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Shareholders’ Rights in the Common Market: A Comparative Study

WENDY N. MUNYON*

The Treaty of Rome,1 signed on March 25, 1957, created the European Economic Community (EEC), an entity whose purpose was the promotion of economic unity among the six member nations2 through the elimination of customs duties between states, unification of external tariffs, provisions for free movement of labor, capital, and services, and the elimination of competitive distortion.3 The ultimate goal was the achievement of an economic unit over a transitional period of twelve years,4 during which time disparity among national laws affecting trade and commerce would be reduced through a program of “approximation.”5 The EEC Council6 is empowered, on recommendation by the Commission,7 to issue directives, binding on member states, which will

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6. The Council is the EEC's decision-making body. Council members are high officials of the ministries of their respective governments, charged with safeguarding their countries' national interests in Council deliberations. Important votes must be passed unanimously or by qualified majority, the votes being weighted in favor of the larger countries. Costonis, The Treaty-Making Power of the European Economic Community: The Perspective of a Decade, 5 COMM. MKT. L. REV. 421, 423 (1967). See 1 CCH COMM. MKT. REP. ¶¶ 4405-06 (1975).
7. The Commission is a general executive and administrative body of thirteen members appointed by mutual agreement among the member states. They must exercise their duties in a manner independent of national interest. See 1 CCH COMM. MKT. REP. ¶ 4471 (1975).
prescribe unified ends to be reached, leaving the choice of means to the individual national governments.  

Articles 52-58 of the Treaty form the basis for a section on the "Right of Establishment," which can be broadly defined as the "right to carry on a non-wage-earning activity in Community countries other than one's own without discrimination on grounds of nationality." This right is consistent with the policies of free movement of goods and services, requiring that the nationals of each Member State receive national treatment in each of the other Member States in regard to commercial endeavors. Central to the concept is Article 54, which directs the formation of a program for elimination of restrictions on freedom of establishment. This program was adopted in December, 1961, setting forth a timetable for the elimination of specific restrictions on establishment. The Council and Commission were specifically directed under Article 54(3) to see that national laws and administrative procedures and practices were coordinated quickly, especially in high priority areas such as removal of restrictions on the ability of Member nationals to acquire property in Member States. Article 54(3)(g), the central subsection for purposes of this discussion, authorizes the Council and Commission to assure the coordination of national laws to the extent necessary to protect the interests of shareholders and creditors of companies or firms organized under laws of the Member States.

Pursuant to this authority, the Commission has between 1967 and 1972 submitted six directives concerning company law to the Council. Only the first directive has been issued by the Council, since the entrance of Britain, Ireland and Denmark to the EEC under the Treaty of Accession of January 31, 1972 resulted in substantial adjustments in the community institutions. Some aspects of the directives have been...
come more controversial with British entry because of major national differences in company structure and shareholder protection.  

This Article will consider the Second and Fifth Proposed Directives as they relate to the national company laws of Britain, France, and the Federal Republic of Germany.  

17. See Dalton, Proposals for the Unification of Corporation Law Within the European Economic Community: Effect on the British Company, 7 N.Y.U.J. Int'l L. & Pol. 59 (1974). Under the British Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 1-462 [hereinafter Act of 1948], British firms are structured as are American firms, with a Board of Directors responsible for company policy and major decisions and officers controlling day to day operations. Id. §§ 176-204. In German firms, on the contrary, a Management Board (Vorstand) is responsible for day to day operations as well as policy questions. The Management Board is appointed by a Supervisory Board (Aufsichtsrat), elected two-thirds by the shareholders and one-third by labor representatives. The Supervisory Board is not directly involved in management but must approve the company's financial statements and serves in a "watchdog" capacity. German Stock Corporation Act (Aktiengesetz), Law of September 6, 1965, [1965] BGBI.I 1089 §§ 76-116, effective Jan. 1, 1966. [Hereinafter AktG]. English translation in GERMAN STOCK CORPORATION ACT (F. Juenger & L. Schmidt transl. 1967). Steefel & von Falkenhausen, The New German Stock Corporation Law, 52 CORNELL L.Q. 519 (1967); Vagts, Reforming the "Modern" Corporation: Perspectives from the German, 80 HARV. L. REV. 23, 50 (1966).


20. Act of 1948 and Companies Act of 1967, 15 & 16 Eliz. 2, c. 81 [hereinafter Act of 1967]. The Act of 1967 was passed to give added protection to shareholders through strengthened audit requirements (§§ 3-14), expanded directors' report requirements (§§ 15-24), and provision of penalties for dealing by directors and their families in company share options (§§ 25-32). The Act also strengthened the power of the Board of Trade to bring civil proceedings in behalf of the company (§§ 35-42).

21. The French Law on Commercial Companies, Law No. 66-537 of July 24, 1966, J.O. of July 26, 1966, (English Translation in FRENCH LAW ON COMMERCIAL COMPANIES (CCH transl. 1971)) was drawn to consolidate the law for all the forms of business association (general and limited partnerships, limited liability companies, and Societes Anonymos or Stock Companies) and to increase shareholder and third party protection. The drafters were mindful of the move toward European unity and borrowed heavily from the German Act, especially in the area of corporate structure. A French S.A. may choose either the traditional form of the Administrative Board or the German two-tiered structure. FRENCH LAW ON COMMERCIAL COMPANIES, supra at 1-7.

22. The primary impetus for the 1965 Act was increased shareholder protection. Because bearer shares are the norm in Germany banks have a great deal of control at shareholder meetings. See Roth, Supervision of Corporate Management: The "Outside" Director and the German Experience, 51 N.C.L. REV. 1369, 1379 (1973). Under the new Act, banks must give shareholders an opportunity to instruct them on voting proxies and are accountable to the shareholders for their votes. Further, the Act strengthens the
presented by the Delaware Corporations Code and the ABA-ALI Model Business Corporations Act, will be compared where pertinent. The Sanders Draft Statute for a European Stock Corporation as modified by the Draft Statute for a European Company submitted to the EEC Council by the Commission will also be considered. Attention will be focused on four aspects of shareholder protection: (1) capitalization; (2) corporate decision-making; (3) the shareholder's relationship with management; and (4) the auditor's responsibility to the shareholder.

I

THE SHAREHOLDER AND HIS CAPITAL

The corporate investor usually purchases an interest in a company with the expectation that his capital will be used toward the generation of profit by the corporation, earning dividends for him, and thereby maximizing the economic value of his shares. His practical expectations are that the company will be adequately capitalized, that he will have an opportunity to maintain his percentage of ownership in the company, that the capital will not be reduced and dissipated without his consent, and that dividends will not be unreasonably withheld. This first section will consider the extent to which his expectations are fulfilled under the various statutes in question.

shareholder's right to obtain information at meetings and lowers barriers to legal remedies. AktG, [1965] BGB1.I 1084, supra note 17, at 19-21. See notes 164-77 infra and accompanying text.


24. P. Sanders. European Stock Corporation Text of Draft Statute (CCH 1969). Citations will be to this draft except where amended in its implementation.

A. MINIMUM CAPITAL REQUIREMENTS

While the primary purpose of a stated capital requirement is the protection of creditors, the shareholder also has an interest in having the corporation adequately funded. The shareholder invests in the company with the expectation that the business will be profitable; therefore, failure on the part of incorporators to anticipate the extent of start-up expenses or first-year losses and to capitalize accordingly represents a substantial threat of complete loss to the shareholder. Moreover, egregious cases of under-capitalization may justify piercing the corporate veil to hold shareholders themselves personally liable in contract or tort actions by third parties.

Though American and British corporation laws effectively require no minimum capital, the French and German Acts require substantial minimum subscriptions. The Second Directive prescribes that each company shall be formed with no less than 25,000 units of account (the equivalent of American dollars). The Draft Statute for a European

Note, The Inadequacy of Stated Capital Requirements, supra note 26, at 829. 30. AktG, [1965] BGBL.I 1089 § 7, requires a stock company to have subscriptions of 100,000 DM (about $25,000). The French Law of July 24, 1966, J.O. of July 26, 1966, § 71 requires minimum subscription of 500,000 francs ($90,000) for an S.A. These high capitalization requirements are in part responsible for a significant difference in American and European company law. While in America the close corporation has developed under the same statutes as the public corporation, in Europe incorporators may choose between the limited liability company and the stock company. A limited liability company is called a private company in Britain, a Societe a Responsabilite Limite (SARL) in France, and a Gesellschaft mit beschränkter Haftung (GmbH) in Germany. This form of doing business is extremely popular in France and Germany because, besides the lesser capital requirements, the disclosure provisions for these organizations are far less stringent than for stock companies. Limits are placed on the number of members in a GmbH or SARL and interests are transferable only through a complicated notarial process in Germany and on approval of other company members in France. Similar provisions apply to the private company in Britain. See CCH DOING BUSINESS IN EUROPE, §§ 22,715, 23,206, 23,276, 23,705 (1972-1974); STEIN, supra note 5, at 237-58; de Vries and Juenger, Limited Liability Contract: The GmbH, 64 COLUM. L. REV. 866 (1964); Vagts, supra note 17, at 33-35.

Company presently requires that the minimum capital be 500,000 u.a. for formation of a European Company through merger or joint establishment of a holding company, 250,000 u.a. for transformation from a stock company under national law to a European Company, and 100,000 u.a. for formation of a joint or sole subsidiary. For all except the European Company, the 25,000 u.a. proposal of the Second Directive seems adequate. The purpose of requiring a minimum capital is to protect creditors and shareholders. American and British corporation statutes assume that stiff capital disclosure requirements serve as adequate protection for both groups. In combination with the disclosure requirements of the First Directive, the Second Directive's minimum of 25,000 u.a. provides adequate shareholder and creditor protection from dissipation of corporate assets and under-capitalization.

To ensure good-faith purchase of stock, the Second Directive mandates that, before a share is issued, it must be 25 percent paid up if issued for cash and 100 percent paid up if issued for property or services. This requirement is borrowed from the German and French laws and is in sharp contrast to the British law at one extreme and the European Company law at the other. In Britain, each shareholder's required payment on purchase is five percent of market value with further payments to be made when the company calls for them or upon sale. In the European Company Statute, all shares, whether issued for

32. 13 E.E.C. J.O. C124/3, Art. 4. The Sanders Draft had required that these amounts be 1,000,000 u.a., 500,000 u.a. and 250,000 u.a., respectively. Sanders Draft, supra note 24, Art. I-3. The capital requirements for the European Stock Company have been set unusually high not only to afford protection to shareholders but also to limit the availability of the corporate form. The drafters were very sensitive to fears that the European Company would prove so attractive that national corporations would convert to European companies, depriving countries of revenue. See Dalton, supra note 19, at 68; Scholten, supra note 29, at 14; Storm, Statute of a Societas Europaea, 5 COMM. MKT. L. REV. 265, 269-71 (1968). Professor Storm proposes also that the European Company should be a large unit by definition in order to compete with American multinationals in Europe. Id. at 267-68.

33. In the United States, disclosure before issue is effected through the Securities Act of 1933, 15 U.S.C. § 77a et seq. (1970). In Britain, the prospectus must include statements of both the authorized capital and the minimum allotment required before the company may commence business. Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 37-48 and Sched. 4.

34. Art. 2(e), 1 CCH COMM. MKT. REP. ¶ 1357 (1974).


36. AktG, [1965] BGBI.1 1089, §§ 27, 36. Where shares are issued for a premium, one-fourth of the premium must also be paid before issuance.

37. Law of July 24, 1966, J.O. of July 26, 1966, Art. 75. The remaining three-fourths of subscribed capital must be paid in within five years. Id. If the company is not organized within six months from the date funds were first deposited, contributors may petition the court for authorization to withdraw their contributions. Id. Art. 39.

cash or in kind, must be fully paid up before issuance.\textsuperscript{39} American corporation laws are generally silent as to minimum paid-in capital, but shareholders are liable to the company for any portion of the price not paid in.\textsuperscript{43} The Securities Exchange Act of 1934 imposes margin requirements greater than 50 percent on purchasers of stock subject to SEC control.\textsuperscript{44} The margin requirement is adequate for shares to which it applies, but there is potential for abuse by American corporations issuing shares not subject to SEC regulation.

An area in which American corporation law affords the shareholder far less protection than the proposed EEC directive is the valuation of non-cash assets. In Delaware and other states, stock may be issued for labor done, personal property, real property or leases as well as cash with the directors' judgment as to the value of the consideration being conclusive unless actual fraud can be demonstrated.\textsuperscript{42} The Second Directive, in contrast, requires that before any shares are issued for property other than cash, such property must be evaluated by an independent person appointed by an administrative or judicial authority. The appointees must report formally to the shareholders on the value of the property and of the shares to be issued for it and the report must be published in the national legal newspaper.\textsuperscript{43} This is similar to the practice in France and Germany. Under French law, a valuation by a court-appointed appraiser must be appended to the by-laws. The valuation must be available for examination by subscribers and is voted on at the organizational meeting. Valuation may be reduced only by a unanimous vote of all subscribers.\textsuperscript{44} To be valid in Germany, a contribution of assets other than cash must be recorded in the articles with the name of the donor and the par value of shares issued in return. The management board, supervisory board, and auditors of the formation must include examination of such transactions in a formation report to be made available to the court of the district, the managing board and the Chamber of Industry and Commerce. Anyone may inspect the report at the court or the Chamber of Industry.\textsuperscript{45}

\textsuperscript{39} Sanders Draft, \textit{supra} note 24, Art. II-1-5(3)(c).
\textsuperscript{40} See, \textit{e.g.}, \textit{Del. Code Ann.} tit. 8, §§ 156, 162 (1975).
\textsuperscript{42} \textit{Del. Code Ann.} tit. 8, § 152 (Supp. 1975). \textit{See also Cal. Corp. Code} § 1109 (West Supp. 1976); \textit{ABA-ALI Model Bus. Corp. Act} § 19 (1971). This lack of protection is serious, however, only for shareholders in completely intrastate corporations where state blue sky laws are weak, since the Securities Act of 1933 §§ 5, 7 and Sched. A provides for strict disclosure of value of assets other than cash to be received for shares. 15 U.S.C. §§ 77(e),(g),(aa) (1970).
\textsuperscript{44} Law of July 24, 1966, J.O. of July 26, 1966, Art. 80.
\textsuperscript{45} AktG [1965] BGBI. I 1089, §§ 26, 27, 34.
The Second Directive proposal seems superior because of the potential in the German system for coercion of auditors where a joint report is submitted. The auditors should appraise independently and should bear responsibility for the appraisals. This system is used in the Sanders Draft, which requires that one or more auditors wholly independent of the founding company file a report including a valuation of contributions in kind, the names of contributors, and the par value and class of shares issued in return. The European Court of Justice will examine every report, another manifestation of the high standards required for the European Company.

British law is heavily reliant on disclosure for the prevention of asset overvaluation. The company prospectus must set forth for the preceding two years, the number and amount of shares issued as fully or partly paid up otherwise than in cash. It must also include the extent to which shares are partly paid, the names and addresses of vendors and descriptions of the property. No formal appraisal is necessary. If the EEC Council issues the Second Directive, British shareholders will have the benefit of an independent appraisal included in the prospectus and will be assured of fully paid-in contributions in kind. Considering the reluctance of common-law judges to interfere in the internal affairs of corporations and impose liability on corporate directors, the continental system of formal appraisal of assets by independent auditors appears to afford shareholders superior protection against watered stock.

B. INCREASE OF CAPITAL

Because the issuance of an additional number of shares is prejudicial to the central and financial status of shareholders, all of the laws under consideration provide that shareholders must approve such issue. In Delaware, a simple majority of the shareholders qualified to vote at a meeting may amend the articles to increase the capital, but if any one class of shares would be prejudiced by the increase, that class, whether normally entitled to vote or not, must also approve the increase by a

46. The criteria to establish independence are to be taken from the French law of July 24, 1966, J.O. of July 26, 1966, Art. 220. Sanders Draft, supra note 24, ¶ 176 provides that auditors may not be: (1) founding board members, contributors in kind or beneficiaries of special preferences; (2) blood relatives and relatives by marriage to the fourth degree of such persons; (3) board members or their spouses of companies owning one-tenth of a corporation of whose capital the principal corporation owns one-tenth; (4) auditing firms of which one of the members is in categories 1-3.

47. Sanders Draft, supra note 24, Art. II-1-4, II-1-5.


49. Act of 1948, 11 & 12 Geo. 6, c. 38, Sched. 4, Part I(8), (9).

50. See notes 265-70 infra and accompanying text.
majority.51 The Delaware statute differs sharply from the European statutes, excluding Britain,52 in that the articles of incorporation may specify "authorized capital" in an amount much greater than the original subscription; the directors may then independently issue new subscriptions without consulting the shareholders until the authorized limit is reached.53

The Second Directive requires only that the general meeting rules in each country be followed in approving a capital increase, and that shareholders in classes specially affected must approve the increase by a majority of those present.54 This provision is weak as it does not equalize shareholder protection because the quorum and the majority provisions vary widely.55 While the directives should not necessarily require all EEC countries to change their laws to provide the most stringent protection possible, some form of common denominator should be found.56 A one-half outstanding capital quorum requirement with a two-thirds voting majority would be reasonable.

Under the Sanders Draft, the French law and the Second Directive, all previously subscribed shares must be fully paid-up before any increase in capital is possible.57 The German law provides that in general

51. DEL. CODE ANN. tit. 8, § 242(c)(1), (2) (1974).
52. See Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 45, 47.
53. DEL. CODE ANN. tit. 8, § 102(a)(4) (1974). This section also gives directors authority to establish new classes of shares with different powers, preferences and rights, up to the authorized capital limit. It is possible, once the original subscription is taken in full, for shareholders under the AktG to approve an authorization of up to 50 percent of the original stated capital, to be taken over a period of five years. AktG, [1965] BGB1.I 1089, § 202(3). A similar provision is found in the Second Directive. Art. 221(2), 1 CCH COMM. MKT. REP. ¶ 1371K (1974). The Sanders Draft adopts this but reduces the statutory period to three years. Supra note 24, Art. III-1-2(3). Where such authorization is given under the Sanders Draft, stringent requirements are placed on the managing board to use it in good faith and account for its use at each shareholders' meeting. Id. Art. III-1-4.
55. While in Britain only a majority of a general meeting need approve a capital increase, German law requires a three-fourths majority of the capital represented and requires that any class of shares affected by the increase also pass the resolution by three-fourths. Act of 1948, 11 & 12 Geo. 6, c. 38, § 61; AktG, [1965] BGB1.I 1089, § 182(1), (2). An extraordinary general shareholders' meeting is required for an increase in France; at least one-half of the voting shares outstanding must be represented and the resolution must pass by a two-thirds majority. Law of July 24, 1966, J.O. of July 26, 1966, Art. 183, 180. If the increase is to be effected by capitalizing reserves, profits, or subscription premiums, however, the vote need be only a simple majority. Id. Art. 155, 180.
56. The Sanders Draft recommendations are predictably cautious and do incorporate the most stringent requirements among the national laws; to increase capital a quorum of shareholders representing no less than one-half the outstanding capital is required; the resolution must pass by a three-fourths majority. Supra note 24, Arts. III-1-3; VII-3.
capital may not be increased while contributions on present stated capital may still be obtained, but this requirement is waived if such amounts are relatively minor.58

The form of protection offered shareholders against any dilution of their voting power or control is the preemptive right. Before a new issue may be offered to the public, shareholders must be given the opportunity to acquire the offered shares on a proportionate basis.59 In American corporations, the preemptive right need not be offered when treasury shares are sold, when shares are given in exchange for property, or when shares are issued only up to the original authorized capital.60 With the single exception of Britain,61 the statutes under consideration have provided for a preemptive right.62 Under the Second Directive the right may be waived by decision of a majority of the general meeting sufficient to amend the articles, on consideration of a report from the directors detailing reasons for the restriction and accounting for the proposed issue price.63 This is the same as the German statute64 and the Sanders Draft65 although more stringent than the French law, which requires only a simple majority.66 Adoption of the Second Directive would, therefore, affect only the British statutes with the effect on actual practices being minimal.


60. Drinker, supra note 59, at 603-07.

61. Although the corporate charter often provides for some form of preemptive right, "in the absence of express provision the only restraint on the directors is that entailed by the rule that they must act as fiduciaries when issuing further capital." Gower, Some Contrasts Between British and American Corporation Law, 69 Harv. L. Rev. 1369, 1380 (1956). The current American trend is to make the preemptive right optional; in California the preemptive right does not exist unless provided for in the corporation's articles. Cal. Corp. Code § 1106 (West 1955). Accord, Del. Code Ann. tit. 8, § 102 (1974). The Illinois Business Corporation Act, § 24, Ill. Ann. Stat. § 157.24 (Supp. 1975), provides that the preemptive right may be limited or denied by the articles.

62. Law of July 24, 1966, J.O. of July 26, 1966, Art. 183; AktG, [1965] BGBI.I 1089, § 186; 1 CCH COMM. Mkt. Rep. ¶ 1372(2), (3) (1974); Sanders Draft, supra note 24, Art. III-1-3. All four statutes provide that the preemptive right exists in proportion to existing interests held and may not be eliminated by company articles.

64. AktG, [1965] BGBI.I 1089, § 186(3).

65. Supra note 24, Art. III-1-3(3).

66. Law of July 24, 1966, J.O. of July 26, 1966, Art. 186. Added protection is given to the French shareholder, however, in the provision that shares of persons who will receive new shares may not be included in the quorum or the vote. Id.
C. REDUCTION OF CAPITAL

In virtually every American jurisdiction, a corporation may voluntarily impair its capital through reduction. The primary purposes of capital reduction are to distribute assets to shareholders, to remedy an existing deficit, to write down asset overvaluations, to reduce the basis for state franchise taxes, and to buy out dissident shareholders. Reduction is much more carefully controlled than increase because of the many opportunities it presents for abuse. Because of the risks involved, most state statutes require a resolution by the board of directors to be approved by a majority of shareholders at a meeting, with notice. Capital may not be reduced unless the remaining assets are sufficient to pay the corporation's debts. A certificate authenticating adoption of the resolution and stating the extent to which capital is to be reduced must be filed with the Secretary of State, and state approval of the reduction must often be obtained. The most effective limitations placed on reduction are those controlling distribution of assets released.

In all the European statutes under consideration a proposal to reduce capital must pass by a majority equivalent to that required to amend the articles. The Second Directive contains a special provision that in any capital reduction all shareholders must be treated equally and, if the transaction may be detrimental to shareholders of any class (where

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69. Id. Reduction may serve as a method for avoiding normally rigorous restrictions on payment of dividends; it may also be used to disguise losses resulting from mismanagement. Id. at 725.

70. Id. at 728-29. See Del. Code Ann. tit. 8, § 244(b) (1974).


Some variation exists among the European statutes in techniques for achieving reduction. The Sanders Draft allows reduction only through lowering of par. Id. Art. III-1-5(2). The German Act allows reduction through lowering of par or consolidation to the extent that the minimum par value cannot be maintained. AktG, [1965]BGB1.I 1089, § 222. A British company may reduce capital by (1) extinguishing liability on any shares not yet paid up, (2) canceling any paid-up share capital which is lost or unrepresented by available assets, (3) paying off any paid-up share capital in excess of the company's needs, or (4) lowering par. Act of 1948, 11 & 12 Geo. 6, c. 38, § 66. Since the Second Directive is silent as to methods of reducing par, its passage would require no change in present laws; an argument can be made that reduction should be limited to lowering par, since the British system is open to abuse through discretionary paying up or retirement of shares.
several categories of shares exist), each class must approve the resolution separately. Adoption of the Directive would require an amendment to this effect in each country, since, though solicitous of creditors with claims antedating reduction, the present statutes make no provision for minority share classes. Such an amendment would clearly be beneficial for the shareholders affected.

Closely interwoven with reduction of capital is the power of a company to purchase its own shares. This power has been used increasingly since the 1960's in America as a vehicle for controlling the debt-equity ratio, for stock option or other compensation plans, and for reduction of the number of shares outstanding, thereby increasing earnings per share. A company's purchase of its shares is highly susceptible to misuse, however, to the serious detriment of both shareholders and creditors. The prevalent American view is that as long as only surplus is used to purchase corporate shares, the position of shareholders and creditors is not compromised. Use of capital is permitted in most statutes only when shares are purchased (1) to eliminate fractional shares, (2) to collect or compromise indebtedness to the corporation, (3) to buy out dissenting shareholders under appraisal statutes, or (4) to effect the retirement of shares. According to Professor Kessler, only the first and


74. In Germany, creditors with antedating claims may request security within six months of passage of the resolution. Payments to shareholders pursuant to reduction may be made only after expiration of the six-month period. AktG, [1965]BGB1.I 1089, § 225. The French Statute gives creditors one month to object, in district court, to the reduction. The court may order payment of the debt or creation of guarantees; no steps may be taken to reduce capital during the period allowed for objection. Law of July 24, 1966, J.O. of July 26, 1966, Art. 216; Decree No. 267-236 of March 23, 1967, J.O. of March 24, 1967, Art. 180 [hereinafter Decree of March 23, 1967]. Similarly, the Sanders Draft provides that any creditors fearing that their rights are jeopardized may submit an appeal to the European Court of Justice within two months of the filing of the minutes of the shareholders' meeting. If the appeal is justified, the Court will require appropriate guarantees before forwarding the amended articles to the Commercial Registry. Supra note 24, Art. III-1-6. The British Act requires application to the court for an order confirming reduction. Creditors may object to the reduction before such order is given, and the court will not confirm the reduction until satisfied that creditors have consented to the reduction or have had their claims discharged. Act of 1948, 11 & 12 Geo. 6, c. 38, § 66.

75. In Britain, the judge confirming the reduction may, in his discretion, alter the voting powers of various classes but such provision is not required. 6 HALSBURY'S LAWS OF ENGLAND 166 (3d ed. 1954) [hereinafter HALSBURY'S LAWS].

76. CARY. CASES, supra note 59, at 1591.

77. ABA-AI MODEL BUSINESS CORPORATIONS ACT § 6 (1971). See DEL. CODE ANN. tit. 8, § 160 (1974) (shares may be purchased only if capital will not be impaired). The result is the same whether the surplus language or the impairment of capital language is used.
third uses are proper, in that corporate considerations outweigh the potential disadvantages to shareholders.78

A company's repurchase of its shares has traditionally been far more stringently regulated throughout Europe than in the United States. In Britain, the decision in Trevor v. Howard79 established the prohibition against share repurchases.80 France prohibits such acquisitions81 with two exceptions: a corporation may buy shares to distribute to employees in a profit sharing plan,82 and companies listed on stock exchanges may purchase up to 10 percent of their own shares, if the price is listed at 10 percent below net asset value per share. In the latter case, the company must provide for reserves equal to the aggregate value of shares held.83 Shares may also be purchased, after a vote at a general shareholders' meeting approving reduction for reasons other than losses, for the purpose of retiring them.84 Germany's statute is also restrictive, allowing the company to acquire a maximum of 10 percent of its own shares only if necessary to prevent serious damage to the company or for offer to employees, or, pursuant to a shareholders' resolution, for redemption in accordance with provisions concerning capital reduction.85 Predictably, the Sanders Draft absolutely prohibits the European Company from acquiring its own shares. It further requires that any company acquired by a European Company divest itself of any shares owned.86 The principal reason for this policy is the availability of less potentially dangerous means of achieving the same goals. For example, instead of repurchasing shares to offer to employees, as the French and German statutes allow, the company may authorize a new issue.87


79. 12 App. Cas. 409 (H.L. 1887).

80. The court reasoned that there was no legitimate purpose for the purchase. If it were to sell the shares, the corporation would be "trafficking," a prohibited practice; if it kept them, it would have reduced the capital indirectly, also prohibited. The only legitimate purpose posited was a buy-out of outsiders or dissidents where the objective was a closely-held company — and this objective should have been reached by inducing shareholders to purchase the shares personally. Id. at 417.


87. Id. ¶ 328.
The Second Directive is the most liberal of the European statutes, providing only minimum conditions for acquisition. The company must purchase shares so that proportional voting strength among shareholders is maintained and may not use the share repurchase power to give insiders an escape from loss. Transactions must be separately authorized by a shareholders' meeting, with the acquisition not reducing net assets below subscribed capital plus unavailable reserves (an approximation of impairment of capital). Shares held by the company may not exceed 25 percent of the subscribed capital. Where necessary to prevent injury to the corporation, the above requirements may be waived as long as the acquisition does not reduce net assets below subscribed capital and the face value or par of the shares purchased is less than 10 percent of subscribed capital. These restrictions do not apply to shares acquired as a result of a vote for capital reduction.

The Second Directive appears to be more liberal than necessary to effect a common scheme among the three member states under discussion. The German scheme is most permissive, but allows acquisition of only 10 percent of the company's shares and then only to prevent serious damage to the company. The Directive seems not to recognize the potential for abuse inherent in large-scale acquisition of company shares. At a minimum, the percentage of shares permitted to be reacquired should be reduced to ten. Serious thought should be given to Professor Kessler's recommendation of a five percent limit.

D. Dividends

Two aspects of dividend policy may provide a basis for comparison of national statutes: (1) who has responsibility for approving dividends and (2) from what sources may they legally be declared. In America, the corporate directors have sole power to declare dividends and may decide whether to pay them in cash, property, or shares of the corporation's stock. American directors bear sole liability for dividends wrongfully declared. In Great Britain, the directors have a responsibility to


prepare before every ordinary meeting a scheme showing profits and losses since the last meeting and recommending distribution of a percentage of the profit as dividends. The recommendation must be approved by the general meeting before any distribution may be made. British law permits payment of dividends only when all calls due have been paid. No payment of dividends may reduce capital stock, and the directors have discretion to set aside "such sum as they may think fit" as a reserve. British courts will not interfere with a director's decision not to pay a dividend, but an individual shareholder may bring suit to restrain an improper payment. In contrast, French law provides that it is the privilege of the shareholders, at general meeting, to allocate the annual retained earnings among distributions to shareholders, disclosed reserves, and earnings carried forward. The German statute, the Fifth Directive and the European Company Statute give the directors power to appropriate a substantial portion of the annual profit to corporate reserves. The balance is to be allocated by the shareholders’ meeting. The British method of allocation appears most reasonable. The directors do not make their decisions unchecked by shareholders, as is the case in America, where freezing out of minority interests and withholding of dividends for tax purposes are real dangers. In addition, the British director is not subject to the whim of the shareholders regarding disposition of profits, nor should he be. Rather, the director’s obligation is to preserve the well-being of the company over the long term, whereas shareholders, lacking business expertise, are likely to favor larger distributions to themselves than are in the company’s best interest. The German provision, in effect a compromise between the French and British systems, limiting the shareholders’ allocation to one-half of the

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95. Companies Clauses Act, 8 & 9 Vict., c. 16, § 122.
96. Companies Clauses Act, 8 & 9 Vict., c. 16, § 122.
98. AktG, [1965] BGB1.I 1089, § 58 (50 percent); Fifth Directive, Art. 50, 1 CCH COMM. MKT. REP. ¶ 1403 (1974) (50 percent); Sanders Draft, supra note 24, Art. VI-6-1 (75 percent). The test for legality of distribution to be used under the European statutes most closely approximates the earned surplus test. No distributions may be made while capital is impaired; and in France and Germany every company must, for the protection of creditors, hold a “statutory reserve” equal to 10 percent of its capital. Law of July 24, 1966, J.O. of July 26, 1966, Art. 345; AktG, [1965] BGB1.I 1089, § 150.
annual profits, is an appropriate restriction of power and should be adopted in the Fifth Directive, since adoption of the British method is unlikely.

The new German and French acts were drawn in part to attract small shareholders. In order to do so, it was necessary to prevent former practices such as the creation of "hidden reserves" which left the shareholder powerless regarding dividends. The solution reached, allowing the directors to appropriate up to 50 percent of the profit as reserves, the other 50 percent being disposed of by the shareholders, seems to be a meaningful and workable compromise. The British implementation of the Directive should not be difficult as shareholders presently vote to approve any distribution of dividends and the Directive does not foreclose the directors from making recommendations as to the disposition of profits—indeed, this seems a wise practice. Under the current laws and proposals, the European shareholder's role in controlling use of corporate profits is far superior to that of his American counterpart.

SUMMARY

The respective American and European laws regarding capitalization produce fairly significant contrasts. In particular, the European law seems to afford the shareholder greater protection in the valuation of assets contributed in kind, reduction of capital, purchase of treasury shares, and authorization of dividends. Despite the strict disclosure provisions of the American federal securities laws, state corporation statutes would be strengthened by the inclusion of sections providing for independent valuation of assets in kind and strict limitation of the amount of capital to be held as treasury shares. As European law moves toward unification, these safeguards should be stressed. The directives should not resort to the most liberal alternatives available, as in the treasury share provision, but should maintain rigorous standards, as in the provision on capital reduction. Despite the difficulties inherent in the coordination of nine national laws, the mandate of Treaty Article 54(3)(g), protection of investors in EEC companies, should be carried out.

99. In 1965 only 7 percent of the British adult population held shares. Only 4 percent held shares in commercial companies as opposed to governmental securities and investment trusts. On the continent, the figures were much smaller. Shareholding was effectively restricted to the wealthy, both by inflexibly high par values and by the popularity of "saving" as opposed to investing. The Economist, July 2, 1966, at 52-3. For a discussion of efforts made to attract German shareholders, see Baker, Shareownership in Germany, 1968 M.S.U. Bus. Topics 47, 68 (1968).

II

THE SHAREHOLDER'S RIGHT TO PARTICIPATE IN CORPORATE DECISIONS

Since the middle of this century, two trends among American corporations have emerged: companies have grown greatly through mergers and conglomerations, and ownership has become very widely distributed. The result is an anomalous position for the shareholder; he is an owner with virtually no control over the management of his property.\textsuperscript{101} Although he is well protected under securities laws against abuses in stock promotion and sales, he is generally powerless to influence management decisions in the absence of ownership of a significant number of shares.\textsuperscript{102}

Under the European company statutes, more power appears to be vested in the company meeting, which must, for example, vote to dispose of company profits and appoint auditors.\textsuperscript{103} The European company has, in the past, been smaller and more closely held than its American counterpart, reflecting the barriers of differing national laws, but the impetus of the policies of the Common Market has been to increase corporate size. This is especially true of the European Company Draft. The effectiveness of shareholder input in Europe is determined to a significant degree by the structure of the company. Britain shares the American form of management in the board of directors and officers. In Germany, and as an option under the French statute, the company is run by a two-tier board; the management tier, the real power in the company, is only indirectly responsible to the shareholders through the supervisory tier. This section will compare the six statutes as they regulate company structure and meetings, shareholders' voting rights and proxies.

A. COMPANY ORGANS

While American or British corporations have essentially two decision-making organs—the shareholders' meeting and the board of direc-


\textsuperscript{102} \textit{Id.} at 250-55. The Securities Exchange Act of 1934 had as an object the restoration of some power to the shareholder, and the New York Stock Exchange requires that stock carry a vote to be listed. However, the management proxy and the tremendous diversity of corporate ownership outweigh these measures. The shareholder does not protest management decisions with which he disagrees because his simple remedy is to sell and invest elsewhere. \textit{Id.}

\textsuperscript{103} See notes 113-16 \textit{infra} and accompanying text.
tors—the typical corporate form in continental Europe is a tripartite model. The components of the European company are the shareholders' meeting, a managing board which performs most of the functions of both the officers and directors in an American corporation, and a supervisory board which appoints the members of the management board and serves in an advisory or "watchdog" capacity. The two-tier European structure has gained momentum since passage of the French commercial statute in 1966, which gives a company the option of adopting the single-tier administrative board form or the German two-tier structure.104 The Fifth Directive makes the two-tier form mandatory,105 however, as does the European Company Statute.106 It is this provision which to a great extent has made passage of both of these proposed statutes so controversial.

Part of the controversy centers on the composition of the Supervisory Board. The German law requires that for companies with more than 500 employees, at least one-third of the members of the supervisory board must represent labor. In the coal and steel industries and in very large companies this number is increased to one-half.107 The resulting dilution of shareholder power has been considered severe, since labor, having essentially the same interests as management in the business aspects of the company, may convert the supervisory board into a tool of the management board, which already has enormous power.108 The two-tier directorate and labor representation on the board (co-determination) have been very controversial in Britain since it joined the EEC. Though both ideas are gaining some acceptance among both labor and management, the extensive changes which implementation would necessitate and the uncertain political climate in Britain indicate that passage of the Fifth Directive and wholesale adoption of the European Company Statute may yet be considerably delayed.109 The relative merits of the two corporate forms have been thoroughly discussed elsewhere,110 and are relevant to this Article only as they affect the shareholders' exercise of control.

106. Sanders Draft, supra note 24, Arts. IV-1-1, IV-2-1.
108. Roth, supra note 22, at 1381.
B. THE CORPORATE MEETING

It is the company meeting which allows the shareholder to exercise whatever degree of control he has. The company articles generally may not be amended without the approval of at least two-thirds of the shareholders attending a meeting, and no change in company structure may be effected without at least a similar majority. The meeting also affords protection to owners of classes of shares since no change in the financial structure of the company can occur without separate approval of each class of shares affected. While in the United States the strength of the management proxy machinery and the wide distribution of ownership have a great effect on individual shareholder control, in Europe other factors such as bearer shares, the relative weakness of proxy machinery, and the lack of quorum requirements may have an equally great effect in discouraging shareholder participation in meetings. This section will consider the form and agenda of meetings in the countries under consideration, and provisions for inclusion of shareholder proposals in proxy statements.

Shareholder meetings in the United States are of two types: annual and special. The annual meeting has as its primary purpose the election of directors, but any other proper business may be considered. The usual quorum requirement is representation of a majority of the outstanding shares. For passage a resolution generally requires a majority of shares present and voting. However, resolutions which will amend the articles of incorporation or the organic structure of the corporation usually require greater majorities, which are specified in the articles. A special meeting may be called by the directors or by such persons as are authorized by the by-laws, but it may consider only the issues set forth in the notice of the meeting.\(^{111}\)

The shareholders' meeting in European countries has more specific functions than the American meeting. Besides electing directors and approving organic changes, the annual British general meeting\(^ {112}\) must approve any distribution of dividends.\(^ {113}\) Shareholder approval is also

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\(^{111}\) Cary, Cases, supra note 59, at 251-53.

\(^{112}\) One general meeting must be held each year; on default, the Board of Trade may call a meeting. Act of 1948, 11 & 12 Geo. 6, c. 38, § 131. An extraordinary meeting must be convened on requisition of members holding 10 percent or more of paid-up capital. Id. § 132. As in the American special meeting, business at an extraordinary meeting is limited to that set forth in the notice convening the meeting. Companies Clauses Act, 8 & 9 Vict., c. 16, § 69.

\(^{113}\) The articles may provide that directors may pay an interim dividend after determining that profits will be sufficient. Final approval by the meeting is required. 6 Halsbury's Laws, supra note 75, at 402.
required for removal of directors, determination of remuneration of auditors and augmentation of capital.\textsuperscript{114} In addition to performing these functions, the German meeting must dispose of retained earnings, release the members of the supervisory and managing boards and appoint auditors.\textsuperscript{115} While the French general meeting convenes primarily to decide all questions relating to annual financial statements, additional duties include ratification of administrators or supervisory board members, approval or annulment of agreements between administrators or managers and the company, and authorization of bond issues.\textsuperscript{116}

Transaction of any business in a British meeting requires a quorum, generally specified in the articles. If none is specified, the minimum is five percent of capital or twenty persons.\textsuperscript{117} While German meetings are subject to no quorum requirement at all, a French meeting is valid only if 50 percent of shares carrying the right to vote are represented at an extraordinary meeting, 25 percent at a general meeting.\textsuperscript{118} Though the necessity of a substantial quorum may cause inconvenience and expense for the management, it seems an important safeguard of minority rights, especially if notice provisions are not adequate, as is the case in Germany.\textsuperscript{119}

A special meeting, one other than the annual meeting called to consider only specific resolutions, may be requested at any time by a minority of the shareholders in Britain,\textsuperscript{120} France\textsuperscript{121} or Germany.\textsuperscript{122} The French provision, in addition, gives the right to call a general or special meeting to the auditors, a court-appointed agent, or liquidators, if the management fails to do so.\textsuperscript{123} This provision is a sound one; anyone in a position to know of management wrongdoing ought to be able to call a meeting and place such knowledge before the shareholders, especially where

\begin{itemize}
  \item \textsuperscript{114} Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 184, 159, 61.
  \item \textsuperscript{115} AktG, [1965] BGBI. I 1089, § 119.
  \item \textsuperscript{116} Law of July 24, 1966, J.O. of July 26, 1966, Arts. 157, 103.
  \item \textsuperscript{117} 6 Halsbury's Laws, supra note 75, at 68. The articles may specify, however, that three members will constitute a quorum. \textit{Id. See} Gower, supra note 61, at 1391, where the American open agenda and substantial quorum requirements are contrasted with the British closed agenda and minimal quorum requirement.
  \item \textsuperscript{119} \textit{See} notes 120-31 infra and accompanying text.
  \item \textsuperscript{120} Act of 1948, 11 & 12 Geo. 6, c. 38, § 134(b). The members wishing to call the meeting must number 5 percent of the shareholders or hold 10 percent of the capital stock.
  \item \textsuperscript{121} Law of July 24, 1966, J.O. of July 26, 1966, Art. 158.
  \item \textsuperscript{122} AktG, [1965] BGBI. I 1089, § 122. Shareholders wishing to call a meeting must control 5 percent or more of the company’s capital unless the articles provide otherwise.
  \item \textsuperscript{123} Law of July 24, 1966, J.O. of July 26, 1966, Art. 158. The court will appoint an agent on the request of holders of 10 percent of the stated capital.
\end{itemize}
legal remedies are less available to the shareholder than they are in the
United States.\textsuperscript{124}

The Sanders Draft incorporates features from both the French and
German laws. Reserved to the shareholders' meeting are the powers to
increase or reduce capital, to issue convertible bonds, to appoint or
dismiss members of the supervisory board, to appoint auditors, to dis-
pose of the annual profit, to amend the articles of incorporation, and to
dissolve, transform, merge, or consolidate.\textsuperscript{125} While no distinction as to
quorum or majority requirements is made between extraordinary and
general meetings, specific requirements are stipulated with respect to
important resolutions such as amendments of the articles.\textsuperscript{126} Minority
shareholders may request the calling of a meeting.\textsuperscript{127}

The Fifth Directive is silent on several important questions relating
to meetings. Although it provides for a general meeting at least once a
year and gives certain minority shareholders the right to call meetings,\textsuperscript{128}
it does not specify the meeting's powers and sets out no majority re-
quirement beyond those provided in national laws.\textsuperscript{129} Furthermore, the Direc-
tive specifies no quorum requirement, a serious failing which may en-
able a potentially small percentage of the shareholders to control com-
pany policy.\textsuperscript{130} Since most of the EEC countries authorize bearer shares,
this directive failing is aggravated since holders of such shares receive
notice of shareholder meetings only through publication. The result, in
countries such as Germany, is that banks, the main depositories of
German shares, vote 85-90 percent of shares in large stock com-
panies.\textsuperscript{131} Though a quorum requirement in the Directive would require a signifi-
cant change in the German shareholder meeting, the change would be

\textsuperscript{124} See notes 286-92, 304-08 infra and accompanying text.
\textsuperscript{125} Sanders Draft, supra note 24, Art. IV-3-1.
\textsuperscript{126} Id.
\textsuperscript{127} Id. Art. IV-3-2.
\textsuperscript{128} Art. 16, 1 CCH COMM. MKT. REP. ¶ 1401R (1974).
\textsuperscript{129} Art. 36, 1 CCH COMM. MKT. REP. ¶ 1402L (1974).
\textsuperscript{130} Lack of a quorum requirement is very dangerous where a resolution not included
in the agenda may be proposed and voted on at the meeting. The Fifth Directive provides
some protection in that no item may be voted on if it did not appear on the agenda except:
(1) dismissal of supervisory board members, (2) the bringing of suits on behalf of the
corporation against such board members, or (3) the calling of a new meeting. In countries
such as Germany, where bearer shareholders are not likely to receive notice of meetings,
the Fifth Directive offers little protection to shareholder rights. See Gower, supra note 61,
at 1391.
\textsuperscript{131} Roth, supra note 22, at 1379. Shareholders in countries permitting bearer shares
apparently view them benignly; tolerance of bank proxies is high and holding shares in
bearer form may result in substantial tax savings. See Storm, Statute of a Societas
Europaea, 5 COMM. MKT. L. REV. 265, 280 (1968); Vagts, supra note 17, at 54.
a beneficial one for the small shareholder and such a requirement should be included.

Besides the protection afforded by quorum and majority requirements, shareholders in all countries considered have the right to submit resolutions for inclusion in the meeting agenda. In the United States the right is provided not by corporations statutes but by the Securities and Exchange Commission in Rule 14a-8. Under the Rule, any shareholder may submit, within a reasonable time prior to the annual meeting, a proposal regarding any proper company purpose. If the company opposes the resolution, the shareholder may also have included in the company's proxy statement a 200-word paragraph supporting it. If the submission of the proposal is timely, the shareholder may present and defend it at the meeting. The German Stock Company Act of 1965 contains a section modeled after Rule 14a-8. A single shareholder who submits a timely proposal has a right to have it communicated to other shareholders unless such communication would be illegal. The proposal may be no more than 100 words in length. However, if the same shareholder has submitted a proposal in the previous two years and failed to present it at a meeting or if the same proposal has been badly defeated at a recent meeting, the company may refuse to publish it. Significantly, the German shareholder may present a proposal nominating a slate of candidates for the supervisory board; the American shareholder has no say in the nomination of directors.

The German and American laws are the only laws affording a single shareholder the right to submit a proposal. In Great Britain a proposal requires the support of five percent of the capital stock or 100 shareholders, who must submit it six weeks prior to the meeting and bear the expenses of publication. While the proposal is limited to 1,000

133. Management may refuse to include the proposal in its proxy form if its submission is not timely or if it fails to comply with restrictions set forth in note 147 infra. A decision not to include the proposal must be reported to the SEC and the shareholder not later than thirty days prior to the date of filing of the preliminary proxy.
135. 17 C.F.R. § 240.14a-8(a) (1975).
139. Act of 1948, 11 & 12 Geo. 6, c. 38, § 140.
words,\textsuperscript{140} the company may refuse to circulate the proposal if it is satisfied the right is being used to publish defamatory matter.\textsuperscript{141} Similarly, under French law, shareholders representing five percent of the capital may submit for inclusion on the agenda any proposal not concerning the election of the administrative or supervisory boards.\textsuperscript{142} While eliminating the harassment of proposals submitted for purely personal reasons, the imposition of the minimum capital or number of shareholders requirements will surely prevent many shareholders from submitting legitimate proposals. Although all shareholders may inspect company registers,\textsuperscript{143} the practical burdens of convincing ninety-nine others of the merits of a proposal and funding publication to all shareholders will be an effective barrier to most incipient proposals.

The French and British requirements are essentially duplicated in the Sanders Draft and the Fifth Directive. The capital requirement under the former is five percent or 250,000 u.a.\textsuperscript{144} and under the latter up to five percent or 100,000 u.a.\textsuperscript{145} Under the Fifth Directive, the shareholder must submit his counter-proposal within five days of the 	extit{dispatch} of the letter announcing the general meeting.\textsuperscript{146} In combination with the capital requirements, this stringent time requirement appears to preclude any small shareholder resolutions. To provide any meaningful right to shareholders to have proposals considered at meetings, the Directive ought to reduce to twenty or fewer the number of signatures required on the petition and extend the time limit at least to conform to the German requirements. Adoption of Rule 14a-8(c)(3) and (c)(4) restrictions would ensure elimination of frivolous proposals.\textsuperscript{147}

\textsuperscript{140} Act of 1948, 11 & 12 Geo. 6, c. 38, § 140; see Gower, supra note 61, at 1393.
\textsuperscript{141} Act of 1948, 11 & 12 Geo. 6, c. 38, § 140.
\textsuperscript{143} Act of 1948, 11 & 12 Geo. 6, c. 38, § 113.
\textsuperscript{144} Sanders Draft, supra note 24, Art. IV-3-2(3).
\textsuperscript{147} Rule 14a-8(c)(3) provides that if the management has, at the shareholder's request, included his proposal in its proxy statement and form of proxy for either of the last two annual meetings and the shareholder has failed to present the proposal in person or by proxy, management may refuse to include the proposal. Under Rule 14a-8(c)(4) management may refuse the shareholder's request to include his proposal if substantially the same proposal has been submitted within the last five years and has received no more than (1) 3 percent of the vote if submitted only once; (2) 6 percent of the vote at its last submission if submitted twice; and (3) 10 percent of the vote at its last submission if submitted three times. Management may not refuse to include such proposal after three years from the last submission. 17 C.F.R. § 240.14a-8(c)(3), (4) (1975).
C. Voting Rights

Except in Britain, where share voting is generally on a per capita basis, the usual rule is that each share is entitled to one vote. Of course exceptions to this rule exist. Preferred stock does not necessarily carry voting power in the United States, although in most states such shares may vote whenever a proposed increase or decrease of capital or a change of preference or powers might have a potentially adverse effect. The German law provides for non-voting preferred shares as well and prohibits multiple voting rights. Company articles in Germany and France may limit the number of votes for a large number of shares held by a single person as long as the limit is imposed uniformly. While voting rights usually do not commence until a share is paid in full, French law requires that every share have at least one vote and provides for a double voting right for any fully paid-up share held by a French national or national of an EEC member state for two years or more. British law is very straightforward on voting rights; every member of the company is entitled to one vote by show of hands at a shareholders' meeting, unless a poll is demanded. In that case, each shareholder votes in proportion to the amount of capital he holds.

The ability to exercise an informed vote depends on the adequacy of notice provisions and shareholder access to company lists and financial statements.
information. Notice requirements among the six statutes do not vary substantially. Generally owners of registered shares must be informed by mail two or three weeks before the date of the general meeting. However, requirements for a special meeting may be more lenient as to time. Holders of bearer shares are usually notified by publication, though the new German law requires banks to act as intermediaries, individually informing those whose shares are on deposit with them of the meeting.

American shareholders are afforded the most complete statutory access to corporate books and records and shareholder lists. State statutes vary widely, however, and the shareholder may be required to prove that he has a proper purpose for inspection or that he meets minimum holding requirements. Although corporations are generally reluctant to allow inspection and will often force a court battle, the stockholder usually wins.

The new French law closely approximates the American statutes. From the date a shareholders' meeting is called, any member of a company or his representative may inspect designated company documents, including the profit and loss statement, the general operating account, the balance sheet, and the remuneration of the highest-paid company officials; he may also inspect and copy the shareholders list. No showing of proper purpose nor minimum capital holding is required.

In Great Britain, the shareholder has access only to stockholder lists. While ten percent of the shareholders may petition the Board of Trade to appoint an inspector if they suspect fraud or misconduct of directors, or if they are not receiving information they would normally

159. See Cary, Cases, supra note 59, at 1020.
161. See, e.g., Act of 1948, 11 & 12 Geo. 6, c. 38, § 133(1)(b) (two weeks).
166. Cary, Cases, supra note 59, at 1026; see Gower, supra note 61, at 1387.
inspectors have been appointed in only a small minority of cases in which complaints have been registered. Merely registering a complaint, however, is often enough to get relief. Nevertheless, the remedy does not seem adequate. Shareholders should have a right to acquire specific information concerning the company's financial status without having to show reason to suspect misfeasance on the part of the directors.

The German alternative to inspection of books, which has been adopted by the Fifth Directive and the Sanders Draft, is to provide any shareholder at the meeting with such information as is necessary to allow him to vote intelligently on matters before the meeting. The management may refuse to supply such information only (1) where release of such information would injure the company, (2) to the extent it relates to specific taxes, or (3) if furnishing such information would render the managing board criminally liable. The Sanders Draft and Fifth Directive allow only the first and third justifications for not furnishing information, but the shareholder may petition the court to require disclosure of any information refused.

If used well, this German requirement should provide significant leverage for active and concerned minority shareholders. Since each shareholder may have access to the annual accounts statement prior to the shareholders' meeting and accountants are required to attend meetings, most aspects of the company's finances should be available. Implementation of this practice in America would increase shareholders' power significantly because of the larger attendance by individual shareholders at American meetings. However, the effect of the adoption of the Fifth Directive would again be felt most in Britain where the requirements that company members be furnished an annual report and

170. Act of 1948, 11 & 12 Geo. 6, c. 38, § 164.
173. Sanders Draft, supra note 24, Art. IV-3-7.
175. AktG, [1965] BGBI.I 1089, § 131. See Kohler, supra note 104, at 77-78; Steefel and von Falkenhausen, supra note 17, at 546-47.
180. See Roth, supra note 22, at 1379.
any information requested at annual meetings would dramatically im-
prove the lot of the minority shareholder.

D. PROXIES

At common law all shareholders had to be present in order to cast
their votes, but as corporations increased in size and number of share-
holders, the personal attendance requirement became impracticable
and proxy voting was instituted. American corporate statutes now
routinely provide for proxy representation. In addition, the SEC af-
fords extensive protection through its proxy regulation procedures to
holders of registered shares of companies with 500 or more shareholders
and assets of over $1,000,000. Any proxy solicitation under Section 14
of the Securities Exchange Act of 1934 must provide the security holder
with information sufficient to give him an adequate factual background
for voting intelligently. All material included in the solicitation must
be filed with the SEC, which has power to enjoin the solicitation or the
voting of proxies where it believes, or has reason to believe, misleading
statements are being used. Thus, all registered shareholders of a com-
pany within the scope of SEC regulations are assured of significant
disclosure of all facts relevant to the casting of an informed vote.

No European statute provides such extensive protection for share-
holders. Under the British Companies Act, every shareholder has the
right to appoint another person, who need not be a shareholder, to
attend the meeting and vote for him. However, the Act requires no
specific disclosure in proxy statements; compared to the American
requirements, therefore, it is pitifully weak.

The French law similarly states that a shareholder may appoint an-
other shareholder or his spouse to represent him at the meeting. Unfor-
ently while such representative has all the rights of the shareholder

181. See Cary, Cases, supra note 59, at 254; Garrett, Attitudes on Corporate Democracy
184. Section 12(g)(1) of the Securities Exchange Act of 1934, as amended by the Securi-
ties Act Amendments of 1964, provides that any issuer with $1,000,000 in assets and a class
of equity security held by 500 or more persons must register its shares. 15 U.S.C. §
78(l)(g)(1) (1970). Such company thereby becomes bound under the proxy rules of Section
187. Act of 1948, 11 & 12 Geo. 6, c. 38, § 136(1). The notice of the meeting must inform
the shareholder of this right. Id. § 136(2).
at the meeting, the statute fails to provide for the sending of information to the shareholder prior to the meeting in order that he may intelligently direct the representative's voting.

The drafters of the 1965 German law were sensitive to the widespread criticism of the practice of having bearer share owners authorize the banks with whom their shares were deposited to represent them at shareholders' meetings for up to fifteen months, which authorizations were often automatically renewed. The shareholder had no effective control over the bank's vote. In fact the bank was not required to inform the shareholder of pending major actions (such as amendment of the articles) until 1952. The three largest banks in Germany thus wielded tremendous power in the country's major corporations.

The 1965 Act borrows somewhat from American proxy regulations. Banks now are obliged to forward to shareholders with certificates on deposit any communications received regarding meetings, resolutions and shareholders' proposals. The bank must also inform the depositor of its own voting proposals and request instructions from the shareholder, indicating that in the absence of such instructions, the bank will vote in accord with its proposals. A form for the shareholder's vote must be attached to the notification, and the bank must further disclose any interlocking management or supervisory board memberships between the bank and the company. Before it may vote any depositor's shares, the bank must have a written power of attorney. Furthermore, it may vote in contravention of the shareholder's instructions only where it may assume that, knowing all the facts, the shareholder would have

189. See Vagts, supra note 17, at 53-58. The author points out several forms of conflict and abuse possible in the bank depository system:

As a depositary of a corporation's funds, the bank may wish to keep the firm from withdrawing its deposits into other uses. As underwriter for the company, it may vote for a new stock issue which disinterested analysts would find unnecessary. As creditor of the company, it may prefer to see its debtor's earnings retained to give it additional security rather than paid out as dividends to the shareholders it is supposed to represent. ... Where the bank is confronted with corporate management not dependent on shareholder support, it may be so anxious to maintain its position as "house bank" that it will be reluctant to question or oppose management actions.

Id. at 57.

190. Id. at 54.

191. Id. at 55.

192. Id. See also Roth, supra note 22, at 1379.


authorized such a change,\textsuperscript{197} and the shareholder must be notified of any such vote with reasons stated for its exercise.\textsuperscript{198} Although the controversy over the banker's vote is far from settled, the shareholder's position appears much stronger as a result of the Act.

The Fifth Directive has incorporated the German provisions with few changes. Every shareholder has the right to appoint another shareholder to represent him at a meeting.\textsuperscript{199} Where any person or company publicly invites shareholders to send proxy forms to him and offers to appoint agents for them, the appointment is valid only for one meeting, or a second meeting with the same agenda.\textsuperscript{200} This contrasts with the German power of attorney which is valid for fifteen months.\textsuperscript{201} In addition to informing the shareholder of the agenda and pending resolutions, the proxy solicitation form must indicate that the annual accounts and contracts requiring shareholder approval are available to any shareholder requesting them.\textsuperscript{202} Furthermore, the solicitor must state how he intends to vote if the shareholder sends no instructions, with provisions for deviating from the shareholder's mandate substantially identical to the German Act.\textsuperscript{203} Adoption of the Directive would provide guidelines for French and British companies which solicit proxies and increase the potential for shareholders to exercise an intelligent, informed vote.

In view of the stringent protection it affords shareholders in other areas, the European Company Statute is surprisingly weak regarding proxies. Given its size and the international character of its shareholders, the European Company, more than most national companies, is likely to have a substantial proxy vote at any meeting. Similar to the British and French enactments, the Statute provides only that a shareholder may appoint a representative (other than company board members) to vote for him at shareholders' meetings and that such appointment must be in writing and deposited with the company prior to the opening of the meeting.\textsuperscript{204} Although the proxy is limited to six months (effectively on meeting),\textsuperscript{205} a provision which the drafters feel gives significant protection to the shareholder in preventing accumulation of proxy power in banks,\textsuperscript{206} this protection appears minimal, particularly

\begin{footnotes}
\item[197] AktG, [1965] BGBI.I 1089, § 135(8).  \\
\item[198] AktG, [1965] BGBI.I 1089, § 135(8).  \\
\item[201] AktG, [1965] BGBI.I 1089, § 128.  \\
\item[204] Sanders Draft, supra note 24, Art. IV-3-5(1), (2).  \\
\item[205] Id. Art. IV-3-5-(3).  \\
\item[206] Id. ¶ 519. 
\end{footnotes}
since a proxy is easily renewable and the lack of any information requirement may lead to abuse. The European Company Statute should as a minimum include a provision such as that drafted in the German Stock Company Act and adopted by the Fifth Directive.

SUMMARY

Judging from the American experience, as European corporations expand and their shareholders become more numerous, great care will have to be taken in order to protect what control the shareholder has. Assuming its implementation under the Fifth Directive, if the supervisory board serves its designated function, it may be an effective tool in safeguarding the shareholders' interests. The German experience has shown, however, that with employee representation on the supervisory board the management board may manipulate the supervisory board. In France, where the two-tier structure is optional, too few companies have adopted it to make a judgment on the effectiveness of an all-shareholder-elected supervisory board.

Deliberate consideration should also be given to quorum requirements. In Germany the lack of a quorum requirement is balanced by fairly stringent proxy regulations and notice requirements; in other EEC countries, however, holders of bearer shares receive notice of meetings only by publication. The combination of no quorum requirement with lax proxy regulations critically undermines the bearer shareholder's right to meaningfully participate in company meetings. The Fifth Directive and the European Company Statute must be reformed to protect this important interest.

Finally, as companies increase in size, it will become more important to ensure shareholder access to company financial information and to have good faith shareholder proposals more readily communicated in the proxy statement. Where the vote becomes the shareholder's only effective voice, he must be able to exercise it in an intelligent and informed manner.

III

THE SHAREHOLDER AND THE DIRECTORS

An extensive study of the directors' duties toward the shareholders would require an entire paper or book. This section will focus simply on those aspects of the shareholder-director or -manager relationship which are regulated by statute: election and removal of directors, shareholder ratification of loans to directors and of contracts in which directors are interested parties, the statutory standard of care required of directors,
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and actions which may be brought by shareholders on behalf of the company against directors who have violated those standards.

A. ELECTION AND REMOVAL

In most American public corporations, shareholders have little effective input into the makeup of the board of directors: "... The fact is that the stockholders elect the directors but they do not choose them. They are chosen by the board of directors itself, which makes the nominations." Proponents of this system argue that it is necessary to have the directors control membership on the board in the interests of efficiency since organization of a real shareholder election would be costly and could well result in a board of such diversity in business skill and interests that essential decision-making would falter. In fact, Professor Chayes argues that the shareholder should be completely disenfranchised because he may so easily remove himself from the corporate constituency.

The contrary argument is that minority shareholders have little effect in shareholder meetings and could most effectively obtain representation on policy matters through election of their own candidates to the board of directors. Cumulative voting, an institution now required in thirteen states either by state constitution or statutes, and permitted in seventeen others, may secure such representation on the board. European commentators frown on cumulative voting and classification of directors; however, because they feel that minority representatives on the board promote factionalism and decrease efficiency:

On the whole, the English still think of boards of directors as supervisory managers, who should be united in policy and outlook with the rest of management, rather than as representatives of divergent interests overseeing the managers...
Other than cumulative voting, the minority shareholder has no effective vehicle for securing board representation. The SEC proxy rules regarding inclusion of shareholder proposals in proxy solicitation materials specifically exclude nominations for elections to corporate office.\footnote{SEC Reg. 14A, 17 C.F.R. § 240, 14a-8(a) (1975). The German proxy statute specifically allows shareholder nomination proposals. See note 138 supra and accompanying text.}

Although corporate statutes provide for election of directors at the annual meeting, shareholders rarely vote against nominees of the directors. The board is, in general, a self-perpetuating body.\footnote{Hetherington, supra note 101, at 252. The self-perpetuation is aggravated by the fact that in the United States, directors generally are subject to no maximum term. See, e.g., Del. Code Ann. tit. 8, § 141 (1974).} Where a vacancy occurs the directors may make an interim appointment, to be ratified or rejected at the next shareholders' meeting.\footnote{Cary, supra note 59, at 154.} Directors in the United States are generally removable only for cause, although a few statutes do provide for removal without cause by shareholders' majority vote. Such removal is rare.\footnote{Id. Cary notes the contrast with European custom in the difficulty of removal of directors. Id. at 155.}

British companies must have at least two directors\footnote{Act of 1948, 11 & 12 Geo. 6, c. 38, § 176. This requirement is in contrast with most American statutes, which permit one-man corporations. See, e.g., Del. Code Ann. tit. 8, § 141(b) (1974).} who must be registered shareholders\footnote{Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 181, 182. An American director usually need not be a stockholder. See Del. Code Ann. tit. 8, § 141(b) (1974).} not more than seventy years old.\footnote{Act of 1948, 11 & 12 Geo. 6, c. 38, § 185.} If not otherwise specified in the articles, one-third of the directors shall retire each year; however, any director may be re-elected immediately or at any time thereafter.\footnote{Companies Clauses Act, 8 & 9 Vict., c. 16, § 88.} In Britain a director may be removed by ordinary resolution of the company at any time before the expiration of his term, provided he receives special notice of the resolution and has an opportunity to be heard on the resolution at the meeting.\footnote{Act of 1948, 11 & 12 Geo. 6, c. 38, § 241.} Remaining directors may fill any vacancy on the board, and such appointment is effective until the expiration of the term being filled.\footnote{Companies Clauses Act, 8 & 9 Vict., c. 16, § 89.}

In French companies adopting the single-tier structure, the shareholders elect members of the administrative board for a term of six years, and these board members may be re-elected.\footnote{Law of July 24, 1966, J.O. of July 26, 1966, Art. 90. The board may consist of from three to twelve members. Id. Art. 89.} They must hold shares equal to the minimum required for participation in shareholders'
meetings. In contrast to the American and British laws, a stock company may serve as a board member, but the company must designate a permanent representative to be subject to the same conditions and obligations as if he were a director in his own name. Additionally, the shareholders may dismiss board members at any ordinary meeting.

French companies have had the option of adopting the two-tier corporation model since 1966. Companies choosing this model maintain an election procedure very similar to that followed by German companies and to the suggested procedures under the Fifth Directive and the European Company proposals. The managing board, or directorate, consisting of one or more persons appointed by the supervisory board, has broad power to carry out the day-to-day functions of the corporation, to formulate policy, and to represent the company in all transactions with outside parties. While the term of managing board members in France is four years, in Germany it is five. Furthermore, in Germany the term may be extended for five years on a resolution of the supervisory board. The managing board member need not be a shareholder. In both France and Germany managing board members are subject to

227. Law of July 24, 1966, J.O. of July 26, 1966, Art. 118. See Kohler, supra note 104, at 71. The French wanted a stock company law comparable to the laws of the other EEC countries, especially Germany; it was felt that adoption of features of the other European laws would improve France's bargaining position in unification negotiation. Corporate ideology thus played a small role in the decision. Id. at 59.
230. Law of July 24, 1966, J.O. of July 26, 1966, Art. 124. See AktG, [1965] BGB1.I 1089, § 82. The French statute enumerates the powers of the management board. The German law provides that the powers of the management board to represent the company "cannot be limited," but that the board must comply with restrictions imposed by the statutes, by the articles of the company, and by acts of the general meeting or the supervisory board.
dismissal by the supervisory board "for compelling reasons," such as breach of duty, incompetence, or a "no-confidence" vote of the shareholders. The supervisory board of the court may fill any vacancy for the remainder of the term and a director wrongly dismissed has an action for damages against the company.

The supervisory board in Germany and France serves to safeguard the interests of the shareholders by reviewing the activities of the managing board, especially with respect to company accounts and finances. In addition, it represents the company in dealings with the managing board both in and out of court. The most significant difference between the German and French boards is that in Germany the supervisory board is elected, two-thirds by the shareholders and one-third by company employees, while in France all board members are elected by the shareholders. The Fifth Directive and the Sanders Draft provide for supervisory boards which follow closely the German pattern.

Some question exists as to the effectiveness of the supervisory board in controlling management. While commentators suggest the board is either too much "inside" or too much "outside," it is clear a workable balance is not easily maintained. Where the supervisors become but


238. The German supervisory board consists of from three to twenty-one members, depending on the stated capital of the company. AktG, [1965] BGBI.I 1089, § 95. The term of office for a board member is four years and vacancies may be filled by the supervisory board for the remainder of the unexpired term. Id. §§ 102, 104. Unless the articles specify otherwise, removal of a member of the supervisory board requires a three-fourths majority of the shareholders' meeting or a court order pursuant to petition of the supervisory board if a "compelling reason" exists. Id. § 103.

239. French supervisory board members must be natural persons and shareholders; their term of office may not exceed six years but members are generally eligible for re-election. Law of July 24, 1966, J.O. of July 26, 1966, Art. 134. The board may fill vacancies subject to shareholder ratification; the shareholders' meeting may dismiss a member of the supervisory board at any time. Id. Arts. 134, 137.

Both the German and the French laws limit the number of supervisory boards on which an individual may serve; in France, the limit is eight; in Germany, ten. Law of July 24, 1966, J.O. of July 26, 1966, Art. 136; AktG, [1965] BGBI.I 1089, § 103(2).

240. See Vagts, supra note 17, at 52. Vagts states that the board meets too infrequently (four times a year) and thus "understands relatively little about the affairs of the firm and often rubber-stamps management decisions." Id.
another arm of the managing board, the shareholder's chances of affecting the composition of the managing board becomes as slim as his American counterpart's.

B. INTERESTED DIRECTOR PROVISIONS

American corporation statutes give directors extensive authority to fix their own compensation, to borrow money from the corporation, and to engage in contracts with the company from which they may benefit substantially. The standard applied to such conduct is whether or not the transaction was "fair" to the corporation or was in bad faith. Under the Delaware Code, a contract between a director and the company is valid if the material facts as to the interest are disclosed and the contract is ratified by a majority of the disinterested directors; however, the interested party may be included in establishing a quorum. The contract is also valid if ratified by a majority of shareholders where the material facts are known. Nevertheless, the interested director generally has the burden of proof with respect to the fairness of the transaction.

The European statutes are somewhat stricter. In the British company, the shareholders' meeting determines the compensation to be paid directors. Furthermore, the company may not make loans to directors except where the company is a subsidiary and the director its holding company or where the director has incurred expenses for the benefit of the company, in which case the loan must be repaid within six months. A director or his firm may contract with the company, however, and retain profits made if such contracts are permitted by the articles, if the director has disclosed all material facts regarding the transaction, and if the company ratifies the contract at a general meeting.

244. Although a very few jurisdictions find such contracts voidable irrespective of fairness, "in a majority of states . . . a transaction involving an interested director is now voidable only if unfair . . . or if the directors acted in bad faith." G. Hornstein, 1 Corporate Law and Practice § 439 (1959).
248. Cary, Cases, supra note 59, at 566. Where the transaction is fair and the interested director does not participate in the voting, the contract, in most jurisdictions, "cannot, even in the absence of ratification, be avoided." Id. at 565.
249. Companies Clauses Act, 8 & 9 Vict., c. 16, § 91.
250. Act of 1948, 11 & 12 Geo. 6, c. 38, § 190.
251. 6 Halsbury's Laws, supra note 75, at 302-03.
French law provides for payment of the directorate to be established in the instrument of appointment for each director. For members of the administrative board or the supervisory board, however, remuneration is limited strictly to attendance fees specified by the shareholders’ meeting and compensation for special tasks. The law prohibits absolutely any loans by the company to members of the managing board, supervisory board or administrative board, their spouses, ascendants and descendants, and any representatives of legal entities with board positions. However, agreements between board members and the company are valid as long as the supervisory board or the administrative board authorizes them, but the auditors’ report must specify the material facts of any such agreement.

The German law and the proposed Fifth Directive are substantially similar in their requirements. Members of the supervisory board and the management board may not determine their own compensation. In addition, all contracts between members of the supervisory or management boards and the company must be authorized by the supervisory board. Though the Directive is silent as to loans, the German Act provides that the supervisory board must ratify any extension of credit to a board member or his family member. Under this act, strict control is placed on the types of transactions permissible, and the resolution must disclose the amount of principal and interest rate involved.

The Sanders Draft allows substantial freedom in the determination of compensation to the supervisory board members, but it strictly prevents loans to any members of the supervisory or management boards, their ascendants or descendants. Agreements in which the

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255. Law of July 24, 1966, J.O. of July 26, 1966, Arts. 103, 143. These sections apply as well to agreements between the company and an enterprise whose directorate or supervisory board includes a member of the management or supervisory board of the company.
258. AktG, [1965] BGBI.I 1089, § 114; Fifth Directive, Art. 10, 1 CCH COMM. MKT. REP. ¶ 1401K (1974). The latter requires authorization at least from the supervisory board, indicating that such agreements may require ratification by the general meeting (emphasis added).
261. Sanders Draft, supra note 24, Art. IV-2-7(1). Remuneration of supervisory board members may be established in the articles of incorporation or determined at the shareholders’ meeting.
262. Id. Art. IV-1-8-(3); Art. IV-2-7(2).
company and members of either board are directly or indirectly interested require approval of the supervisory board,\textsuperscript{263} and an interested supervisory board member may not participate in the vote.\textsuperscript{264}

While the British law in all these respects gives the shareholder more protection than any other, the American corporation law affords the least. Though shareholder determination of director remuneration and ratification of interested director contracts may present practical difficulties in some cases, it would certainly have an inhibiting effect on ethically questionable transactions. Where directors may ratify each other's contracts or loans, the temptation of abuse is strong. In Europe, where such transactions must be disclosed only after they have taken place, and where no Rule 10b-5 remedy or derivative action is available, shareholder ratification is the best guarantee of protection. For the small company, the British rule is preferable to civil liability since ratification of contracts would not be impractical and it is cheaper than litigation. With the European emphasis on company expansion, however, stronger sanctions are needed to prevent abuse in this area. Shareholder remedies should be strengthened through laws analogous to American securities regulations. Such a provision should be included in the Fifth Directive.

C. STATUTORY STANDARD OF CARE

At common law, courts were reluctant to interfere with the business judgment of company directors: "It is not the business of the courts to manage the affairs of the company. That is for the shareholders and the directors."\textsuperscript{265} Liability has been imposed, however, where directors have committed palpable fraud, waste of company assets, or actual or legal overreaching.\textsuperscript{266} Generally, however, American courts have imposed lia-

\textsuperscript{263} Id. Art. IV-2-1(2); Art. IV-2-7(3).
\textsuperscript{264} Id.
\textsuperscript{266} Spering's Appeal, 71 Pa. 11, 10 Am. Rep. 684 (1872) established that . . . directors are personally responsible to the stockholders for any losses resulting from fraud, embezzlement or willful misconduct or breach of trust for their own benefit and not for the benefit of the stockholders, for gross inattention and negligence by which such fraud or misconduct has been perpetrated. . . .
\textit{Id.} at 24, 10 Am. Rep. at 693.
bility sparingly; the "reasonable man standard" has been the judicial norm and liability is usually restricted to cases where the director's wrong is egregious.267 All but one of the ten states which have statutory provisions for the standard of care have adopted this negligence standard.268 Only Pennsylvania requires that a director, standing in a fiduciary relationship to the corporation, must discharge his duties "with that diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in their personal business affairs."269 The New York statute, setting out the "ordinarily prudent man" standard, also provides that directors shall be justified in relying on the accuracy of the financial statement as presented by the corporation president or officer having charge of the corporate books.270

Fortunately, minority shareholders are not solely dependent on judicial and statutory protection. The federal securities laws relating to the purchase and sale of stock have also been a fertile source of director liability. Under Section 11 of the Securities Act of 1933,271 directors may be liable for any misstatement or omission in a securities registration statement.272 Civil liability may also be incurred under Section 14(a) of the Securities Exchange Act of 1934273 for including false and misleading statements in proxies274 or omitting material statements therefrom.275 Under Section 16(b) of the 1934 Act,276 a director is penalized for engaging in "short-swing" trading; that is, he must return to the company any profits realized from the buying and selling of company stock within a six-month period.277 In recent years, however, the most significant source of director liability has been SEC Rule 10b-5,278 which makes unlawful any fraudulent action in connection with the purchase or sale of any security registered on a national securities market.279

279. See, e.g., SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, cert. denied, 394 U.S. 976,
British case law has developed standards of care which are very similar to the Pennsylvania requirements in that a director is liable for negligence if he fails to exercise such care as a reasonable man might exercise in similar circumstances on his own behalf. Directors may act in reliance on the officers of the company whom they are entitled to trust, and they are not required to know the contents of the company's books. Directors are not held for "mere imprudence in errors of judgment." Yet while a director is not liable for untrue representations in the balance sheets if he honestly believed them to be true, he is held liable for material misrepresentation of fact in the company prospectus. Thus, although comparable to the American statutes and judicial holdings, the British liability provisions are weaker than the SEC laws.

The major comparative weakness of British law is in available remedies. Generally only the company may bring an action against a director. An individual shareholder, under the rule in Foss v. Harbottle, may not bring a representative suit "if the action complained of is one which could be effectively remedied by a vote of a simple majority at a general meeting." Shareholder suits against corporate directors for negligence are not recognized. The Companies Act of 1948 did afford some relief in Section 210, which gives the court a right to intervene on behalf of "oppressed" minority shareholders and prescribe whatever remedies it deems necessary.

**References**


283. 6 Halsbury's Laws, supra note 75, at 310. See Re New Mashonaland Exploration Co., [1898] 3 Ch. 577; Turquand v. Marshall, 4 Ch. App. 376 (1869).


285. Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 38, 46. A director may not be liable for misstatements of a co-director in a prospectus unless he has expressly authorized or tacitly permitted its issue. Cargill v. Bower, 10 Ch. D. 502 (1878).

286. 6 Halsbury's Laws, supra note 75, at 306-07.

287. [1843] 2 Hare 461.

288. Gower, supra note 61, at 1385.


290. The shareholder may bring the action on his own behalf, but he has the burden of establishing that the behavior complained of is oppressive. Inefficient or careless behavior is not enough; one must show actions establishing a lack of probity or fair dealing, designed to gain an unfair advantage over the shareholder. See Re Five Minute Car Wash Service, Ltd., [1968] 1 All E.R. 242.
only where the facts of the case would otherwise dictate that the company should be wound up.\textsuperscript{291} Thus far the provision has afforded little relief because the courts have interpreted it strictly.\textsuperscript{292} The Jenkins Report\textsuperscript{293} in 1962 recommended an easing of the requirement that the facts justify winding up. Instead of requiring the shareholder to prove a pattern of oppressive conduct, the Report indicated that isolated instances should be sufficient to maintain proceedings.\textsuperscript{294} Although the courts have not embraced this liberal recommendation, Gower states that Section 210 has nevertheless had a strong \textit{in terrorem} effect.\textsuperscript{295} Regardless, the section should be strengthened so that it will provide actual relief without undue burdens on the shareholder. In conjunction with more forceful disclosure requirements, it could provide significant protection.

The German statutory requirements regarding the management and supervisory board members' duty of care are much stricter than the American and British requirements of directors. A German board member must act "with the care of a diligent and prudent executive,"\textsuperscript{296} and where the board member's performance is in question, he has the burden of proof.\textsuperscript{297} Although if the board member acts pursuant to a valid shareholders' resolution no liability attaches,\textsuperscript{298} authorization by the supervisory board does not preclude liability.\textsuperscript{299} Specifically, the statute enumerates repayment of capital contributions to shareholders, issuance of share certificates before capital is paid in, and distribution of company assets as actions which may entail liability.\textsuperscript{300}

Although the statute on its face appears to give the shareholder pro-
tection against board member incompetence, the remedial provisions and judicial interpretation are barriers to shareholder claims. No individual shareholder or derivative action exists. Instead, any action against managing or supervisory board members must originate in the shareholders' meeting or at the behest of holders of 10 percent of the capital stock who have held such stock for three months or more. Even if a claimant brings suit within six months of the shareholders' meeting as required, the court is unlikely to impose liability. Though the German standard of care is stated much more strongly than the American standard, its enforcement is relatively weak. Board members are rarely held liable to the corporation because of a prevalent judicial feeling that they must be free to take risks. Except for violation of the specific statutory provisions enumerated above, the practical result is very similar to the American "business judgment" rule.

The French statute, like most American state statutes, is silent as to the duty of care to be imposed on management and supervisory board members. The only guidelines are provided in sections which bind the members to secrecy on confidential company matters and which provide that they may be held liable for violation of statutes or by-laws or for "faults committed in their management." Given the tendency of German judges to refrain from imposing liability in the face of a strict statute, the notably weak French enactment in comparison appears to open wide the door to management abuse. A relatively stronger damage section may, however, partially compensate for this weakness. While the statute itself authorizes a derivative suit by shareholders either individually or as a class, the clause's implementing decree limits this right

301. See Eckert, Shareholder and Management: A Comparative View on Some Corporate Problems in the United States and Germany, 46 IOWA L. REV. 12, 72-83; Vagts, supra note 17, at 58-60.

302. AktG, [1965] BGB1.I 1089, § 147(2). The company itself must be a party to any suit against members of the management or supervisory boards. Generally the supervisory board represents the company, but agents may be designated by the general meeting or the court to bring the action where there is distrust of the supervisory board. Thus, while the corporation is an indispensable party to litigation in Germany and the United States, there is a crucial difference in that the participation of the [German Company] is absolutely necessary in order to have a plaintiff at all, whereas the American corporation is joined [in a derivative action] in order to make binding upon it the results of the litigation.

Eckert, supra note 301, at 77.

303. Steefel and von Falkenhausen, supra note 17, at 532.

304. Id.


by stipulating that any individual bringing suit must represent one-twentieth of the stated capital holdings and must bear all expenses.\textsuperscript{308} Because of the substantial burden of expenses in derivative suits, the statute is likely to give little relief, and minority shareholders remain essentially defenseless against corporate mismanagement.

With respect to the issue of the standard of care, the European Company Statute is substantially similar to the German act. Management board members must act with the care of conscientious administrators\textsuperscript{309} and must be bound to secrecy on confidential company matters.\textsuperscript{310} The Act also provides that members shall be jointly and severally liable for violations of the statute, of the company by-laws, or for faults committed in their management.\textsuperscript{311} Any managing board member who can show specific lack of liability and prove he notified the supervisory board in writing of the act or failure to act as soon as he became aware of it may be absolved,\textsuperscript{312} but authorization from the supervisory board does not absolve the management board of liability.\textsuperscript{313}

The shareholder's remedy for mismanagement is a suit for damages brought by the supervisory board against one or all members of the management board\textsuperscript{314} or a derivative suit brought by holders of five percent of the stated capital or shares with a par value of 250,000 u.a.\textsuperscript{315} Though this standard is essentially the same as that stipulated in the French statute, the size of the European Company makes satisfaction of the capital holding requirement very difficult. While the Statute is more favorable to the shareholder than the French statute in awarding costs to the plaintiffs at the expense of the company,\textsuperscript{316} the plaintiffs are personally liable for the company's costs if the suit is dismissed. If the action was malicious, the company may also sue for damages.\textsuperscript{317} The combined factors of the capital holding requirement and liability for expenses in case of dismissal will be effective barriers to shareholder action. To offer more adequate protection, the Statute should provide for individual shareholder action. The threat of liability for damages and the expense of bringing an action would be sufficient deterrents to strike suits.

\textsuperscript{309} Sanders Draft, \textit{supra} note 24, Art. IV-1-9(1).
\textsuperscript{310} \textit{Id.} Art. IV-1-9(2).
\textsuperscript{311} \textit{Id.} Art. IV-1-10(1).
\textsuperscript{312} \textit{Id.} Art. IV-1-10(2).
\textsuperscript{313} \textit{Id.} Art. IV-1-10(3).
\textsuperscript{314} \textit{Id.} Art. IV-1-11(1).
\textsuperscript{315} \textit{Id.} Art. IV-1-11(2).
\textsuperscript{316} \textit{Id.} Art. IV-1-11(3).
\textsuperscript{317} \textit{Id.} Art. IV-1-11(4).
On the issue of the standard of care, the Fifth Directive offers nothing more than the lowest common denominator. Article 14 provides only that the company has an action for damages against the members of the management and supervisory boards for breaches of law or company statutes or “other wrongful acts” committed by board members in furtherance of their duties.\(^{318}\) A board member may exonerate himself by showing no fault on his part but, as in the German Act, authorization of the supervisory board is no defense to management board liability.\(^{319}\)

While the company may bring an action on the resolution of a simple majority of its members, one or more shareholders representing five percent or more of the capital or shares valued at 100,000 u.a. may also commence an action.\(^{320}\) The statute does not provide for allocation of expenses. Therefore, while the Fifth Directive similarly suffers from the capital holding limitation on shareholder suits, it does not incorporate expense reimbursement provisions which adequately discourage frivolous or malicious actions.

Thus, no European company law or proposed law provides protection for the shareholder equal to that established under the American securities laws and derivative action. As the European population increases its share holdings, greater demand for more effective relief from management incompetence or abuse is likely to lead to increased access to the courts for the individual shareholder. This trend is already apparent in Great Britain, which has been slightly ahead of the continent in encouraging increased individual ownership of shares.\(^{321}\) The American provisions for civil liability of officers and directors in this area appear to provide an effective model for European laws.

**Summary**

The European company laws rely heavily on statutory disclosure provisions to prevent improper behavior on the part of directors. Consequently, contracts with the company and loans from it, where permitted, must be approved by the shareholders or the supervisory board. In America the corporation statutes do not regulate strictly and thus contain much potential for abuse; but in a company whose shares are registered under the securities laws, any fraudulent behavior connected with the sale or purchase of shares may result in significant civil liability.

\(^{321}\) THE ECONOMIST, July 2, 1966, at 52.
Some commentators have suggested that the European director has a higher sense of honor or loyalty than his American counterpart, and that the restraining statutes are adequate protection for the shareholder.\textsuperscript{2} Again, company size and the extent of distribution of shares may be significant factors in control over behavior of the directors; the two-tier form also may play a role. It is likely that as corporations grow the present statutes will become less adequate, necessitating a more effective remedy for the individual shareholder, such as the derivative suit.

IV

SHAREHOLDERS AND THE ACCOUNTANTS

In most American corporations, company auditors are seen merely as a division of the management arm. A disagreement between management and the auditors may be cause for replacement of the auditors and the shareholders may not interfere in the decision.\textsuperscript{323} Only Massachusetts requires that the shareholders' meeting approve the directors' choice of an auditor;\textsuperscript{324} although companies regulated under the Investment Company Act of 1940\textsuperscript{325} must also submit proposed auditors for shareholder ratification. Of 7,000 companies filing proxy statements with the SEC in 1973, 3,121 asked for shareholder approval of auditors but 1.5 million unlisted and unregistered companies, of which more than 100,000 have assets over $1,000,000 are under no duty to file auditors' reports or to have their accounts certified by Certified Public Accountants.\textsuperscript{326} For the protection of shareholders in these companies, state corporation codes should adopt independent auditor provisions similar to those found in the statutes of the countries under consideration.

In Britain, each annual shareholders' meeting appoints auditors to serve until the next meeting. The auditors are reappointed unless they are not qualified for reappointment or have given notice of unwillingness.

\textsuperscript{322} See Eckert, supra note 301, at 37-44.
\textsuperscript{326} Hawes, \textit{supra} note 323, at 1.
\textsuperscript{327} Conard, \textit{An Overview of the Laws of Corporations}, 71 Mich. L. Rev. 623, 646-48 (1970). Conard points out, significantly, that auditors who are fired because of disagreements with management have no duty to complain to the shareholders. Recent amendments to § 13 of the Securities Exchange Act of 1934 require companies to file a report if the auditor certifying their most recent report has been changed; the company must inform the Commission of any disagreements occurring within the previous eighteen months and the auditor may defend his position in a letter to the SEC. Hawes, \textit{supra} note 323, at 16.
to serve, or unless the company passes a resolution appointing another auditor or expressly providing for the termination of the present one.\textsuperscript{328} The effectiveness of these provisions has been illustrated by a few noted cases in recent years wherein management proposals to appoint new auditors have been defeated or withdrawn prior to a vote in circumstances where auditor disagreement with management policies was apparent. Where auditor disapproval of management policies is apparent, shareholders abandon their rubber-stamp ratification of management policies.\textsuperscript{329} Presumably this would be the case if a similar situation faced an American corporation.

The French and German statutes are more restrictive than the British concerning qualifications of auditors. Whereas in Britain the auditor is disqualified if he is not a member of a recognized body of accountants or is an officer or servant of the company, employee or partner of such person, the continental auditor must meet certification requirements and may not have been an officer or employee for three years previous to his appointment.\textsuperscript{330} Also disqualified in France are corporate founders, contributors of assets of any kind, beneficiaries of special preference, board members, and any relatives up to the fourth degree of such persons, as well as board members and their relatives of corporations owning 10 percent or more of the principal company.\textsuperscript{331} French shareholders may defeat the appointment if holders of 10 percent or more of the stated capital object in court to such appointment and the court sustains their objection.\textsuperscript{332}

Where the auditors find irregularities in a corporation's accounts, they must call attention to them at the next shareholders' meeting. They are also obliged to inform the State Prosecutor of any offenses of which they have knowledge. Although the auditors may not be dismissed without a hearing either before the shareholders or before state prosecutorial or judicial authorities, they may be held liable for failure to disclose any such irregularities in their report to the shareholders.\textsuperscript{333}

The German statute provides that where the auditors disagree with company management on the interpretation of the financial statement and the business report, either party may apply to the district court for

\begin{itemize}
\item \textsuperscript{328} Act of 1948, 11 & 12 Geo. 6, c. 38, § 160.
\item \textsuperscript{329} Hawes, \textit{supra} note 323, at 9.
\item \textsuperscript{331} Law of July 24, 1966, J.O. of July 26, 1966, Art. 220.
\end{itemize}
at a hearing. The court's decision is appealable only at its discretion. The Fifth Directive includes the French and German requirements of disaffiliation from the corporation for three years prior to appointment and the stipulation that any auditor must be certified or approved by a judicial or administrative authority. Furthermore, a shareholder or members of the supervisory or management boards may apply to the court within two weeks to cancel the appointment of any auditor improperly delegated. While no specific provision is made for recourse in case of disagreement, the Directive states that the auditors have a duty to prepare a report stating whether or not the company has complied with the national law and company statutes and whether or not the auditors have observed any serious danger to the company's financial well-being. It also provides that except where "proper grounds" exist, the auditors may not be dismissed by the general meeting before the end of their terms. Contrary to the British and German provisions for annual appointment of auditors, the Fifth Directive follows the French law and specifies a term of years. The inclusion of a provision, such as contained in the British or German acts, that any disagreement between auditors and management should be arbitrated by either the shareholders or a court would clearly strengthen the Directive.

The Sanders Draft provides that shareholders' meetings shall elect annual auditors as specified under national law. Though the Draft grants the auditors broad powers to inspect the company records and requires a report stating any grounds for suspecting overstatement or understatement of items in the balance sheet, the Draft fails to specify any remedy in case of disagreement with management. It provides only that holders of five percent of the capital may bring suit in the Court of Justice if they believe that the annual report of the company does not comply with the statutes. The auditors under this statute appear to have far less protection from management coercion than do company auditors under national laws. Given the nature of the enterprise and the

339. Act of 1948, 11 & 12 Geo. 6, c. 38, § 159.
343. Sanders Draft, supra note 24, Art. IV-4-1.
344. Id. Art. VI-4-2.
345. Id. Art. VI-4-5.
sophistication of the anticipated European Company management, this omission is surprising. Careful attention should be given to this part of the Draft before it is enacted. The Draft does include a provision for the appointment of special auditors where facts giving rise to the suspicion of gross breach of duty exist—but this requires too much. The workability of the British, French and German statutes indicates that a provision modeled after one of the national laws should be included in the Draft.

CONCLUSION

The comparative analysis has revealed significant differences between American corporation law, the existing laws of France, Great Britain and Germany, and the proposed European Company Statute and Fifth Directive. Some of these distinctions can be explained primarily by the number, size and diversity of corporations. American securities law is far more sophisticated than European law because such a high percentage of the population owns shares and because many of the corporations issuing securities are so large and diversified that internal shareholder control is impossible. The proxy system has become highly developed in this country because share ownership is not localized and meeting attendance is impossible for the bulk of stockholders.

A highly significant distinction is in the concept of the shareholders' meeting itself. The European statutes uniformly speak of three corporate organs—the management board, the supervisory board, and the company meeting. The meeting has definite and specified functions. As evidenced, the shareholders establish policy in authorizing dividends, approving capital increases and reductions, and appointing auditors, functions which are left to the directors in America. The “group” concept applies to all functions of the meeting. Generally an individual shareholder may never act on his own; a five or ten percent minority is required for resolutions to be placed on the agenda, for the request of a special meeting, or for challenges to qualifications of board members and directors.

A result of this “group approach” is the comparative rigidity of the corporation laws. The American laws can afford flexibility because they are supported by the securities laws and because an aggrieved shareholder may individually bring a suit against a director or officer on behalf of the corporation. The injury to the shareholder need not be direct, as long as the company is injured. The German shareholder, in contrast, does not have the benefit of the derivative action and may sue

346. See notes 112-16 supra and accompanying text.
347. See Eckert, supra note 301, at 70.
in tort only when he is directly injured. The difficulty of obtaining relief after the fact in Europe has thus led to institution of statutory prior restraint. The standard of responsibility for corporate directors is an objective one. Incompetence attributable to lack of ability or lack of fitness for the job affords no valid excuse. The applied standard becomes a mechanical test of whether or not a statute has been breached.\textsuperscript{348}

The proposed statutes for company law in the EEC draw heavily from the German and French laws, perpetuating this mechanical approach. As corporations in those countries take advantage of new transnational merger and consolidation patterns and increase in size, the old pattern will become less satisfactory and more flexibility will be demanded. British law offers some of this flexibility, but the British statutes have not been incorporated into the proposed company law. It is to be hoped as the Fifth Directive and the European Company Statute progress toward passage by the EEC Council and Commission they will be amended to reflect the more flexible standards of the British and American laws.

\textsuperscript{348} Id. at 69.