "voice" and "exit." "Voice" here should be understood as the shareholders' input in corporate decision making. "Exit," in contrast, refers to the right of dissenting shareholders to exit the company by selling their stake to the company at an "appraised" value. The United States clearly opts for exit, while Continental Europe chooses to give shareholders voice. Indeed, appraisal was introduced in the United States when unanimity in the shareholders' meeting was no longer required to approve a merger.

A similar conclusion to that on cumulative voting applies to preemptive rights. Delaware fails on this part of the index because of the permissive approach of its corporation law. Against the background of diffuse stock ownership structures and an allocation of most substantive powers to the board, however, this right would not be as valuable as it is in Continental Europe. In a concentrated ownership structure as typically exists in Continental Europe, preemptive rights prevent the reference shareholder from reinforcing her position by diluting the fairly large stakes of other shareholders. In a dispersed ownership structure, the size of the controllers' stake is small already. Why bother diluting shareholders who

305 At least, this was the claim of the plaintiff in McDonough v. Copeland Refrigeration Corp., 277 F. Supp. 6 (E.D. Mich. 1967); and Janney v. Philadelphia Transp. Co., 128 A.2d 76 (Pa. 1956): The courts concluded that the practice was not illegal under Michigan law and not in conflict with the Pennsylvania constitution, respectively. McDonough, 277 F. Supp. at 8; Janney, 128 A.2d at 80.

306 COX & HAZEN, supra note 60, at 766.

307 Pistor et al., supra note 258, at 830-31.

308 COX & HAZEN, supra note 60, at 1367.
do not even have one percent of the company's stock? It is in a concentrated ownership structure that the majority required for the waiver of preemptive rights can be reached most easily. Indeed, this right is often set aside. The divergent power allocation works in the same direction. In the United States, preemptive rights do not have the same crucial role in capital increases as in Continental Europe, simply because the size of the board's equity stake is not as important. The board can undertake most actions without needing shareholder consent and therefore does not worry as much about the size of stockholders' stakes. Put differently, the board is not as heavily inclined to keep their stakes small by diluting them if they grow large. From the viewpoint of the shareholder whose stake is diluted, this is not unimportant, but it is still less of a disaster, since every single share does not carry as much voting power as in Continental Europe. Apart from the takeover scenario, the importance of preemptive rights would surface solely if a corporation could sell stock at a discount at will, which would probably be considered a breach of the directors' fiduciary duties. Accordingly, preemptive rights may not be as important in the United States as elsewhere.

The last anti-director right—the ability of shareholders who, together or individually, represent ten percent of the company's stock to call a meeting—is probably most deeply influenced by the difference in economic structure and legal fundamentals. First of all, under Delaware law the board can undertake more actions without formal shareholder consent. In Continental Europe, some of those actions necessitate consent in a shareholders' meeting. Thus, the board will more often take the initiative to call a meeting itself, or otherwise it will have to deal with more issues at the annual meeting. Stockholders less often experience a need to call a meeting themselves.

Viewing the situation from the perspective of the directors and managers, one reaches the same conclusion. The convening of a meeting can have a more drastic impact in Continental Europe than in the United States, so this right must be assigned with prudence. When shareholders convene a meeting, the board is obligated to include their proposals in the meeting's agenda. These proposals can relate to a much broader range of issues than in the United States, since a shareholders' meeting can decide more issues in Continental Europe. Thus, once a meeting has been convened, the ball starts rolling and the board does not have control over its direction and endpoint.

309See 2 RIPERT & ROBLOT, supra note 58, at 622 (for France); Vagts, supra note 20, at 600 (for Germany).
In addition to the legal factor, namely, the differing impact of the shareholders' meeting, the economic factor also affects the threshold that should be set for calling a meeting. It is evident that in a dispersed ownership structure, it is more difficult to reach a ten percent threshold than in a structure where the stakes are generally larger. As mentioned above, in Belgium, the first ten voting blocks typically each represent more than four percent of the company's equity. In such circumstances, a twenty percent threshold may be easier to meet than a ten percent threshold where shareholders are diffuse.

C. The Relationship with Ownership Structures and Many Other Elements

The anti-director index is only one of many elements that are more intelligible in light of the theory of distribution of legal powers. The most important of this array of elements is the difference in stock ownership structures in the United States and Continental Europe. Indeed, there is a strong conceptual relationship between the allocation of legal powers in a country and the typical ownership structure of its companies. It is on this point that the benefits of using the allocation of legal powers as a starting point rather than investor protection become clear.

Consider the following scenario in order to explore the logical relationship between the allocation of legal powers to ownership structures: a company normally starts off with an entrepreneur, a group of entrepreneurs, or one or more entrepreneurs together with a venture capitalist. Since they have control over the company, they will hereafter be called "the original controllers." If successful, the company at a certain point in time may need additional capital than can be privately raised, or for other reasons the original controllers may decide to go public. How public? Here is the big difference. In the United States, where the balance of legal powers tilts towards the board, the original controllers can sell out virtually all equity without losing control. Once the original controllers have appointed themselves or their straw men as directors, they can make all decisions in the normal life of the corporation without needing the formal support of the shareholders' meeting. The controllers also do not have to worry very much that shareholders will initiate a vote on and approve a dissident proposal. In addition, U.S. boards can safely entrench themselves. Thus, there is no compelling need for the original controllers

\[310\text{It does not make a difference for the following analysis whether all individuals have control together or only one or a few of them. The term} \text{"original controller" refers to those who effectively have control.}\]
to retain a large share of the company's equity, which is a costly thing to do. They can safely sell off stock or increase capital without subscribing to it themselves, and at the same time maintain control over the business. They, of course, may decide to transfer control to some specialized managers, but they control who it is that gets control. They do not just let it go to the public at large and see who grabs it; control over a company is too valuable for that to happen.

The same firm would be forced to act differently in a Continental European setting. Once the original controllers have decided to go public, they need to determine how much equity they will put up for sale to the public. Here again, the importance of the allocation of legal powers is evident. If they sell out their controlling stake, they will depend on the shareholders' benevolence even for some regular and frequently-occurring decisions. Obviously, this is not an appealing prospect. Directors and managers prefer not to be bothered by meddlesome shareholders who do not know as much about the company's business as they do. They do not want to be dependent upon shareholder permission for every action they undertake. What makes this prospect even worse is that those shareholders can at any moment decide to replace directors they dislike. Not surprisingly, many original controllers, horrified by this uncertain future, decide to retain a considerable part of the voting rights in order to avoid it. If they do not, another shareholder or group of shareholders can easily grab control over the company. The stable situation is thus one where the board is, or is trusted by, the holder(s) of the majority of the stock. The U.S. courts have well understood that entrenchment promotes dispersed ownership. In Paramount Communications, Inc. v. QVC Network, Inc., for instance, the court held that incumbents are also in Revlon mode when

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311 A large stake creates the risks associated with an undiversified portfolio, and renders it less worthwhile to divert firm profits. It also places a limit on the ability to increase capital, and hence debt financing, and hence firm growth.

312 A determined shareholder, of course, could acquire a majority and replace the board, even though that process might take more than a year. Bebchuk et al. have shown that this hypothesis is highly unlikely. Bebchuk et al., supra note 290. Therefore, the high costs associated with holding a large stake do not weigh against the low probability of a successful proxy contest.

313 The higher the voting requirements, the larger this stake must be. Fortified majority requirements, however, generally apply to "extraordinary" situations, such as mergers and winding-up, for which a U.S. board would also need significant shareholder approval. Given the exceptional occurrence of these events, the founders will probably not take into account these higher thresholds in determining the stake that is to be retained.


315 637 A.2d 34 (Del. 1993).
a controlling shareholder will emerge in the surviving corporation. This 
was why the court did not want to protect the planned sale by merger, even 
though the facts of the case were otherwise very similar to those of 
*Paramount v. Time.*

Thus, the reaction of the original controllers to the existing allocation 
of legal powers pushes towards a specific ownership structure. It is their 
incentives that will determine ownership structure in the first place. In 
Continental Europe, the original controllers will not sell out enough stock 
for the ownership structure to become dispersed. The need to retain a large 
stake outweighs its costs. Potential investors do not even have a chance 
to buy a stake that imparts control. But stock does entitle them to voting 
rights on certain matters, and, as a consequence, the voting blocks other 
than that of the original controller are also significant. In the United 
States, outside investors do have the possibility to buy a large stake. It, 
however, would not give them a say over anything but a theoretical input 
in the election of directors and the amendment of bylaws. It has been 
shown above, however, that even with a majority stake, this power is 
meaningless as long as one does not have sufficient seats on the 
board—also typically for the election of directors. In short, ownership 
is determined by the need for incumbents to maintain control within a given 
framework of legal powers rather than, as LLSV contend, by the 
willingness of shareholders to buy shares in a dispersed ownership 
structure.

Conceptually, the relationship between the distribution of legal 
powers and ownership structures could also go in the other direction. Once 
a concentrated ownership structure has come into existence, majority 
shareholders could lobby the legislature to enact provisions that will make 
the board dependent upon the stockholders. This way, a majority 
shareholder can not only appoint her straw men to the board, but she can 
also make sure that the directors will remain loyal. Conversely, the U.S. 
corporate setting would lead management to push for legislation in the 
direction of considerable directorial and managerial independence. This

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316 571 A.2d 1140 (Del. 1989).
317 See supra note 313 and accompanying text.
318 See the figures for France and Belgium supra Part III.B.
319 With regard to the takeover context: Bebchuk et al., supra note 290. With regard to 
annual elections and removal during the term, see supra Part III.C.5 of this article.
320 See Donald, supra note 236, at 37 (suggesting that majority shareholders in Germany 
pushed the legislature for more shareholder rights, although not arguing that this was with the 
purpose of making the board dependent). See also Lucian A. Bebchuk, *Making Directors 
Accountable*, HARV. MAG., 29, 30 (Nov./Dec. 2003) ("The key to re-election is simply remaining 
on the firm's slate.").
would explain not only the above-identified fundamental differences with Continental Europe, but also some technical rules. For instance, it has been shown above that the proxy mechanism is best developed in the United States, where it puts management at an advantage. In contrast, a reference shareholder in a typical continental European corporation has every interest in keeping the proxy mechanism virtually unused. The reason is that the stake of the reference shareholder is often not large enough to push through a decision if all shareholders show up or are represented at the meeting. Since the majority or enhanced majority requirements hold within the shares represented at the meeting, it is in the reference shareholder's interest that not too many other (possibly dissenting) shareholders attend the meeting. Consider an annual meeting where only forty percent of the stock is represented. If the reference shareholder votes in favor of a proposal with a stake of twenty-one percent, the proposal has received a simple majority. In principle, enough shareholders should attend the meeting in order to meet quorum requirements. These quorum requirements, however, are usually not very high, and if they are, it is to the advantage of the reference shareholder that they are not met, so that a second meeting must be convened for which no quorum or a lower quorum is required. In that case, a reasonably small stake will be sufficient to approve a decision. Clearly then, a successful proxy mechanism is not on the wish list of a reference stockholder in Continental Europe.

The empirical correlation between the distribution of legal powers and ownership structures is obvious for the United States and Continental Europe. The situation is somewhat more complicated for the United Kingdom and Australia, which for several reasons should be considered a group separate from the United States in the field of corporate law. In addition, the causal relationship remains to be fully explored through a

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321 See supra Part III.B.
322 Commercial Code, art. L. 225-98 (France) (simple majority of the represented shares in an ordinary meeting), art. L. 225-96 (majority of two thirds of the represented shares in an extraordinary meeting); Companies Code, art. 63 (Belgium) (simple majority of the represented shares by application of general rules of deliberation), art. 558 (majority of three-fourths of the represented shares in an extraordinary meeting).
323 Commercial Code, art. L. 225-98 (France) (no quorum for the second convening of the ordinary meeting), art. L. 225-96 (quorum of one-fourth for the second convening of the extraordinary meeting); Companies Code, art. 558 (Belgium) (no quorum for the second convening of the extraordinary meeting). Since there is no quorum requirement for the ordinary meeting in Belgium, the meeting does not need to be convened a second time.
324 The typical ownership structure in these countries is one of dispersion, although to a lesser extent than in the United States. Becht, supra note 206. In addition, legal provisions such as the mandatory bid hinder the concentration of ownership.
historical analysis, but the reflections above provide us with some indications. First, the principle that the board in the United States is the holder of primary management power goes back to old case law from the beginning of the twentieth century, while the distribution of legal powers in Continental Europe seems to have gravitated toward giving more powers to the shareholders than in the United States. Second, board entrenchment is often but incorrectly considered to be a recent evolution. This article has shown that entrenchment against takeovers is not the only thing that matters. The question whether shareholders can remove directors without cause is even more important. Again, this is a point on which the United States and Continental Europe have differed for a long time. At common law, the impossibility for shareholders in the United States to remove directors without cause was even an absolute principle, though some exceptions have been made to this rule more recently. In Continental Europe, the removal of directors at will by the shareholders is also a longstanding principle.

Presumably, the legislature started to distribute powers differently in the United States and in Continental Europe on the basis of some different underlying principles. The effects of technical legal rules further pushed ownership structures to develop in different ways on each side of the Atlantic. Subsequently, the controllers—to be understood as board and management in the United States and as the reference shareholder in Continental Europe—exercised their influence on the legislature to enact provisions that locked in their respective positions. This interplay between ownership structures and allocation of legal powers has caused the United States and Continental Europe to evolve further in different directions. To the extent that this different distribution of legal powers was not the

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325 Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cuninghame, 2 Ch. 34 (Eng. C.A. 1906).
326 See supra notes 276-94 and accompanying text.
327 See supra notes 295-96 and accompanying text.
328 One example is the following: In 1934, the Belgian legislature made unlawful the so-called "mixed bank," which engaged in both banking and stock holding and selling. As a reaction, banks split up and divested themselves of their securities business, but still run both via a holding company. Koen Geens, Corporate Governance: Wat is Mode en Wat Beklijft? [Corporate Governance: What is Fashion and What Will Sink in?], in KNEELPUNten VAN DERTIG JAAR VENNootsCHAPsRECHT [BOTTLENECKS OF THIRTY YEARS OF COMPANY LAW] 733, 744 (1998). This did not happen in the United States despite a similar severance of the securities and banking lines of business one year earlier by the Glass-Steagall Act, after in 1956 the Bank Holding Company Act proscribed the affiliation of banks with any commercial firm, including holding structures. ROE, STROng MANAGERS, supra note 3, at 98. Needless to say that such prohibition did not exist in Belgium. There, holding companies were also used to circumvent the no longer existing provision that nobody could exercise more than twenty percent of the existing votes.
exclusive cause, it was and remains at the very least a factor that keeps existing ownership structures in place. New companies are starting up in a given legal framework that now more than ever pushes them towards a given ownership structure. This account finally gives path dependence a concrete face.\(^{329}\)

Recall the investor protection explanation for different ownership structures. LLSV find that countries with better anti-director rights statistically have a "significantly lower" concentration of ownership.\(^{330}\) They identify two reasons why ownership in countries with poor investor protection, encompassing both anti-director rights and creditor rights, would be more concentrated. First, shareholders would be willing to forego a stake that would impart significant control only if the law protects them sufficiently against expropriation. If such protection did not exist, they would discount that in the share price and/or require a majority shareholder to monitor the board and management. Second, poor protection of investors would make it feasible to expropriate on a substantial scale. Therefore, shareholders would want a larger stake in order to control management and avoid being expropriated.\(^{331}\)

Without denying the importance of protecting investors, the above analysis shows the problem with this link between investor protection and ownership structures. It arises from LLSV's assumption that shares impart control, and hence the possibility of expropriation. This is indeed the case for Europe, but not for the United States. Part III has demonstrated that in a U.S. corporation, the original controller does not need to retain a majority stake in order to expropriate. The board and management can act just as independent from the shareholders when engaging in less well-intended activities as in well-intended decisions. Conversely, in Continental Europe, both are difficult when the board and the majority shareholder(s) do not cooperate. Poor protection of investors would therefore reinforce the tendency for European corporations to concentrate ownership, but would not encourage concentration in the United States. Shareholders worry about whether or not they are expropriated, not about whether this is done by a controlling shareholder or by an independent management.

The possible implications of the new insight into the distribution of powers do not end with a revision of the anti-director index and its alleged implications for ownership structures. There are several possible correlations. The following are suggestions which make a closer examination worthwhile. The value of control, for instance, could take on a new dimen-

\(^{329}\)See Bebchuk & Roe, supra note 3 (rule-driven path dependence).

\(^{330}\)La Porta et al., supra note 5, at 1150.

\(^{331}\)Id. at 1145; La Porta et al., supra note 11, at 13.
sion. It is not necessarily limited to the possibility of extracting private benefits of control, but should probably also include the ability to manage the corporation's affairs in an untroubled, and possibly more efficient, way. In order to achieve independence in Continental Europe, the board and management have to rely on a large share of the stock. In contrast, a large stake is not necessary to run the company relatively independently in the United States. As a consequence, private benefits of control in the United States should not be measured simply by looking at the price that buyers are prepared to pay for a majority stake. That would underestimate the value of control and could explain why many studies have found that private benefits of control are smaller in the United States. In the United States, it is the board positions that count.

Martin Lipton and Steven Rosenblum argue fiercely that the lower degree of intervention by shareholders could in some cases increase the efficiency of the management of the corporation. This may sometimes be the case, at least in companies with ideal managers. But the distribution of powers theory could explain firm growth in a way that does not fully depend on the quality of the manager. The need in Continental Europe to retain a majority stake seriously limits the ability of corporations to raise capital in the market, which is often the basis for additional debt financing. Along these lines, the distribution of legal powers could partially explain firm growth and size, factors that have often been associated with better legal protection of shareholders. These, in turn, possibly reinforce the divergence in ownership structures. A more substantial investment is required to hold a majority stake in a company that has a large amount of stock outstanding than in a typical European firm where the amount of stock is limited by the financial strength of the controllers. The need to retain control may also help us understand why in Continental Europe stock markets are less developed. First, it will prevent many companies from applying to the stock exchanges for listing. Second, the existence of majority stakes renders the stock of the company less liquid.

335 Indeed, in Continental Europe few companies are listed on stock markets. Becht, supra note 206, at 2.
In a Continental European setting, the participation of the controllers can be smaller where the corporate law permits the issuance of stock without voting rights or with more voting rights. This may explain why concentration of share ownership (as opposed to voting blocks) is a little lower in the Netherlands, where shares can be "certificated," i.e., divested of voting rights, and in France, where shares with double voting rights can be issued. Another phenomenon that could be related to the way powers are allocated in a legal system is the frequent use in the United States of stock options. This is so successful only because a rational director does not spontaneously hold much of the company's stock. All of the above suggestions need more research and inevitably many other factors will be found to interfere with the described mechanisms. It would be an interesting undertaking to reassess many other aspects of corporate law in light of the allocation of legal powers in a given jurisdiction.

D. Underlying Principles

The distribution of power between the board and the shareholders in the United States tilts towards the board. Is this in contradiction to a common view among U.S. lawyers that their system is one of shareholder primacy? The answer depends on what exactly they mean by shareholder primacy. As Stephen Bainbridge has pointed out, the term "shareholder primacy" is often misunderstood. He wrote:

[the term shareholder primacy typically connotes two distinct principles: (1) The shareholder wealth maximization norm, pursuant to which directors are obliged to make a decision based solely on the basis of long-term shareholder gain... [. (2) The principle of ultimate shareholder control. Although shareholders do not wield day-to-day authority, they purportedly exercise ultimate decisionmaking authority through proxy contests, institutional investor activism, shareholder litigation, and the market for corporate control.]

Shareholder primacy in the United States obviously refers to the first principle. Shareholder wealth maximization is a fundamental tenet of U.S. corporate governance, but this aim is to be pursued by the board, acting for

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336 For France, see Commercial Code, art. L. 225-123. For the Netherlands, see Civil Code, art. 3:259 and PIETER SANDERS, DUTCH COMPANY LAW 46-48 (1977).
337 Bainbridge, supra note 217, at 45-46.
the shareholders as a "sort of Platonic guardian." Bainbridge rightfully believes that since the vast majority of corporate decisions are assigned to the board, the United States does not, in fact, follow a shareholder primacy model. Indeed, where a board has to maximize shareholder value but can act almost independently, one should rather speak of board primacy, or more realistically, management primacy. As an example of a shareholder primacy model, Bainbridge names Slovenia, not coincidentally a Continental European country. Indeed, in Continental Europe the second principle definitely holds: control is in the hands of the shareholders.

Shareholder primacy is not the only, or even the highest, norm in Continental European corporate law. It may seem that Continental Europe is being associated with a proprietary point of view, according to which shareholders own the corporation and therefore retain fundamental decision-making power. That is not so. Such a claim would fail to explain the importance Continental European legislation attributes to the "interests of the firm" as a goal in the operation of a firm, an aim that is not restricted to the pursuit of shareholder interests. It would ignore the existence of the codetermination system in Germany and of workers' participation in the Netherlands. Also, in France, Belgium, Italy and many other countries, employees do have a say, though those legal provisions are often to be found in labor law rather than in corporate law. Similarly, in Bainbridge's example of a shareholder primacy model, Slovenia, a civil law country of German origin, labor is involved in corporate decision making. Stakeholders thus have more input in a corporation's decision making than in the United States. This difference recently became painfully acute in the derailment of the revision of the OECD principles of corporate governance earlier this year when, much against the will of the United States, France insisted on making employee participation "encouraged" rather than simply "permitted."

338 Id. at 51.
341 Bainbridge, supra note 217, at 53-55.
Then again, stakeholder input is also not the highest principle of Continental European corporate law. Europe's peculiarity is not that it is a stakeholder economy in contrast to the shareholder economy of the United States, as is often reported. The United States cannot be contrasted with Continental Europe in terms of whether shareholders are the ultimate owners of the company versus only one of many factors of production, or contractarianism versus communitarianism. This would be inconsistent with the finding of this article that shareholders' authority is larger in Continental Europe than in the United States.

What then is the ultimate distinguishing characteristic between corporate law in the United States and that in Continental Europe? It could be how much interference the board and management must tolerate. In Continental Europe, both shareholders and stakeholders have considerable involvement in decision making in the company. Put negatively, in its operation the board and management can be bothered by almost anyone who has something at stake in the corporation. In the United States, the board is more independent and must obtain shareholder approval only for the most vital decisions. "[T]he board of directors thus is not a mere agent of the shareholders, but rather is a sui generis body."343 Shareholders' input is basically limited to the election of directors, which is "the ideological underpinning upon which the legitimacy of directorial power rests."344 By comparison with Continental Europe, the United States has a managerial culture. Management (and the board) can focus on its duty of shareholder wealth maximization. It does not have to worry about the opinion of the shareholders and stakeholders, except in extraordinary circumstances.345 Managers are considered capable persons whose extraordinary skills must be rewarded handsomely. European managers can only dream of their high salaries.

A broadening of perspective on the essential difference in ideas on the role of the board and management, not only vis-à-vis shareholders, but also in relation to stakeholders in general, could help us to account for many aspects of corporate life—although the above suggestions need more thorough research. An example is the strong correlation Mark Roe finds between employee rights and ownership concentration.346 Where board and

343 Bainbridge, supra note 217, at 51.
344 Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988). Not everyone agrees that this is sufficient. Bebchuk, for example, argues that directors should be more dependent on shareholders. Bebchuk, supra note 320, at 30.
345 A clear surfacing of this attitude is the abolition in the United States of preemptive rights, where they are considered as a restraint on future financing of public companies. Cox & Hazen, supra note 60, at 1088.
346 Roe, Political Determinants, supra note 3, at 136-39.
management are allowed to act independently and ownership is dispersed, not only will shareholders have little power, but employees will also have limited rights. Conversely, in a jurisdiction where the board is given considerably less deference, ownership will tend to be more concentrated and shareholders and employees will have more rights. A focus on the degree of independence left to the board in governing the corporation could also accommodate Mahoney's theory that the key difference between common law and civil law traditions is that the former are characterized by strong protection against state action, whereas in the latter, the state is interventionist. There are many more plausible relationships, which unfortunately go beyond the scope of this article. A focus on the different role of board and management in the United States and Continental Europe promises to open up many questions for further research and may even reach as far as differences in social theories.

V. CONCLUSION

This article demonstrates how important it is to study a broad array of sources of law and social and economic phenomena when practicing comparative law. It is a widespread assumption in the field of comparative corporate law that investor protection is of better quality in common law countries than in civil law countries. A meticulous study of the corporate laws of the United States, France and Belgium strongly suggests that if there is such a difference, it is much smaller than is often assumed. This finding jeopardizes the countless studies that assume a different degree of investor protection.

This study also argues that the fundamental difference in corporate law between the United States and Continental Europe lies in the typical distribution of powers within a corporation. In the United States, the board, or better, management, has the necessary legal powers to run the corporation without many possibilities for other constituencies of the corporation to intervene. In Continental Europe, the law generally confers much more authority upon stockholders, in fact, so much more that the board cannot possibly ignore their point of view. A board that is determined to run the corporation independently and without unforeseen

347Mahoney, supra note 3. Rather than focusing on minority shareholders' rights, Mahoney suggests "a different and broader link from legal origin to more dispersed governmental power and from there to superior protections for property and contract rights." Id. at 519. A possible explanation is that the "interventionist" states in civil law countries impose more regulations to protect certain categories, e.g., by giving a say to shareholders and employees. In common law countries, the state would leave more freedom to economic actors such as the board and management of a corporation.
interventions by others must retain or act in concert with—which may be understood as being appointed by—a majority shareholder. The result—and partially also the cause—is a prevailing concentrated ownership structure in Continental Europe, while ownership is usually dispersed in the United States.

This difference in the way corporate law distributes the powers within a corporation has too often been neglected in legal and economic scholarship. Its influence reaches beyond the technical rules of investor protection. Revising received theories from this new angle therefore promises to yield many new insights. A number of aspects of corporate life that have troubled scholars would become more intelligible against a backdrop of the distribution of legal powers. This article has suggested relationships between the allocation of legal powers and firm growth and firm size, stock market development, the value of control, the magnitude of executive pay, and the function of stock options. Economic elements like these, of course, can never be explained by one single factor, and the distribution of legal powers is no exception to that rule. It would be an interesting undertaking to investigate the exact strength of the explanatory power of this distribution.

In addition to laying new paths for further research, a comparison between the distribution of legal powers in U.S. and Continental European corporations would foster legal reform initiatives. Such initiatives in Europe often aim to reduce ownership concentration and to decrease the control of reference stockholders. This article suggests how difficult it may be to accomplish these ambitions if shareholders continue to hold the lion's share of power in the corporation. The new insights of this article could also lead to a more constructive contribution to recent projects in the United States. The recent SEC proposal on Security Holder Director Nominations, the revised OECD Principles of Corporate Governance (2004), and Bebchuk in several articles make or advocate cautious steps in the direction of empowering shareholders in the United States. What they do not always stress sufficiently is how important this empowering of shareholders is for success in involving them in corporate decision making. These and other evolutions continuously change the above sketched interrelations between law and economics. It will be worthwhile to continue to closely follow the evolution of ownership structures in the next coming years.