

Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light

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In this article, I attempt to provide a comparative historical account of the debate whether corporations and, by derivative, their managers should exclusively attempt to run the company to the benefit of shareholders, or whether they should be permitted or required to take the interests of others groups (stakeholders) into account. The comparison focuses on the US, Germany and France and includes a cursory look at the UK. The core theory of the paper is that the historical debates exhibited important differences that can be attributed to differences in stock ownership structure.

Before the backdrop of divergent ownership patterns, proponents of a strong position of management on one side, and proponents of a stronger focus on shareholder interest on the other side had to address different economic issues. In the US, Berle and Means famously identified the prevalence of a strong separation of ownership and control in 1933. US-style dispersed ownership has always generated debates about the question how to best address what is today described as an agency cost problem, but also to what extent managerial power was legitimate.

By contrast, larger blocks of share ownership prevailed around 1930 in Continental Europe, as they still do today. Participants in the German and French debates were therefore concerned with issues of controlled companies and corporate groups, which undermined the power of the board of directors. At the same time, the comparatively strong influence of shareholders raised other concerns that were rarely an issue in large US corporations, such as large shareholders benefits of control and shareholder influence and conflicts between competing groups of shareholders that arguably harmed business development. Institutional theories of the corporation, which are traditionally hospitable to stakeholder concerns, therefore were employed as a defense of the corporation against its shareholders. The different nature of the main issues put pro-management and pro-shareholder on different sides of the shareholder-stakeholder debate on the two sides of the Atlantic. Reform-oriented critics of the prevailing allocation of control advocated an institutional theory of the corporation to protect the “business as such” in Continental Europe, and by proxy, its stakeholders from destructive shareholder influence. While it was a “reformist” goal in the US to limit the power of management to the benefit of shareholders, Continental critics of the status quo sought to limit allegedly excessive shareholder influence and to strengthen management.

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1. Introduction

What is, and what should be the ultimate purpose of the corporation? What goals should directors be required and/or permitted to pursue? While there is widespread agreement that ultimately “corporate enterprise should be organized and operated to serve the interests of society as a whole”,¹ corporate law systems at least superficially diverge on how this objective can best be advanced. The conventional, although not unanimous answer in law and economics circles is that the goal should be the maximization of shareholder value, whereas the protection of the interests of other stakeholders such as employees, suppliers, costumers, local communities etc. should be left to contracts or other fields of law.²

These questions have stirred debate among scholars and practitioners in much of the developed world. Both the US and the most important Western European corporate law jurisdictions have had such debates. The participants sometimes knew about debates in other countries, sometimes they did not. Adolph Berle, for example, engaged in a famous exchange with Merrick Dodd that is typically seen as foreshadowing later shareholder-stakeholder discussions in 1932. He was aware of the work of Walther Rathenau, the forerunner of the German debate, and cited him in the seminal book he wrote with Gardiner Means.³ German scholars studying the debates have often looked to the US for inspiration during the past decades, and they sometimes tend to identify certain US positions with certain German positions.

¹ *E.g.* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 438, 441 (2001).

² Hansmann & Kraakman, *id.*, at 449.

³ ADOLF A. BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 352 (1933).

Nevertheless, there has been relatively little comparative study of these debates. The objective of this paper is to fill part of this gap. I propose that its respective national manifestations were strongly influenced by an important aspect that is stressed by modern comparative corporate governance scholarship, namely cross-country differences in corporate ownership structure: Today, the US and the UK are normally thought to be characterized by dispersed ownership, while in more or less all other countries' economies concentrated ownership persists even in most of the largest firms.⁴ While the exact time when dispersed ownership developed is far from clear,⁵ the comparative intellectual history developed in this paper reveals that ownership structure (or the ownership structure taken for granted by analysts) strongly influenced the national versions of what we would today call shareholder-stakeholder debates. Following the emergence of the large, "modern corporation" (in the words of Berle and Means⁶), scholars, policymakers and practitioners in the US and Germany, and later in France and the UK, attempted to make sense of what they observed in corporate practice, and to influence courts and legislation.

Before the backdrop of these patterns, proponents of a strong position of management on one side, and of a stronger focus on shareholder interest on the other side, had to address different economic issues. Since dispersed ownership was identified as the

⁴ According to the conventional wisdom, the US and the UK have dispersed ownership in most large firms, whereas elsewhere, concentrated ownership prevails. *E.g.* Raphael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate ownership around the world*, 54 J. FIN. 471 (1999).

⁵ Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009) (arguing that, contrary to the conventional wisdom and most other empirical evidence, dispersed ownership is not more prevalent in the US than elsewhere). It is disputed when the UK developed dispersed ownership. Most scholars believe that dispersion set some time between the 1950s and the 1980s. *See e.g.* Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 466-468 (2001); MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE 100 (2003); *but see* Julian Franks, Colin Mayer & Stefano Rossi, *Ownership: Evolution and Regulation* (2006), 29 REV. FIN. STUD. 4009 (2009) (arguing that dispersed ownership was already present in the early 20th century).

⁶ BERLE & MEANS, *supra* note 3.

dominating structure in the US in the 1930s by Berle and Means, scholars were concerned with the strong position of managers. A considerable degree of “institutional independence” of the corporation from shareholders was always seen as descriptively obvious since Berle and Means. Long before the rise of economic analysis of law and the focus on managerial agency cost in corporate law policy, the main concern resulting from this structure was whether and how managers should be constrained. Some hoped to commit them to shareholder value, while others wanted to enlist them as guardians of the interest of all corporate constituencies. Even Adolf Berle, a prominent member of the first camp who was skeptical about the aptitude of managers as guardians of a larger goal of the firm, resigned to managerial power, but hoped to constrain managers through regulation. Members of the second camp were more optimistic about managers’ ability and willingness to consider concerns beyond those of shareholder. Later analysts continued this debate, but added the additional complication of the impact of markets as a constraining force. The defining characteristic around which all debates revolve is still the power of managers. “Stakeholder” and “institutional” arguments tended to serve the purposes of corporate insiders, i.e. “strong managers”, to defend their entrenched position from assaults of outsider shareholders, or, more likely, analysts seeking reform and intending to hold managers more accountable and therefore pushing for more orientation towards shareholder value.

By contrast, larger blocks of share ownership prevailed around 1930 in Continental Europe, and they by and large persist today. Participants in historical Continental European debates therefore had to address issues of controlled companies in corporate groups. Furthermore, in the absence of an atomized shareholder structure and, in consequence, an all-powerful board of directors, the potential for conflict between compet-

ing groups of shareholders became a major concern, which, at least according to the opinion of some, impeded the creation of welfare by large corporations.

The core comparative argument of this article is a very specific one: In consequence of the difference in the relative importance of these two concerns, the “reformist” camp in the US and Continental Europe ended up on two different sides of the debate. In the US, excessive shareholder influence was obviously not an important issue. Scholars were concerned with excessive managerial power that was criticized as lacking legitimacy. Pluralist or “public interest” arguments tended to be a defense for managers (unless they were coupled with regulatory intervention⁷), while critics of the current status quo tended to be the ones emphasizing shareholder interests and assailing the managerial stronghold. By contrast, in Germany and France, analysts who sought to change the status quo by limiting the excessive influence of the apparently power-wielding group needed to constrain shareholder influence, and thus advanced theories emphasizing the “institutional” character of the corporation, which are typically more hospitable to “stakeholder” concerns. These were intended to “defend” the corporation against the effective controllers of the firm – large shareholders – in order to limit outside influence on businesses that was frequently seen as detrimental. Institutional theories of the corporation developed by scholars therefore served the purpose of defending corporations against their shareholders. The “interest of the corporate entity” – a core issue of the German and French discussions – was intended as a mechanism to balance conflicting interests and to avoid abuses, although the practical significance – at least in Germany – has probably remained rather limited. “Reformers” usually ended up on the shareholder side of the debate in the US, but on the stakeholder side in Continental Europe.

⁷ An example would be RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION (1976).

This article proceeds as follows. Section 2 sets the stage by describing the relevant modern economic theory and the stakes of the debate: Why does it matter what the goal of corporate law is, and what economic issues are affected by the controversy about the institutional or contractual understanding of the corporation? Section 3 very briefly describes the US debate (as it is well-known), but tries to contextualize it before the backdrop of dispersed ownership and collective action issues of shareholders. Section 4 provides a relatively detailed account of the historical German debate and argues that a non-atomistic ownership structure was important for its development. Section 5 does the same for France. Section 6 wraps up this article by summarizing these comparative theories and argues that developments in US law, but also English industrial democracy of the 1970s debate fit the pattern. Section 7 concludes.

2. The underlying economic conflicts of interest

2.1. Economic theory, stakeholders, and centralized management by the board of directors

In this article, I do not intend to pass judgment over the various theories and to take a strong position endorsing shareholder wealth maximization or a stakeholder view,⁸ and I also do not intend to promote any of the traditional “legal” theories about the nature of the corporation. Defining the legal nature of the corporation appears to be of little academic value. Nevertheless, legal theories cannot be completely left aside, since economic “stakeholder” theories seem to fit more closely to “institutional” legal theories of corporate law. Broadly speaking, since the 19th century corporations have been construed as “artificial entities”, “aggregates”, or “natural entities”, with each theory being

⁸ A certain sympathy for a stakeholder view informed by economics should be obvious from Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT’L L.J. 129 (2009).

identified with different political currents.⁹ While the artificial entity theory emphasizes the role of the state in creating the corporation,¹⁰ the aggregate theory focuses on the underlying contractual relationship. The natural entity theory points out the existence of the corporation outside the law, which is seen as a reflection of that social reality.

Leaving the role of the state aside, the contractual theory is more often identified with the “shareholder” position in the debate about the purpose of corporate law, whereas the entity theory is often identified with a broader objective. True, it is of course possible and perfectly sound economics to interpret the corporate “nexus of contracts” to include contractual relationships with employees, creditors, suppliers and others, but traditional contractual theories of corporate law tend to focus only on the contract between shareholders when the corporation is formed, and to view the corporation more or less as an aggregate of shareholders. Institutional theories view corporations as distinct from shareholder interests, and thus make it easier to justify limitations on shareholder actions, particularly when these harm other groups with a stake in the firm. While all theories carry some ideological baggage, they either explicitly or implicitly address certain economic issues, or at least concerns grounded in one economic theory or the other. For the objective of this article, it is not necessary that each concern is warranted; however, each of them seems to have given momentum to the debate. Given that an “entity” or institutional often coincides with a “stakeholder” view of corporate law, I will sometimes use the terms “institutionalism” and “pluralism” interchangeably.

The first motivating economic issue is of course the agency problem in the shareholder-manager relationship, which is also the single issue most strongly fueling corpo-

⁹ John C. Coates IV, *Note: State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 NYU L. REV. 806, 809 (1989).

¹⁰ A famous endorsement of the theory is *Dartmouth College v. Woodward*, 17 U.S. 518 (1819).

rate law debates in the US today. The underlying concern is that directors and officers, if left unconstrained, will, on the one hand, squander the assets firm or shift them into their own pockets through self-dealing transactions, and on the other hand, frequently just not work hard enough to achieve the best possible result for shareholders. In the nexus of contracts view that dominates the economic analysis of corporate law, the reason why shareholders deserve particular concern compares to other constituencies is the special nature of the relationship with the corporation: Since shareholders do not have explicit contractual rights, but are left with the firm's residual cash flows,¹¹ their position is most strongly at risk, in the good and the bad sense, but they also have the best incentives to monitor managers and other constituencies in order to maximize the total value of the firm.¹² If managers maximize shareholder value, it follows logically that all other constituencies will also be fully satisfied. On the other hand, the more pragmatic reason for shareholder primacy, famously brought forward by Adolph Berle, is the relative easiness of holding directors accountable to the clear objective of shareholder primacy, as opposed to the multi-faceted goal of holding them accountable to stakeholders or the wider interests of society.¹³

Contemporary stakeholder theory, informed by economics, asserts that at least the theoretical argument endorsed by shareholder primacists is a simplification with certain uses, but also important drawbacks. The underlying assertion is that not only shareholders, but also other groups in the firm, are residual claimants: employees, for example,

¹¹ FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 11 (1991).

¹² Armen A. Alchian & Harold Demsetz, *Production, Information Cost, and Economic Organization*, 62 AM. ECON. REV. 777, 781-783 (1972).

¹³ A. A. Berle, Jr., *For Whom are Managers Trustees: A Note*, 45 HARV. L. REV. 1365, 1368, 1372 (1931); See Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 731(2007) (arguing that looser accountability also hurts stakeholders with managers' loss of accountability to shareholders).

are often thought to invest in specific human capital with limited use outside of the particular firm, e.g. sets of skills that cannot easily be transported elsewhere without a transition cost (which may not only include further learning, but also moving expenses).¹⁴ Since investment of this type is costly, it will be efficient to protect employees (or other stakeholders where similar arguments apply) from “expropriation” by the group effectively controlling the firm (at least if this group is strongly mindful of the financial interests of shareholders). In this view, the attenuation of shareholder control over directors, and a divergence from shareholder primacy as a matter of the objective of directorial decision-making may be beneficial because it facilitates specific investment and the long-term development of the corporation to the benefit of all of its stakeholders.¹⁵ True, participants in historical debates about the nature and purpose of the firm were not steeped in the theory of the firm and organizational economics, but they usually thought they knew what is good for firms from academic analysis and practical experience, and, by proxy, for society, hoping that aiming at broader societal goals would be to the benefit of both.

At the same time, contemporary corporation law and economics theory sheds light on why a strong institutional understanding of the corporation was often an important aspect in historical debates. While the literature emphasized a contractual nature of the

¹⁴ See e.g. HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 26 (1996); James M. Malcolmson, *Individual Employment Contracts*, in 3 *HANDBOOK OF LABOR ECONOMICS* 2291, 2311-2337 (Orley Aschenfelter & David Card eds. 1999) (reviewing the labor economics literature on contractual protection of specific investment); Larry Fauver & Michael E. Fuerst, *Does good corporate governance include employee representation? Evidence from German corporate boards*, 82 *J. FIN. ECON.* 673, 679 (2006); Edward P. Lazear, *Firm-Specific Human Capital: A Skill-Weights Approach*, IZA DISCUSSION PAPER NO. 813 (June 2003), at <http://ssrn.com/abstract=422562> (discussing the nature of specific investment); John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 *MICH. L. REV.* 1, 74 (1986) (discussing learning about social networks within an organization); ANNALIE SAXENIAN, *REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128*, 35 (1994) (describing the geographical aspect of specific investment by quoting an engineer contrasting the difficulty of getting another job in the same industry in Texas on one hand and the easiness in Silicon Valley on the other)..

¹⁵ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 *VA. L. REV.* 247 (1999).

corporation in the early years of the law and economics movement, the importance of a strong centralized management has been emphasized by some scholars in recent years. The two main models of this type have been described as “hierarchical models”.¹⁶ The team production theory of corporate law, developed by Margaret Blair and Lynn Stout, describes the board of directors as a mediating hierarchy standing between shareholders and other corporate constituencies. Without being strongly accountable to any group (including shareholders), the board is the position to assign the rents produced by the corporation to all groups, thus permitting specific investment by everyone and allowing long-term business development by creating a nexus of specific investment.¹⁷

Another group of analysts has little sympathy for stakeholder concerns, but argues that the prominent role of the board to the exclusion of shareholder serves shareholders’ very own interest: While this argument is common among practitioners, particularly in the takeover context,¹⁸ Bainbridge provides a theoretical framework grounded in economic theory, arguing that decision-making by shareholders instead of the board would suffer from serious defects. He argues that shareholders typically agree that corporations should maximize shareholder wealth, but disagree about how to best pursue this goal. Furthermore, they suffer from collective apathy and rational ignorance, which reduces the quality of potential authoritative shareholder decisions. Thus, given the complexity corporate decision-making, he argues that it is preferable to concentrate it at the

¹⁶ Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 714-717 (2004).

¹⁷ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 288-289 (1999); see also Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q. J. ECON. 387 (1998); Bruno Frey & Margit Osterloh, *Yes, Managers Should Be Paid Like Bureaucrats*, 14 J. MGMT. INQ. 96, 99-100, 101-102 (2005); Gelter, *supra* note 8, at 136-143.

¹⁸ Martin Lipton, *Takeover Bids in the Target’s Boardroom*, 35 BUS. L. 101 (1979) (arguing that shareholders benefit from takeover defenses).

level of the board of directors, which constitutes a relatively homogeneous group of people with good information and incentive, as this will generally yield better results.¹⁹ Others have pointed out that the interests of different groups of shareholders often diverge strongly from each other, which is likely to create friction and inhibit decision-making in corporations.²⁰

This line of argument takes us back to the fundamental question why corporations are formed in the first place, and why DGCL 141(a), which grants broad authority to directors, is not a losing proposition right from the beginning. In spite of the obvious potential for agency cost that is the biggest concern for corporate law, centralized management clearly has a transaction cost advantage, as it facilitates decision-making by a relatively small group of people who (in the best case) have the information, capabilities and incentives to run the firm well. All in all, there seems to be a trade-off in corporate governance between managerial discretion and entrepreneurial action on one side, and accountability to shareholders on the others.²¹

Hierarchical theories of corporate law are characterized by a reliance on the strong position of the board of directors. Legal personality, combined with centralized management, has long been known to be an important element for the long-term development of business. An implication of these approaches is that too much influence of shareholders may be detrimental for various reasons: First, shareholder influence may, at least under certain conditions, further a myopic focus on short shareholder value maximization; this

¹⁹ Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 199 HARV. L. REV. 1735, 1744-1751 (2006).

²⁰ Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 577-593 (2006); *contra* George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, CASE RESEARCH PAPER SERIES IN LEGAL STUDIES, WORKING PAPER 09-22, 8-25 (2009), at <http://ssrn.com/abstract=1435400>.

²¹ Alessio M. Paccès, *Controlling the Corporate Controller's Misbehaviour*, RILE WORKING PAPER NO. 2009/01, 8-11 (2009), at <http://ssrn.com/abstract=1327800>.

aspect was one of the major elements of the debate about takeovers during the 1980s, where the channeling of an extractive financial interest seemed, at least to critics of the takeover wave, to result in a destruction of value through the breakup of firms, to the loss of jobs, and to a subversion of the firm's creditworthiness and the claims of prior creditors through the excessive load of debt brought about by high leverage made possible by junk bonds. Managerial apologists often argued that this seeming short term shareholder interest was misguided, and that managers had the better information to determine whether a takeover bid was in the shareholders' best interest or not. Second, the interests of different groups of shareholders may diverge *ex post*, which is why it may be in their own interest to tie their hands *ex ante* to shield the firm from disruptive conflict.

Stakeholder theorists have added the emphasis that boards of directors may, through their partially shared interest with employees, shield them against short-term interference by shareholders that is now often described as holdup in economic theory.²² Even in finance, stakeholder concerns seem to be taken more seriously than they used to be. In the latest edition of their leading finance textbook, Brealey, Myers and Allen note that “managers and employees of a firm are investors, too. ... If you give financial capital too much power, the human capital doesn't show up – or if it does show up, it won't be properly motivated.”²³ By going public, stockholders can commit “not to interfere if managers and employees capture private benefits when the firm is successful.”²⁴ Indeed, it appears that, if the firm's senior managers were completely insulated from shareholder involvement and not accountable at all (even through indirect capital-

²² OLIVER HART, *FIRMS, CONTRACTS AND FINANCIAL STRUCTURE* (1995).

²³ RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, *PRINCIPLES OF CORPORATE FINANCE* 949 (8th ed. 2006).

²⁴ BREALEY ET AL., *id.* at 949 n.36.

markets based mechanisms such as equity-based compensation or the market for corporate control), they would have no reason to favor shareholder interests over those of any other group.²⁵ They would sometimes be aligned with shareholders, sometimes with employees or others. In spite of pervasive shareholder primacy norm rhetoric, a duty to pursue shareholder interests has hardly ever been enforceable outside of situations where directors were acting in their own self-interest,²⁶ in the US and elsewhere.²⁷ In fact, employees share an interest with managers regarding issues that do not involve what could be described as theft or conflicted decision-making, but fundamental business decisions. It is crucial for them whether managers threaten to close a plant, to reduce the workforce, or just drive a hard bargain in collective negotiations with unions. While shareholders have a financial interest in shareholder value maximization, which may require such actions, managers may not share it if they prefer a “quiet life” with corporate stability and no plant closures that involve labor strife.²⁸ In particular, the debate

²⁵ This is usually thought to be the situation in a non-profit organization. See e.g. Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L. J. 835, 846-848 (1980); Edward L. Glaeser & Andrei Shleifer, *Not-for-profit entrepreneurs*, 81 J. PUB. ECON. 99 (2001).

²⁶ Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L. Q. 403, 427 (2001).

²⁷ Compare the business judgment rule in the US, which protects directors from judicial review unless they fail to gather the relevant information before deciding, act in good faith and stay clear of self-interest. See PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(c) (Am. L. Inst. 1994). Regarding the UK, see PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW, no. 16-15 (8th ed. 2008); Brian Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1401 (2006) (pointing out that judges are unlikely to second-guess business decisions even in the absence of a formal business judgment rule); regarding France, see YVES GUYON, I DROIT DES AFFAIRES, n° 459 (12th ed. 2001); regarding Italy, see Giuseppe Campana, *La responsabilità civile degli amministratori delle società di capitali*, 2000 NUOVA GIURISPRUDENZA CIVILE COMMENTATA, II, 215, 224-226; Antonio Rossi, *Art. 2392: Responsabilità verso la società*, in IL NUOVO DIRITTO DELLE SOCIETÀ 790, 796-803 (Alberto Maffei Alberti ed. 2005). German law even adopted a provision modeled on the US business judgment rule (§ 93 I 2 AktG, as amended by UMAG, September 22, 2005, BGBl I, 2802), but only after a broad managerial latitude had been already recognised by in the case law [BGH 21.4.2004, II ZR 175/95, “ARAG/Garmenbeck“ see e.g. Erich Schanze, *Directors' Duties in Germany*, 3 COMPANY, FIN. & INSOLVENCY L. REV. 286, 291 (1999)].

²⁸ Marianne Bertrand and Sendhil Mullianathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111 J. POL. ECON. 1043, 1066-1067 (2003).

about hostile takeovers suggests that employees and top management are often natural allies.²⁹

2.2. Looking beyond the US

While economic analysis of law still remains primarily an American pastime,³⁰ it has made some headway in other legal academic discourses, some ECJ cases essentially permitting regulatory competition³¹ have unleashed an avalanche of economically oriented literature about its possible effects on Europe.³² Agency cost analysis has remained predominant, possibly because of an unrelated parallel development, namely the UK-inspired trend towards “codes of good corporate governance” addressing the grievances of small investors in equally swept the Continent in the 1990s and early 2000s.³³

By contrast, the hierarchical models of corporate law have received little attention. Thinking about the underlying economic concerns of Continental European corporate law academics around 2000, this is maybe not surprising. The policy goal that began to

²⁹ E.g. Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 120-122 (1987); M. Pagano & P.F. Volpin, *Managers, Workers, and Corporate Control*, 40 J. FIN. 841, 865 (2005) (“managers and workers are natural allies against a takeover threat”); see also Jordi Surroca and Josep A. Tribó, *Managerial Entrenchment and Corporate Social Performance*, 36 J. BUS. FIN. & ACCT. 748 (2008).

³⁰ Nuno Garoupa & Thomas S. Ulen, *The Market for Legal Innovation: Law and Economics in Europe and the United States*, 59 ALA. L. REV. 1555 (2008); Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*, 31 HASTINGS INT’L & COMP. L. REV. 295 (2008).

³¹ Centros Ltd v. Erhvervs- og Selskabsstyrelsen, Case C-212/97, [1999] E.C.R. I-1459; Überseering BV v. Nordic Construction Company Baumanagement GmbH, Case C-208/00, [2002] E.C.R. I-9919; Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, Case C-167/01, [2003] E.C.R. I-10155.

³² E.g. STEFANO LOMBARDO, *REGULATORY COMPETITION IN COMPANY LAW IN THE EUROPEAN COMMUNITY* (2002); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT’L L. 477 (2004); Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259 (2004); John Armour, *Who Should Make Corporate Law? EU Legislation versus Regulatory Competition*, 58 CURRENT LEGAL PROBS. 369 (2005); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law: Perspectives on European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3, 43-48 (2005); Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247, 253-264 (2005).

³³ See e.g. Ruth V. Aguilera & Alvaro Cuervo-Cazurra, *Codes of Good Governance*, 17 CORP. GOV 376 (2009).

dominate the debates was attracting investment by international institutional investors. However, in spite of changes in some Continental corporate governance practices, e.g. the cautious withdrawal of German banks from extensive share ownership in industrial firms,³⁴ concentrated ownership structures have by and large remained in place. Thus, while German law on the books provides a similarly insulated position of board members as US corporate generally does, in practice the position of board members is rather weak vis-à-vis powerful shareholders in the Contemporary European world of corporate governance. Implicitly, both team production theory and director primacy theory rest on another variable that are not mentioned by their proponents, namely dispersed ownership that impedes direct shareholder involvement in managerial decision-making. While hierarchical theories therefore seem to provide a good fit for an important subset of US publicly traded corporations, they have substantial problems in Continental Europe, where large shareholders continue to exert considerable control over management even in firms comparable in size to the largest American ones.³⁵ Hierarchical models of corporate almost do not work well, if at all, in firms with controlling shareholders, at least not without modification.³⁶ In a situation where managers are de facto always subjected to a risk of being replaced by a controlling shareholder, it is obvious that they will be inclined

³⁴ E.g. Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 AM. J. COMP. L. 497, 502-503 (2001).

³⁵ See eg Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership around the World*, 44 J. FIN. 471 (1999); Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Marco Becht & Alisa Röell, *Blockholdings in Europe: An international comparison*, 43 EUR. ECON. REV. 1049 (1999); ROE, *supra* note 5, at 100; Mara Faccio & Larry H.P. Lang, *The ultimate ownership of Western European Corporations*, 65 J. FIN. ECON. 365 (2002); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy*, 119 HARV. L. REV. 1641, 1645 (2006) (summarizing the empirical evidence); *but see* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009) (arguing that, contrary to the conventional wisdom and most other empirical evidence, dispersed ownership is not more prevalent in the US than elsewhere).

³⁶ Cf. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 909 (2005).

to please him to avoid eviction.³⁷ When there is no single controlling shareholder, but a number of blockholders in (potentially) controlling or changing coalitions, managers and directors are likely to want to please these. In a stakeholder theory framework, shareholders would have to provide stakeholders with a reason why they would not have an incentive to harm them.³⁸ The theory's applicability is also undermined in a dispersed ownership setting when managers have a strong incentive to maximize shareholder wealth. Given these factors, I have elsewhere suggested that laws strengthening the position of employees in the firm may be more desirable from an efficiency perspective in countries with concentrated ownership than in ones with dispersed ownership.³⁹

In Continental Europe, “institutional” theories of the corporation, which emphasize the independent role of the corporation from its shareholders, dominated corporate law scholarship over many decades (at least until 1990).⁴⁰ In this paper, I advance the theory that an institutional theory of the corporation had a function going beyond that in the US: In the US, the to some degree independent nature was largely taken for granted, given the strong position of the board of directors in the largest part of corporation, in which scholars were interested. By contrast, in the German theory, at least when you look at the 1930s debate, the institutional theory served as a defense of the firm against its shareholders.⁴¹ A similar pattern emerges in France. The reason, I argue, is that Continental European firms never developed an “atomistic” share ownership pattern as the

³⁷ E.g. Gérard Charreaux & Philippe Desbrières, *Corporate Governance: Stakeholder Value versus Shareholder Value*, 5 J. MGMT. & Gov. 107, 116 (2001).

³⁸ Gelter, *supra* note 17, at 154-168, 168-176.

³⁹ Gelter, *supra* note 17.

⁴⁰ See e.g. Philipp Klages, *The Contractual Turn: How Legal Academics Shaped Corporate Law Reforms in Germany*, at <http://www.mpifg.de/people/kg/downloads/Contractual%20Turn.pdf> (suggesting that “corporatist” arguments have been outcompeted by “contractarian” arguments since about 1990). I am not aware of a similar sociological study in France, but the trend seems to have been similar.

⁴¹ Compare Baird & Rasmussen, *Anti-Bankruptcy* about parallel structure of debt and anticommons problem in recent bankruptcies.

US did. Scholars advancing such theories were concerned with the containment of shareholders because of their disruptive effects on corporate activity.

3. Strong managers, weak owners: contextualizing the historical US debate

The US debate is very well known and can therefore be kept short here, but it needs to be contextualized for the comparative objective of this paper. US corporate governance is (almost) unique given the prevalence of dispersed ownership structure of most large US firms, which, I argue, shaped the debate. Since Berle and Means, scholars have perceived large firms dominated by managers. A large degree of institutional independence was therefore seen as self-evident. As I try to show in this section, the concern of the participants in the debate was therefore mostly whether and how managerial power needed to be curbed (obviously this opinion was not unanimously held).

While the case law on the famed shareholder primacy norm – on which we will get back in section 6 – has been characterized by disputes in controlled corporations, the model that has captured the imagination of scholars has always been that of the large, publicly traded firm. The cornerstones of academic paradigm set by the Berle-Dodd debate of the 1930s. In the course of finalizing the seminal treatise “The Modern Corporation and Private Property”⁴² that he was writing with the economist Gardiner Means, Adolf A. Berle published an article in the Harvard Law Review emphasizing the fiduciary position of directors and analogizing from trust law to corporate law. Having empirically studied the separation of ownership and control and identified what we would now call agency problems, he argued for great judicial discretion to police conduct by managers.⁴³ His

⁴² BERLE & MEANS, *supra* note 3.

⁴³ Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

original concern was not at all the relationship between a firm and non-shareholder constituencies, but chiefly the protection of shareholders against management and particularly their equal treatment in issues such as preemptive rights and dividend payments. Merrick Dodd, another luminary of corporate law at that time, argued against Berle's suggestion that stockholders should be considered the sole beneficiaries of corporate activity, as large corporations had become the subject of public interest and developed a life and a responsibility of their own as a going concern.⁴⁴ As distant stockholders would hardly become subject to "a professional spirit of public service",⁴⁵ the board had discretion to act also in favor of other interests would be more socially desirable. Managers should not be seen as fiduciaries of shareholders, but rather of the corporation as an institution instead of its members.⁴⁶ Berle promptly rebutted Dodd's critique, arguing that private property was an essential element of American society, providing income streams in times of old age, childhood and sickness. If management were not strictly accountable to passive proprietors, the problem of management furthering primarily its own interest (to the detriment of everyone) would be exacerbated.⁴⁷ However, in 1954 Berle conceded that Dodd's point of view had prevailed.⁴⁸

Reading the last chapters of Berle and Means' work, Berle seems to have modified his position as early as 1932. The two authors speculate that corporate law may be moving toward a new concept, in the course of which the owners of the firm would lose full control over the corporation, to the benefit of "the paramount interests of the commu-

⁴⁴ E. Merrick Dodd, Jr., *For Whom Are Managers Trustees?* 45 HARV. L. REV. 1145 (1931).

⁴⁵ Dodd, *id.*, at 1153. In some sense this seems to resemble Elhauge's recent argument that distant shareholders are not as much subject to social pressures as they should be, whereas managers are. 33

⁴⁶ Dodd, *id.*, at 1162-1163.

⁴⁷ Berle, *supra* note 13, at 1365.

⁴⁸ ADOLF A. BERLE, *THE 20TH CENTURY CAPITALIST REVOLUTION* 169 (1954); see also Adolf A. Berle, *Foreword*, in *THE CORPORATION IN MODERN SOCIETY* ix, xii (Edward S. Mason ed. 1959).

nity”, allowing “corporate leaders” to “set forth a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profit from the owners.”⁴⁹ Berle almost seems to join Dodd here. One possible conclusion might be that Berle’s position was simply inconsistent, or that the chapter reflected Gardiner Means’ position more strongly.⁵⁰

Bratton and Wachter’s recent attempt to understand the debate before the background of political struggles surrounding the New Deal provides an interesting interpretation. They argue that Berle and Dodd were adherents of different varieties of corporatism that were endorsed by different groups of pundits vying for the attention of presidential candidate (and later president) Franklin D. Roosevelt.⁵¹ While reformers in both camps agreed that more centralized planning was needed to avoid the excesses of the capitalist system that had brought about the crisis, they differed on important details. The “business commonwealth” camp, some of whose representatives Dodd cites in his article, favored planning on the industry level, with powerful managers taking a prominent role. The progressives, who went on to prevail in the early years of the Roosevelt administration, favored government planning and a significant role of unions. Berle was a partisan of this group and played a prominent role in the planning of the New Deal.⁵² When Berle’s rebuttal to Dodd came out, his work with Means was in its final stages, and he had already transformed from his earlier incarnation as an analyst of corporate law doctrine into a New Deal progressive. While he did not disclose these new goals in

⁴⁹ BERLE & MEANS, *supra* note 3, at 355-356.

⁵⁰ See William W. Bratton, *Berle and Means Reconsidered at the Century’s Turn*, 26 J. CORP. L. 737, 761-762 (2001); Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought*, 30 L. & SOC. INQ. 179, 205-209 (2005).

⁵¹ William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and the Modern Corporation*, UNIVERSITY OF PENNSYLVANIA LAW AND ECONOMICS RESEARCH PAPER NO. 07-24, 27-29 (2007), at <http://ssrn.com/abstract=1021273>.

⁵² Bratton & Wachter, *id.*

his rebuttal, his argument is, at its core, based on the idea that the elimination of the fiduciary obligation of management to shareholders would endow them with undesirable absolute power.⁵³ Seen in the light of Dodd’s adherence to the pro-management camp in the political debate, Berle’s opposition to a broader duty of managers within corporate law seems consistent with both his earlier articles and his work with Means. He believed that, absent regulation, a strict duty to shareholders was the best check on managerial power, and Berle and Means were not only concerned with the separation of ownership from control, but maybe even more with the concentration of economic power in the hands of a few.⁵⁴ Acknowledging the suggestion of a corporation serving the community on its own accord to be utopian, they suggested that the implementation of a “communitarian” conception of the corporation would first require a “convincing system” to be worked out, in which the problem of “too many principals” (as we might say today) would be resolved.⁵⁵

In his later work, Berle acknowledged that Dodd’s position had been proven right in the end (even on normative grounds), arguing that the managerial class should accept the responsibility resulting from power; if they would not, America was likely to become more statist, as government would have to step in.⁵⁶ Bratton and Wachter explain that for Berle, Dodd’s position had not been right at the time of its publication in 1932, but had become the right answer only as a result of the New Deal regulatory state. Under the new system, a large part of the economy was subject to regulation, in which public policy was able to shape managerial action.⁵⁷ In 1962, Berle affirmed his belief that, for

⁵³ Berle, *supra* note 13, at 1367.

⁵⁴ Tsuk, *supra* note 50 (pointing out this aspect of Berle and Means).

⁵⁵ BERLE & MEANS, *supra* note 3, at 356.

⁵⁶ BERLE, *supra* note 48, at 172-173.

⁵⁷ Bratton & Wachter, *supra* note 51, at 39-40.

this reason, managers were more to be trusted to live up to the necessarily high standards in their powerful function in 1962 than they were in the late 1920s.⁵⁸

For the objective of this paper, the most important point is that both Berle and Dodd were making their point before the backdrop of powerful management and passive investors. The subsequent corporate law subsequent debate never completely stopped, but it remained within the path prepared by the Berle-Dodd exchange. Analysts differed whether managers were part of the problem and needed to be constrained, or whether they were part of the solution and deserved more discretion. By and large, analysts, including Berle, resigned to managerial power given the circumstances, but offered few alternatives. If they did, they were grounded rather in regulation than in corporate law.⁵⁹ Managerial power came to be seen as an inevitable technological and organizational development, as shown by Alfred Chandler's famous historical account, who credited the rise of the managerial class for the development of the large firm and its success.⁶⁰ John Kenneth Galbraith argued that the firm's "technostructure", composed of managers and other leading groups in the corporation, resulted in a situation where it led a life on its own, distant from the shareholder.⁶¹ Galbraith had no particular prescription for corporate governance and, maybe typical for this period, acknowledged that the goal of the firm was in practice no longer profit maximization (as neoclassical producer theory had assumed), but growth and market share. Shareholders seemingly were of little concern,

⁵⁸ Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 437 (1962).

⁵⁹ A.A. BERLE, JR., POWER WITHOUT PROPERTY 107-110 (1959); see also Abram Chayes, *The Modern Corporation and the Rule of Law*, in THE CORPORATION IN MODERN SOCIETY 25, 40-41 (Edward S. Mason ed. 1959) (arguing that the voiceless position of shareholders is in fact deserved, as they are sufficiently protected by disclosure requirements).

⁶⁰ ALFRED DUPONT CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977); see also Edward S. Mason, *Introduction*, in THE CORPORATION IN MODERN SOCIETY 1, 9-10 (Edward S. Mason ed. 1959).

⁶¹ JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE (1st ed. 1967; 4th ed. 1985; reprint 2006).

and the stock price was of some minor psychological importance at best.⁶² Some scholars even believed shareholder voting rights to be so unimportant that they considered their abolition.⁶³

It seems that the typical view of this period to “abuses” of power would have been government intervention: Berle argued that the legitimacy of the power of self-perpetuating managers was the public consensus,⁶⁴ and Eugene Rostow suspected that excessive use of managerial power for political goals might trigger legislative reactions.⁶⁵ William Cary’s critique of the purported “race to the bottom”⁶⁶ can be understood as part of the same trend, as can be Ralph Nader et al.’s attempt to “tame the giant corporations” by introducing federal chartering.⁶⁷ Milton Friedman’s famous 1970 essay against corporate social responsibility⁶⁸ seems to have represented a minority opinion during that period. In any case, the most important overall concern characterizing the debate of that time was not shareholders, but the absence of compelling legitimacy of managerial power that was thought to go beyond the economic sphere.⁶⁹ All of these scholars shared a concern about striking the right balance in the regulation of management activity primarily with a view to the shareholder-manager relationship. With the development of the law and economics movement in the 1960s and 1970s, markets (including capital markets, product markets, and the market for managerial labor) were

⁶² Berle, *supra* note 58, at 446.

⁶³ Chayes, *supra* note 59, at 151; Bayless Manning, *Review of Livingston: The American Stockholder*, 67 YALE L. J. 1477, 1490-1493 (1958).

⁶⁴ BERLE, *supra* note 59, at 109-110.

⁶⁵ Eugene V. Rostow, *To Whom and For What Ends is Corporate Management Responsible?* in THE CORPORATION IN MODERN SOCIETY 46, 68 (Edward S. Mason ed. 1959).

⁶⁶ William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974).

⁶⁷ NADER ET AL., *supra* note 7. See particularly *id.*, at 75 (“in nearly every large American business corporation, there exists a management autocracy”).

⁶⁸ Milton Friedman, *The social responsibility of business is to increase its profits*, NEW YORK TIMES, SUNDAY MAGAZINE, Sept. 13, 1970, at 17.

⁶⁹ *E.g.* Mason, *supra* note 60, at 5-9; Rostow, *supra* note 65, at 60.

recognized as an additional constraint on managerial decision-making.⁷⁰ This, however, did not change the fundamental nature of the conflict of interest between atomistic shareholders and strong managers that analysts were preoccupied with.

This brief account of the debate up to about 1970s shows one important pattern: quite unsurprisingly in light of the prevailing share ownership patterns, the issue at hand remained whether and how to constrain powerful managers. Shareholder primacy was typically seen as a method of constraining them, while the stakeholder argument that was most strongly identified with Merrick Dodd served as a defense against this constraint.

4. A Continental contrast: German block ownership and the role of the theory of the “*Unternehmen an sich*” (business as such)

In the comparative corporate governance literature, the German corporate governance system is almost notorious for its focus on stakeholder interests.⁷¹ The main reason most scholars would give today is codetermination on German supervisory boards, which creates a limited, but significant influence of employees on managerial decision-making but granting them a number of seats on the supervisory board.⁷² A cautious version of codetermination was introduced in the early years after World War I, but abolished by the Nazis.⁷³ Codetermination was reintroduced initially after World War II, with a particularly strong version in the coal and steel industry, partly because it was thought

⁷⁰ For an important early contribution see Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

⁷¹ Hansmann & Kraakman, *supra* note 1, at 444-446.

⁷² See e.g. Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in EMPLOYEES AND CORPORATE GOVERNANCE 163 (Margaret M. Blair & Mark J. Roe eds. 1999); Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure*, in THE ANATOMY OF CORPORATE LAW 33, 63-64 (Reinier Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda & Edward B. Rock 2004).

⁷³ KNUDSEN, *supra* note 326, at 32; Pistor, *id.* at 166; Otto Kahn-Freund, *Industrial Democracy*, 6 INDUS. L. J. 65, 83-84 (1977) (describing it as a “half-hearted scheme”).

to keep business power in check as a response to large firms' cooperation with the Nazis.⁷⁴ Furthermore, iron and steel codetermination may have helped to appease the allies, who otherwise might have dismantled key German industries in the years following World War II.⁷⁵ The "regular" codetermination scheme of one third of employee representatives on the board of firms with more than 500 employees was supplemented by a system of quasi-parity codetermination in the largest German firms in a 1976 law, which applies in firms with more than 2000 employees and grants employees equal representation.⁷⁶

It is less well known that German corporate law has long been dominated by an understanding of the corporation as an entity distinct from shareholders and the idea of an "interest of the firm" or "of the business." The theoretical underpinnings go back to an academic debate of the 1920s and early 1930s. The 1937 corporate law, which was partly characterized by Nazi skepticism to the influence of capital, clearly moved towards this concept of the corporation, although its initial adherents were located in a very different position in the political spectrum. However, the Nazis were not favorably disposed toward labor representation, either, but sought to create strong leadership in corporations that was independent from both interest groups, an idea for which even US corporate law served as one source of inspiration.

The 1937 Act remained in place after the war was further developed into the 1965 act that is still in force today (of course with many amendments). German scholars have generally argued that the 1937 enactment was much less a product of fascist ideology (otherwise it could hardly have had the legitimacy to remain in place after 1945), but was

⁷⁴ KNUDSEN, *id.*, at 33.

⁷⁵ Pistor, *supra* note 72, at 167.

⁷⁶ Pistor, *id.*, at 168-175. However, it is important to note that in the case of a tied vote, the vote of the chairman, who is invariably a shareholder representative, is decisive.

largely the result of the ongoing debates of the Weimar Republic, for which the idea of the “business as such” played an important role. I argue that the theory of an “independent interest” of the firm, which began to lose support only during the 1990s, was not merely a social or economic reflection of de facto powerful managers after the managerial revolution, but to a stronger degree intended a defense against the interference of shareholders and the problems that were often thought to be the result of it and often seen as detrimental. Differences in ownership structure and the role of shareholders therefore had an impact on the development of the debate and ultimately on the law.

4.1. In the realm of majority shareholders

One might feel tempted to trace the German proclivity to an institutional theory of the corporation and stakeholder orientation to 19th century legal theory. However, while Otto von Gierke’s espousal of a natural entity theory of the firm near the end of the 19th century⁷⁷ is well known, the roots of a German “stakeholder theory” are more recent. Legal policy remained steeped in economic liberalism in the late 19th and the early 20th century, and the law continued to emphasize shareholders’ ownership of the corporation, as a result of which shareholders retained complete control over corporate matters during that period.⁷⁸ The *Reichsgericht* (then the German Supreme Court), opined in a 1904 decision:

“The corporation is not a self-serving estate of property; it is its designation to work for shareholders and to reassign its assets to them, during its existence in the form of profits, after its dissolution by means of distribution.”⁷⁹

⁷⁷ OTTO GIERKE, *DAS DEUTSCHE GENOSSENSCHAFTSRECHT* (1868).

⁷⁸ Wolfgang Hefermehl & Johannes Semler, *Verfassung der Aktiengesellschaft: Vorbemerkung*, note 10-11, in *MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, BAND 3* (2nd ed., Bruno Kropff & Johannes Semler eds, 2003).

⁷⁹ RGZ 59, 423, 425 [own translation].

The context of this statement is peculiar: The founding shareholders had orally agreed to proportionally reimburse the corporation for the administrative costs of incorporation, but the appellate court had refused to enforce the promise against the minority shareholder. The *Reichsgericht* was merely stating that the value of the corporation would rise as a result of the payment, from which shareholders, as the owners, would benefit accordingly. Thus, the promise should not be qualified as a gift, which would have required notarization to be enforceable. While the court was clearly following a contractarian understanding of the corporation, the decision's significance should probably not be exaggerated. The application of contractual theory was even more apparent in a number of subsequent decisions on majority-minority conflicts, in which the court failed to follow the minority's argument that the decisions of the majority in the shareholder meeting harmed the corporation. In the Hibernia case, the majority – a number of banks had decided to issue preferred shares (without preemptive rights) in order to prevent the Prussian government – the minority plaintiff – from gaining control, the court held that

“the majority of share ownership decides about the administration of the corporation and about what is to be done or not to be done in the interest of the corporation and its shareholders.”⁸⁰

Similar statements were found in other opinions,⁸¹ and as late as 1920 the *Reichsgericht* explicitly stated (in another case on the exclusion of preemptive rights) that majority decisions define the “interest of the corporation.”⁸²

⁸⁰ RGZ 68, 235, 246.

⁸¹ RGZ 68, 314, 317; RGZ 85, 170, 172.

⁸² RGZ 107, 67, 71. On these decisions, see FRANK LAUX, DIE LEHRE VOM UNTERNEHMEN AN SICH 37-38 (1998).

4.2. The dark origins of German pluralism

These cases strongly smack of majority-minority conflicts and not of shareholder-stakeholder ones (the second having a peculiar political slant). The same is true for important aspects of the famous debate about the concept of the “enterprise as such” (*Unternehmen an sich*) during the Weimar Republic, which is usually cited as the origin of the movement towards what we might call stakeholder orientation today. The most important antecedent of the debate was Walther Rathenau, who published a booklet about the state of affairs of corporations in 1917 (“Vom Aktienwesen”).⁸³ Rathenau was not a legal scholar, but an industrialist, social theorist, and politician.⁸⁴ Describing how German corporations had been transformed from ventures of a small number of business partners into truly great enterprises during the past decades, and how family ownership was disappearing,⁸⁵ he addressed various corporate governance issues such as the role of the members of the supervisory board. Corporate law, he argued, had not been able to keep up with progress. His main concern, however, was apparently interference from shareholders. To some extent his treatment of shareholder involvement seems odd to a modern reader schooled in thinking about corporate governance in terms of ownership structures and the connected agency problems. He did not distinguish between blockholders and dispersed investors, but between long-term shareholders expecting an adequate yield on their investment and speculators seeking short-term capital gains.⁸⁶ Rathenau was preoccupied mainly with the latter group and denounced,

⁸³ WALTHER RATHENAU, *VOM AKTIENWESEN. EINE GESCHÄFTLICHE BETRACHTUNG* (1917). For good overviews see e.g. ADOLF GROSSMANN, *UNTERNEHMENSZIELE IM AKTIENRECHT* 141-143 (1980); ARNDT RIECHERS, *DAS “UNTERNEHMEN AN SICH”* 7-10 (1996).

⁸⁴ He was politically affiliated to the liberal *Deutsche Demokratische Partei* (German Democratic Party) and assassinated by right-wing extremists while serving as foreign minister in 1922.

⁸⁵ RATHENAU, *id.*, at 7-13, 23-25.

⁸⁶ RATHENAU, *id.*, at 26.

for example, that corporate law no longer required a minimum time period of stock ownership before a shareholder was entitled to vote.⁸⁷ He also complained that legal scholars, courts and newspapers frequently exhorted managers to follow the wishes of the shareholder meeting.⁸⁸ In spite of being an advocate of democracy in the political arena, he pointed out that even democratic states typically do not allow parliament to vote on each and every issue, but delegate day-to-day activities to a smaller group of people.⁸⁹ Hypothesizing that the shareholders of Deutsche Bank could vote to liquidate the firm, he argued that the government could not allow this to happen and would surely interfere by passing a special law.⁹⁰ He did not clarify why the firm's assets should be worth more than the stock price, so that it would pay for shareholders to vote for such a proposal and invest the proceeds in government bonds;⁹¹ however, in this context he made his famous connection between corporate law and the public interest, suggesting that that large firms were an important factor in the national economy, whose significance exceeded private interests by far.⁹²

While much has been made of this reference,⁹³ Rathenau's booklet rather gives the impression of a director complaining about annoying shareholders than that of one developing an economic or social theory. Haussmann, Rathenau's most frequently cited

⁸⁷ RATHENAU, *id.*, at 29.

⁸⁸ RATHENAU, *id.*, at 34.

⁸⁹ RATHENAU, *id.*, at 59.

⁹⁰ RATHENAU, *id.*, at 39. Landsberger, writing in 1932, sees Rathenau's prediction as confirmed in view of government intervention in favor of banks during the global economic crisis. See Herbert Landsberger, *Der Rechtsgedanke des „Unternehmens an sich“ und das neue Aktienrecht*, 7 ZENTRALBLATT FÜR HANDELSRECHT 79, 82 (1932).

⁹¹ Theoretically, such a theory might have arisen if the government had pressured Deutsche Bank e.g. into extending unprofitable loans. Rathenau discusses this possibility in the context of the war economy, which may explain the particular concern for the public interest.

⁹² RATHENAU, *id.*, at 38.

⁹³ See Oskar Netter, *Zur aktienrechtlichen Theorie des „Unternehmens an sich“*, in Festschrift Herrn Rechtsanwalt und Notar Justizrat Dr. Jur.H.C. Albert Pinner zu seinem 75. Geburtstag 507, 547-550 (Deutscher Anwaltsverein, Berliner Anwaltsverein & Firma Walter De Gruyter & Co. eds. 1932) (criticizing Haussmann for exaggerating Rathenau's communitarian ideas).

critic, explained that his classification of shareholders and his focus on speculative investors with his personal experience at AEG, the German equivalent to GE founded by Rathenau's father. In that company, management indeed faced "an unspecified multitude of shareholders without a particular majority group."⁹⁴ Hausmann criticized that Rathenau gave insufficient consideration to the role of large shareholders, while in reality firms with majority groups were more common.⁹⁵ In a longer book published in 1918 ("Von kommenden Dingen"), in which Rathenau summarized his social, political and economic visions, he described how large corporations were turning into "institutions resembling the state"⁹⁶ He suggested that the "joy of creation" was already overshadowing the desire for financial profit, and that the "official idealism identical with that prevailing in public service" dominated.⁹⁷ It may well have been this highly optimistic view of both management and public service that encouraged his hopes that autonomous corporations, standing between the private sector and the state, could become a building block of the post-capitalist society he was expecting to develop.⁹⁸

At first glance it might seem that Rathenau, the publication of whose 1917 booklet is often seen as a defining moment for the German debate (i.e. comparable to the role of the Berle-Dodd debate in the US), cannot easily be placed into the theory of this article, given the apparent assumption of a dispersed ownership structure. However, it is indeed typically Continental, as the dispersed ownership structure described by Rathenau is not

⁹⁴ FRITZ HAUSSMANN, VOM AKTIENWESEN UND VOM AKTIENRECHT 20 (1928). Hausmann uses the term "AEG type" to describe firms that we might call "Berle-Means" type firms today. It is possible that hyperinflation had led to increased ownership concentration in the early 1920s. *Infra* notes 112-114 and accompanying text. Before this backdrop, Netter's assessment that Rathenau wanted to protect the majority from the minority does not seem accurate. See Netter, *id.* at 552.

⁹⁵ HAUSSMANN, *id.*, at 26.

⁹⁶ WALTHER RATHENAU, VON KOMMENDEN DINGEN 143 (1918). Other than his booklet on corporate law, this work was also translated into English and cited by Berle and Means. See WALTHER RATHENAU, IN DAYS TO COME 121 (transl. Eden & Cedar Paul 1921).

⁹⁷ RATHENAU, VON KOMMENDEN DINGEN, *id.* at 144-145; RATHENAU, IN DAYS TO COME, *id.*, at 122-123.

⁹⁸ RATHENAU, VON KOMMENDEN DINGEN, *id.* at 146-150; RATHENAU, IN DAYS TO COME, *id.*, at 124-128.

entirely the atomistic version encountered by Berle and Means, where shareholders are purely passive, but a German variety, where they are not. His concern was clearly not excessive managerial power, but the intervention of shareholders (both the majority and the demands of investors), for example by requesting dividends, thus depleting liquidity. Managers had to make concessions to these demands. While Berle, Dodd and other Americans were discussing the extent of managerial power and whether to constrain them, Rathenau's concern was how to protect the company and its business activity from shareholders. Within the framework of the US debate, one might be inclined to group him with scholars defending the powerful role of management.⁹⁹ However, given his focus on public policy in his second book, he should better be classified as close to social planners such as Berle after the New Deal. However, this aspect of his work was not the one that primarily influenced the debate among *legal* commentators advancing an institutional theory of the corporation.

Among these, Haussmann was the first who addressed Rathenau's theories and coined the term "*Unternehmen an sich*." He used it to describe how he understood Rathenau,¹⁰⁰ criticizing him and other economic theorists, including John Maynard Keynes, who had suggested that large corporations tended towards "self-socialization" in a lecture given in Berlin in 1926.¹⁰¹ Haussmann studied the major conflicts of interest within firms and argues that, while the interests of the controlling shareholder typically coincide with that of the "business as such", the main conflict being the one between

⁹⁹ E.g. Stephan M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006); *contra* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

¹⁰⁰ RIECHERS, *supra* note 83, at 16.

¹⁰¹ JOHN MAYNARD KEYNES, DAS ENDE DES LAISSEZ-FAIRE: IDEEN ZU VERBINDUNG VON PRIVAT- UND GE-MEINWIRTSCHAFT 32-33 (1926); JOHN MAYNARD KEYNES, THE END OF LAISSEZ-FAIRE 42-43 (1926) (German and English publication of this lecture); see HAUSSMANN, *supra* note 94, at 30. Keynes was in fact describing the weak position of shareholders in large firms, in which case management was no longer promoting maximum profits for shareholders, but able to relegate them to receiving "adequate dividends."

large shareholders and transient investors.¹⁰² His legal argument did not rest on the “business as such”, as he argued that the corporation was not an end in itself, but on the “collective interest of shareholders.” He suggested that shareholders were tied to this interest, which should be used to provide the decisive balance in cases of conflicts.¹⁰³

Other legal writers, however, viewed the concept of an independent interest of the corporation more favorably, such as Oskar Netter, who espoused the theory of the *Unternehmen an sich* as a legal theory rooted in the real life of corporations.¹⁰⁴ Shares held by the firm’s management – a controversial issue during the Weimar Republic – should be deemed permissible unless they were not used to convey special advantages to the controllers to the detriment of the corporation.¹⁰⁵ The use of voting rights by shareholders should be limited by the duty of loyalty, he argued, which is tied to the interest of the corporation; the duty of loyalty thus implied recognition of the principle of the “business as such”.¹⁰⁶ This interest should also be the measure in majority-minority conflicts about the firm’s business policies,¹⁰⁷ and in disputes about the extent to which the firm should be permitted to withhold dividends from distribution.¹⁰⁸ Similarly, Landsberger argued that the corporation had developed into an independent organization, thereby establishing the *Unternehmen an sich* as a real-world fact to be reflected by the law.¹⁰⁹ The business organized as a corporation thus was therefore to be considered a purpose in itself, and the underlying legal principle a factor needed to balance the inter-

¹⁰² HAUSSMANN, *id.*, at 52-54.

¹⁰³ Fritz Haussmann, *Gesellschaftsinteresse und Interessenpolitik in der Aktiengesellschaft*, 30 BANK-ARCHIV 57, 64-65 (1930). For a description of the development of his views, see RIECHERS, *supra* note 83, at 21.

¹⁰⁴ Netter, *supra* note 93, at 583.

¹⁰⁵ Netter, *id.*, at 587.

¹⁰⁶ Netter, *id.*, at 592.

¹⁰⁷ Netter, *id.*, at 596-599.

¹⁰⁸ Netter, *id.*, at 600-602.

¹⁰⁹ Landsberger, *supra* note 90, at 84, 88.

ests of “providers of capital, owners, proprietors of influence”, who “even where they possess a majority, are pitted against the interest of the totality of shareholders, which is recognized as a legal person by the law.”¹¹⁰ Landsberger, who cited Gierke’s theory as a basis for his, argued that the point of the theory is simply to emphasize the importance of the entirety of shareholders, as opposed to their individual interests; stability of the corporation was the key, also in view of the public significance of the firm.¹¹¹

The Weimar period saw an intense discussion about the term that extended beyond the handful of authors referred to here. While the idea of managerial independence had adherents in socialist circles, it served business interests as well. The hyperinflation period of following World War I had facilitated the acquisition of large ownership shares and changes in the prevailing majorities due to the redistributive effects of inflation, and possibly because the prices of stocks did not grow as fast as inflation.¹¹² This helped in particular foreign acquirers, which caused concern about excessive foreign influence (*Überfremdung*).¹¹³ While the development of ownership structure during that period is not clear,¹¹⁴ managers and controlling shareholders therefore began to entrench their positions through issuing multiple-vote shares or shares to a trustee of the corporation, typically banks, which increased the influence of these institutions on industrial firms.¹¹⁵

¹¹⁰ Landsberger, *id.*, at 86.

¹¹¹ Landsberger, *id.*, at 87-88.

¹¹² Heinz-Dieter Assmann, in 1 GROSSKOMMENTAR AKTIENGESETZ, *Einleitung*, comment 131 (Klaus J. Hopt & Herbert Wiedemann eds. 1992); LAUX, *supra* note 82, at 127.

¹¹³ Curt Eduard Fischer, *Rechtsschein und Wirklichkeit im Aktienrecht*, 154 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 85, 101 (1955); Assmann, *id.*; Gerald Spindler, *Kriegsfolgen, Konzernbildung und Machtfrage als zentrale Aspekte der aktienrechtlichen Diskussion in der Weimarer Republik*, in 1 AKTIENRECHT IM WANDEL 440, note 17 (Walter Bayer & Mathias Habersack eds. 2007).

¹¹⁴ Caroline Fohlin, *The History of Ownership and Control in Germany*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 223, 229 (Randall K. Morck ed. 2005).

¹¹⁵ See e.g. Assmann, *supra* note 112, at 133; Fohlin, *id.* at 262-263; Spindler, *id.* notes 21-50.

Curt Fischer¹¹⁶, viewing the debate on the *Unternehmen an sich* in retrospect after World War II, criticized the erosion of individual rights of shareholders and disclosure duties, while divergences from the one-share-one-vote principle increased, so that large shareholders' became more entrenched and powerful.¹¹⁷ The opinions voiced in the course of the debate were highly diverse, and the same is true for its academic assessment in later decades. While some argued that its purpose was to legitimize the power of managers and the group of shareholders supporting it,¹¹⁸ others suggested that the point was rather to empower directors, who had no particular interest in shareholder profits, to advance "general economic concerns".¹¹⁹

While all of these readings seem well-founded in some aspect of the complex debate, for the comparative objective of this article it is necessary to focus on another one that seems not to have received a lot of attention, namely the role of ownership structure. To that end, it is necessary to focus on distinctions between Rathenau and the legal writers of the late 1920s and 1930s, who had a different background and different objectives. Rathenau did not believe he had much to say about corporate law and merely observed the separation of ownership and control, much as Berle and Means did in the US. As Haussmann pointed out, Rathenau's view was distorted by his personal experience at AEG, while concentrated ownership prevailed in most large German firms.

¹¹⁶ In the mid-1930s the young Curt Fischer had still criticized the proposals of the corporate law reform committee as not having absorbed Nazism to a sufficient degree. *E.g.* Curt Fischer, *Führerprinzip und Verantwortlichkeit im neuen deutschen Aktienrecht*, 1934 DER PRAKTISCHE BETRIEBSWIRT 29; Curt Fischer, *Resignation vor der Anonymität in der A.-G.*, 1934 DIE DEUTSCHE VOLKSWIRTSCHAFT 1004. On Fischer's biography see Werner Schubert, *Einleitung zu Band I*, in 1 AKADEMIE FÜR DEUTSCHES RECHT 1933-1945, PROTOKOLLE DER AUSSCHÜSSE: AUSSCHUSS FÜR AKTIENRECHT XX, XXX n. 70 (Werner Schubert, Werner Schmid & Jürgen Regge eds. 1986) [hereinafter: AKADEMIE FÜR DEUTSCHES RECHT].

¹¹⁷ Fischer, *id.*, at 94-101; see also CLAUS OTT, RECHT UND REALITÄT DER UNTERNEHMENSKORPORATION 179 (1977).

¹¹⁸ Fischer, *id.*, at 101-106; ERNST-JOACHIM MESTMÄCKER, VERWALTUNG, KONZERNGEWALT UND RECHTE DER AKTIONÄRE 13-16 (1958); RUDOLF WIETHÖLTER, INTERESSEN UND ORGANISATION IM AMERIKANISCHEN UND DEUTSCHEN RECHT 38 (1961).

¹¹⁹ WOLFGANG ZÖLLNER, DIE SCHRANKEN MITGLIEDSCHAFTLICHER STIMMRECHTSMACHT BEI DEN PRIVATRECHTLICHEN PERSONENVERBÄNDEN 69 (1963); RIECHERS, *supra* note 83, at 177.

Rathenau's hope that autonomous large firms would contribute to the development of his utopian world of tomorrow was therefore of little significance. However, with his managerial background he was typical insofar as he voiced concern about *shareholder* decisions and requests, which set him sharply apart from the later American debate. The German legal writers a decade later had a similar concern that was unimportant in the Berle-Means world, namely conflicts of interest between shareholders that apparently were a lot more important in the German corporate world of that time than in its American counterpart. These authors followed a "sociological" method of the law, which viewed the law and the real world as mutually dependent.¹²⁰ Thus, legal authors such as Netter¹²¹, Landsberger¹²² and Geiler¹²³ argued that shareholders should be constrained in their decision-making by the interests of the business, understood as a separate entity from shareholders. Thus, the theory of the *Unternehmen an sich*, even though it was not always explicitly referred to, was a constraint on shareholders' actions. Even Haussmann, who denied the independent interest of the interest of the business (or of the firm) sought to limit shareholder influence by tying them to the interest of the "entirety of shareholders."¹²⁴ With this difference in emphasis, Haussmann probably could be classified as a shareholder primacist. While Rathenau had maybe misunderstood the preeminent problems under the most common type of ownership structure, and the goal of his

¹²⁰ Karl Geiler, *Die wirtschaftsrechtliche Methode im Gesellschaftsrecht*, 68 BEITRÄGE ZUR ERLÄUTERUNG DES DEUTSCHEN RECHTS (GRUCHOTS BEITRÄGE) 592 (1927); KARL GEILER, BEITRÄGE ZUM MODERNEN RECHT 35 (1933) (both arguing that "is" and "ought" should not be seen as separate, and suggesting the application of legal sociology in corporate law). On the transient flirtation of early 20th century scholars with legal realism see generally Grechenig & Gelter, *supra* note 30, at 349-352.

¹²¹ Netter, *supra* note 93, at 592.

¹²² Landsberger, *supra* note 90, at 87-88.

¹²³ GEILER, *supra* note 120, at 82.

¹²⁴ Haussmann, *supra* note 103, at 64. Netter criticized Haussmann's reliance on the "collective interest" of shareholders as inappropriate, since the collective interest could not be the sum of individual interests. Therefore, the only way would be to rely on majority decisions, which would be problematic because of private benefits of control. See Netter, *supra* note 93, at 577-578.

initial sermon were those of a practical businessman, both he and these later authors sought to protect managerial power from shareholders and the disputes among them, which stands in contrast to the concern about managerial power emphasized by Berle and Means. Rathenau may have hit a chord with later authors who shared a similar concern, but in a different context.

The case law underwent a parallel development, in which the *Reichsgericht* (Supreme Court) moved away from the majority-focused understanding of power within the firm. In the 1927 “Hamburg-Süd” opinion, it refused to invalidate a shareholder decision to increase the firm’s capital by issuing new multiple-vote shares to a consortium controlled by the management and supervisory board members, from which other shareholders were excluded.¹²⁵ The effect was an effective entrenchment of management, given that only 25% of par value had to be paid up front, while the outstanding stock traded at 220%.¹²⁶ While most of the court’s approval of the takeover defense is relentlessly positivistic,¹²⁷ the opinion also declines that the structure could be contrary to public policy, since there were good reasons why the firm should be protected from shareholders:

“It is obvious that the financial expansion and protection of the corporation in particular are of decisive significance to secure its autonomy and independence, and that a blocking majority in its common stock could endanger its viability and, in any case, the beneficial continued development of the corporation...This is in fact absolutely along the lines of other provisions of the defendant firm’s articles, which obviously aim at preserving the enterprise as such and its autochthonous character while repelling shareholders’ interests.”¹²⁸

¹²⁵ RGZ 119, 248.

¹²⁶ RIECHERS, *supra* note 83, at 113.

¹²⁷ The court emphasizes that none of the individual elements of this early takeover protection was contrary to the law.

¹²⁸ RGZ 119, 256 (own translation).

In fact, in this case there was a threat to the firm (or its management), as it was facing a takeover attempt by a (German) bank. (The plaintiff was an association of shareholders.¹²⁹) Generally the case law was moving towards putting more limits on shareholders conduct in exercising their right to vote during the 1920s. After describing the case law, a 1930 article summarized the state of the law as follows:

“The shareholder is not prevented from letting his own interests guide his vote. However, the ballot, and thus the shareholder resolution, is against public policy if the majority pursues selfish goals in a one-sided way at the cost of the company, or at the cost of the minority, without the latter being necessitated by the good of the company.”¹³⁰

The intense Weimar Republic and early Nazi Germany debates about the reform of corporate law ultimately led to the famous § 70 of the 1937 *Aktiengesetz*, a provision that is often cited in the stakeholder debate. It stated that the management board was required

“to manage the corporation as the good of the enterprise and its retinue and the common wealth of folk and realm demand.”¹³¹

Most importantly,¹³² the reform put the relationship between management and shareholders on its head. The management board was charged by the law with the exclusive responsibility of managing the company¹³³, with unsolicited interference by the

¹²⁹ RIECHERS, *supra* note 83, at 112.

¹³⁰ Walter Horowitz, *Über die Freiheit der Abstimmung im Aktienrecht*, 59 JURISTISCHE WOCHENSCHRIFT 2637, 2638 (1930).

¹³¹ § 70 German AktG of 1937, translation following Detlev F. Vagts, *Reforming the “Modern” Corporation: Perspectives from the German*, 80 HARV. L. REV. 23, 40 (1966). “Folk and realm” is used here to translate “*Volk und Reich*”, a wording that (at least today) would be clearly associated with Nazism that was duly purged from the law in the 1965 reform. The translation suggested by Thomas Raiser, who translates “*Gefolgschaft*” as “membership”, seems questionable. See Thomas Raiser, *The Theory of Enterprise Law in the Federal Republic of Germany*, 36 AM. J. COMP. L. 111, 123 (1988).

¹³² RIECHERS, *supra* note 83, at 167 (suggesting that the practical importance of § 70 was close to zero compared to other reforms).

¹³³ § 76(1) AktG.

supervisory board or by shareholders not being legally binding.¹³⁴ While previously the meeting of shareholders had been the supreme controlling body,¹³⁵ its role now became a comparatively limited one.¹³⁶ Since 1937, the management board has been appointed and dismissed by the supervisory board, which requires cause to prematurely revoke the management board members' appointment (which includes a shareholder vote of no confidence that is not obviously abusive).¹³⁷ Supervisory board members can only be dismissed prematurely by a supermajority of three quarters in the shareholder meeting.¹³⁸ Since the reform, the shareholder meeting can legally only get involved in management decisions when a decision is submitted for a vote by management.¹³⁹ Franz Schlegelberger, the leading official in the German Ministry of Justice at the time of the reform, famously described the shareholder meeting as the "dethroned king" of the corporation.¹⁴⁰

¹³⁴ Hans Joachim Mertens, in KÖLNER KOMMENTAR ZUM AKTIENGESETZ, § 76, comment 42 (vol. 2, 2nd ed., Wolfgang Zöllner ed. 1988/1996); Wolfgang Hefermehl & Gerald Spindler, in MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, § 76, comment 21 (vol. 3, 2nd ed., Bruno Kropff & Johannes Semler eds., 2003); UWE HÜFFER, AKTIENGESETZ § 76, comment 10 (8th ed. 2006) (also pointing out that there is no fiduciary relationship between either management board and individual shareholders or a management board and the shareholder meeting); see also BGH 30.3.1967, II ZR 245/63, 1967 NEUE JURISTISCHE WOCHENSCHRIFT 1462; Dieter Eckert, *Shareholder and Management: A Comparative View on Some Corporate Problems in the United States and Germany*, 46 IOWA L. REV. 12, 20 (1960).

¹³⁵ On the historic development see e.g. Hefermehl & Semler, *supra* note 78, comments 10-20.

¹³⁶ The provision is mandatory [HÜFFER, *supra* note 134, § 23, comment 36], except for the case of a control agreements under § 291(1) AktG, according to which a controlling entity (an "enterprise" such as a parent company) has the right to control the firm, but is subject to certain special duties. See generally Peter Hommelhoff, *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: the Strengths and Weaknesses of German Corporate Group Law*, 2 EUR. BUS. ORG. L. REV. 61, 64-66 (2001); Gerard Hertig & Hideki Kanda, *Creditor Protection*, in THE ANATOMY OF CORPORATE LAW, *supra* note 72, at 71, 86; Gerard Hertig & Hideki Kanda, *Related Party Transactions*, in THE ANATOMY OF CORPORATE LAW, *supra* note 72, at 101, 124-125.

¹³⁷ § 84(3) AktG.

¹³⁸ § 103(1) AktG.

¹³⁹ § 119(2) AktG. Previously, the shareholder has been entitled to give instructions to management under § 235 HGB.

¹⁴⁰ FRANZ SCHLEGELBERGER, DIE ERNEUERUNG DES DEUTSCHEN AKTIENRECHTS 28 (1935). Schlegelberger served as the Third Reich's minister of justice in 1941/42 and served some years in prison after the war. See also E. Geßler, *Vorstand und Aufsichtsrat im neuen Aktienrecht*, 66 JURISTISCHE WOCHENSCHRIFT 497, 497 (1937) (pointing out that previously large shareholders and banks had ensured that the shareholder meetings had the desired content).

The extent to which the previous debate about the *Unternehmen an sich* influenced these reforms has recently become a matter of dispute. According to the traditional narrative that emerged after World War II, the 1937 Act and these reforms trace their development to the broader current in German legal and economic thought that had begun with Rathenau and had then found their legislative conclusion,¹⁴¹ even though they also reflected the Nazi *Führerprinzip* (leader principle), under which the president of the management board should take a preeminent role over its other members.¹⁴² Even Curt Fischer, who had opposed the *Unternehmen an sich* during the 1930s,¹⁴³ suggested that the idea of the “leader principle” did not result in many new developments, but rather in a codification of the corporate practice of several decades.¹⁴⁴

In addition, it has been pointed out that (even after the Nazi takeover) German policymakers looked towards American law for inspiration. Johannes Zahn, who had acquired an SJD degree at Harvard Law School,¹⁴⁵ criticized the theory of the “*Unternehmen an sich*” for carrying Marxist thought into private law,¹⁴⁶ but nevertheless proposed the powerful position of the board in the corporate law of the US states as the basis for German reform in his 1934 book in order to restructure the relationship between shareholders and directors in Germany. Like their American counterparts, Ger-

¹⁴¹ E.g. BRUNO KROPPF, AKTIENGESETZ 13 (1965) (official report on the 1965 reform); Vagts, *supra* note 131, at 48; Knut Wolfgang Nörr, *Zur Entwicklung des Aktien- und Konzernrechts während der Weimarer Republik*, 150 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 155, 161 (1986); RIECHERS, *supra* note 83, at 166; DIRK BAHRENFUSS, DIE ENTSTEHUNG DES AKTIENGESETZES VON 1965, 45 (2001); SUSANNE KALSS, CHRISTINA BURGER & GEORG ECKERT, DIE ENTWICKLUNG DES ÖSTERREICHISCHEN AKTIENRECHTS 320 (2003).

¹⁴² See Jan von Hein, *Vom Vorstandsvorsitzenden zum CEO?* 166 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 464, 475 (2002).

¹⁴³ Fischer, *Führerprinzip*, *supra* note 116, at 29.

¹⁴⁴ Fischer, *supra* note 113, at 109.

¹⁴⁵ According to the title page of the book. In the preface he reports having worked as “scientific assistant at the Seminar for Comparative Private Law of Harvard University.”

¹⁴⁶ JOHANNES C. D. ZAHN, WIRTSCHAFTSFÜHRERTUM UND VERTRAGSETHIK IM NEUEN AKTIENRECHT. ANREGUNGEN ZUM NEUBAU DES DEUTSCHEN AKTIENRECHTS AUF GRUND EINER VERGLEICHENDEN DARSTELLUNG DES DEUTSCHEN UND NORDAMERIKANISCHEN AKTIENRECHTS 39 (1934).

man directors should become leaders of a business organism independent from changing majorities in the shareholder meeting.¹⁴⁷ Zahn, whose research influenced the corporate law reform committee's work during the mid-1930s,¹⁴⁸ agreed with the plan to strengthen the role of management, personally being close to bank and business interests.¹⁴⁹

In a recent article, Bernd Mertens doubts the received wisdom and argues that the reforms were not the logical continuation of a previous development, but rather an ideological new beginning.¹⁵⁰ He suggests that the reason for the preponderant view (according to which Nazi ideology was merely reflected by some of the language of the law) was that scholars and policymakers sought to distance themselves from that period.¹⁵¹ He is of course right in pointing out that the 1930 draft for a new corporate law did not include the provisions discussed here,¹⁵² and that the discussion about the

¹⁴⁷ ZAHN, *id.*, at 94. While Zahn emphasized that American law, not having been influenced by Roman law, was based on "Teutonic" legal principles, he suggested that the strong position of directors in the US stems from the idea of liberty of the individual (as businessman), a precept that entirely differed from what was considered "German" at that time. ZAHN, *id.*, at 13, 201 *passim*. However, Zahn also discussed Dodge v. Ford in great detail and concluded that managers should act to the benefit of shareholders (*id.*, at 41-48). The Berle-Dodd exchange apparently came too late to be included in his book.

¹⁴⁸ Schubert, *supra* note 116, at XLVII (thanking Ernst Geßler, one of the leading drafters of both the 1937 and 1965 acts, for bringing this to his attention); von Hein, *supra* note 142, at 476; *contra* Bernd Mertens, *Das Aktiengesetz von 1937 – unpolitischer Schlussstein oder ideologischer Neuanfang?* 29 ZEITSCHRIFT FÜR NEUERE RECHTSGESCHICHTE 88, 98 n54 (2007). Mertens argues that the pre-1945 sources do not support the claim of Zahn's influence, and that German law moved even further away from the US board system by inhibiting the supervisory board's involvement in management. It is true that Zahn recognized that the ideological basis of managerial leadership was very different in the US. However, von Hein (*id.*, at 476) correctly points out that ZAHN (*id.*, at 17) considered the "leader principle" to be a fixture of American corporate law (other than in his book), and that the protocols of committee meetings show that he participated. He presented his case before the corporate law committee of the Academy of German law on February 9, 1934. While he did not explicitly refer to American law, he proposed, among other things, to make management independent from shareholders in order to allow the "average investor" to see management as "the entrepreneur", and to establish a clearer duty of loyalty between shareholders. See AKADEMIE FÜR DEUTSCHES RECHT, *supra* note 116, at 60-65 (transcript of the meeting).

¹⁴⁹ RIECHERS, *supra* note 83, at 159.

¹⁵⁰ Mertens, *supra* note 148, at 91-108.

¹⁵¹ Mertens, *id.*, at 115.

¹⁵² Reichsjustizministerium, *Entwurf eines Gesetzes über Aktiengesellschaften und Kommanditgesellschaften auf Aktien*, reprinted in 2 QUELLEN ZUR AKTIENRECHTSREFORM DER WEIMARER REPUBLIK (1926-1931) 847 (Werner Schubert ed. 1999).

Unternehmen an sich doctrine remained controversial.¹⁵³ However, even Hjalmar Schacht, the Minister of Industry, opposed the most extreme proposals that might have implemented a completely authoritarian *Führerprinzip*, which would have eliminated any residual shareholder control. Schacht conceded that large firms needed to obtain capital, which would not be possible without at least limited shareholder influence.¹⁵⁴

The overall emerging picture of the debate is that German analysts of the interwar period were strongly concerned with the presence of different shareholder groups, changing majorities, and controlling shareholders, which was not much of a concern in American “Berle-Means” type corporations. The *Unternehmen an sich* debate reacted partly to this. Stakeholder concerns did not play the primary role. Employee interests only seem to have entered the German Aktiengesetz as a result of the enactment of § 70. The influential treatise by Schlegelberger and other senior officials of the Ministry of Justice argues that the “retinue” of the enterprise refers to its employees, whose well-being the members of the management board must take care of.¹⁵⁵ But of course, keeping the common good of folk and realm in mind was the preponderant objective among all, thereby integrating the firm into the policy framework of the German national economy.¹⁵⁶

¹⁵³ An overview is provided by RIECHERS, *supra* note 83, at 154-169.

¹⁵⁴ Walter Bayer & Sylvia Engelke, *Die Revision des Aktienrechts durch das Aktiengesetz von 1937*, in 1 AKTIENRECHT IM WANDEL 619, notes 49-52 (Walter Bayer & Mathias Habersack eds. 2007) (citing Schacht’s speech held before the Academy for German Law on November 30, 1935); *but see* Peter Doralt, *Die Unabhängigkeit des Vorstands nach österreichischem und deutschem Aktienrecht – Schein und Wirklichkeit*, in DIE GESTALTUNG DER ORGANISATIONS-DYNAMIK. FESTSCHRIFT FÜR OSKAR GRÜN 31, 37 (Werner H. Hoffmann ed. 2003) (suggesting that the draftsmen only paid lip service to the *Führerprinzip* and implemented a program skeptical of capitalism and anonymous capital).

¹⁵⁵ FRANZ SCHLEGELBERGER, LEO QUASSOWSKI, GUSTAV HERBIG, ERNST GESSLER & WOLFGANG HEFERMEHL, AKTIENGESETZ, § 70, comments 6, 7 (3rd ed. 1939).

¹⁵⁶ SCHLEGELBERGER ET AL., *id.*, comment 8.

4.3. Post-War reception

The Aktiengesetz 1937 remained in place in Western Germany after the end of World War II without any significant changes.¹⁵⁷ With the exception of the default provision that the chairman of the management board could decide alone in the case of disagreements,¹⁵⁸ the reforms were retained after the war. As Bruno Kropff (one of the leading drafters of the subsequent 1965 reform) points out, by that time the distribution of competences between shareholders and the two boards had by and large come to be considered appropriate.¹⁵⁹ Thus, it seems safe to say that in spite of its ideological component, much of the substance of the act must initially have seemed defensible on policy grounds. While there was some debate whether the shareholder meeting should again be granted the power to get involved in business decisions, the distribution of competences according to the 1937 reform was still considered adequate.¹⁶⁰ Peter Doralt (writing in 2003) echoes this view when he explains why the limited role of the shareholder meeting and the legal entrenchment of the board of directors are considered mandatory today:

“The reason is ... that the corporate constitution set out in the *Aktiengesetz* is seen as an optimal guarantee, on the one hand, for serving the public economic interest in a well-functioning enterprise, and, on the other hand, for protecting the interests of current and future shareholders (against management, and, if they exist, large shareholders) and of creditors (against management and shareholders).”¹⁶¹

While employee interests had not been the focus of the debate of the 1920s, this gradually changed in the post-War Federal Republic. Scholars no longer espoused the

¹⁵⁷ E.g. Mertens, *supra* note 148, at 110.

¹⁵⁸ See Bruno Kropff, *Reformbestrebungen im Nachkriegsdeutschland und die Aktienrechtsreform von 1965*, in 1 AKTIENRECHT IM WANDEL 670, note 57 (Walter Bayer & Mathias Habersack eds. 2007).

¹⁵⁹ Kropff, *id.*, note 60

¹⁶⁰ Kropff, *id.*

¹⁶¹ Doralt, *supra* note 154, at 40.

Unternehmen an sich, but focused on the *Unternehmensinteresse* (the interest of the enterprise) as set out by § 70. While no uniform interpretation of the term has ever emerged, post-war scholarship continued to understand the enterprise, or the corporation, to be distinct from shareholder interests.¹⁶² The first post-War edition of one of the leading treatises of German corporate law emphasized how the reform led to an insulation of management from shareholders and argued that the independent responsibility of the management board

“is not an alien contaminant in corporate law resulting from faulty national socialist economic thought. This provision rather takes into account a development of the structure of business, particularly the big enterprise in its macroeconomic and social importance, which is by no means restricted to the domain of corporate law in Germany. Even though one might deplore that particularly corporate law and the practice of large firms – even before the reform of 1937 – is moving more towards the “business as such” [...], this development cannot be stopped and will lead to a certain reduction of shareholders’ role as formal owners.”¹⁶³

The general idea of the “good of the enterprise” survived the enactment of a new Aktiengesetz in 1965 at least in some form, when the old § 70 was replaced by a new § 76 that merely reiterated the board’s independence (much like DGCL § 141(a)), but was devoid of an explicit corporate goal. However, the legislative report made it clear that no change in the law was intended;¹⁶⁴ in fact, it pointed out that it was self-evident that

¹⁶² *But see* Fischer, *supra* note 113, at 101-106; *see also* RIECHERS, *supra* note 83, at 1 (noting in the introduction to his 1996 book that the term “Unternehmen an sich” is still popular).

¹⁶³ Walter Schmidt & Joachim Meyer-Landrut, § 70, comment 1, in 1 AKTIENGESETZ GROSSKOMMENTAR (Carl Hans Barz, Robert Fischer, Ulrich Klug, Konrad Mellerowicz, Joachim Meyer-Landrut, Wolfgang Schilling & Walter Schmidt 2nd. ed. 1961) (own translation).

¹⁶⁴ *See e.g.* Joachim Meyer-Landrut, § 76, comment 9, in 1 AKTIENGESETZ GROSSKOMMENTAR (Carl Hans Barz, Herbert Bröner, Ulrich Klug, Konrad Mellerowicz, Joachim Meyer-Landrut, Wolfgang Schilling, Herbert Wiedemann & Hans Würdinger, 3rd. ed. 1973).

managers would have to take capital, employee and public interests into account.¹⁶⁵ Not only commentators, but also the constitutional court stated that this also applies to the ownership of stocks,¹⁶⁶ notably in the decision when it found that the 1976 codetermination statute was constitutional.¹⁶⁷

The new, expansive codetermination law of 1976¹⁶⁸ may have further fuelled arguments in favor of what we today call a stakeholder-oriented interpretation of the law, but in fact a certain stream of literature that was clearly pluralist in nature actually began earlier. In terms of theory, legal scholars writing in the 1960s and 1970s increasingly tended to adopt a sociological theory of corporate law, in which the *Unternehmensinteresse* was by some authors traced to the idea that the enterprise constitutes a social collective.¹⁶⁹ The corporation was seen as an amalgamation of the interests of owners, workers and managers,¹⁷⁰ the proper goal of which was to maintain the existence of the

¹⁶⁵ See the official reasoning for the proposal in KROPFF, *supra* note 141, at 97. For an overview of the development of the rule see Vagts, *supra* note 131, at 40-41; cf. Mertens, *supra* note 134, § 76, comment 16 (stating that the language of the 1937 act was still relevant; Klaus J. Hopt, *Aktionärskreis und Vorstandsneutralität*, 22 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 534, 536 (1993). However, some authors did not agree with this interpretation. See e.g. Wolfgang Hefermehl, in 2 AKTIENGESETZ, § 76, comment 20 (Ernst Geßler, Wolfgang Hefermehl, Ulrich Eckardt & Bruno Kropff eds. 1973, 1974) (suggesting that no such requirement exists). The German law's Austrian offshoot to this day explicitly requires the management board to pursue the good of the enterprise while having regard to the interests of stockholders, employees and the public interest (§ 70 Austrian AktG of 1965).

¹⁶⁶ BVerfGE 14, 263/282 "Feldmühle".

¹⁶⁷ BVerfGE 50, 290, 315 f "Mitbestimmung".

¹⁶⁸ MITBESTIMMUNGSGESETZ, BGBl. I 1976, S. 1153.

¹⁶⁹ THOMAS RAISER, DAS UNTERNEHMEN ALS ORGANISATION 133-157 (1969); Thomas Raiser, *Das Unternehmensinteresse*, in FESTSCHRIFT FÜR REIMER SCHMIDT 101, 117 (Fritz Reichert-Facilides, Fritz Rittner, Jürgen Sasse eds. 1976); also see Wolfgang Schilling, *Das Aktienunternehmen*, 144 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 136 (1980); contra Fritz Rittner, *Aktiengesellschaft oder Aktienunternehmen?* 144 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 330, 330-334 (1980); WERNER FLUME, UM EIN NEUES UNTERNEHMENSRECHT (1980).

¹⁷⁰ Wolfgang Zöllner, *Einleitung*, in KÖLNER KOMMENTAR ZUM AKTIENGESETZ, EINLEITUNGS-BAND, comment 130 (1st ed., Wolfgang Zöllner ed. 1984) (pointing out that the continued existence of old, unproductive firms serves no one); Michael Kort, in 19 GROSSKOMMENTAR AKTG § 76, comment 53 (Klaus J. Hopt & Herbert Wiedemann eds. 2003); Wulf Goette, *Leitung, Aufsicht, Haftung – zur Rolle der Rechtsprechung bei der Sicherung einer modernen Unternehmensführung*, in FESTSCHRIFT AUS ANLASS DES FÜNFZIGJÄHRIGEN BESTEHENS VON BUNDESGERICHTSHOF, BUNDESANWALTSCHAFT UND RECHTSANWALTSCHAFT BEIM BUNDESGERICHTSHOF 123, 127 (Karlmann Geiß, Kay Nehm, Hans Erich Brandner & Horst Hagen eds. 2000).

firm, taking the interests of various groups into account¹⁷¹, and to maintain its long-term earning power.¹⁷² In that view, it is in the discretion of the management board to pursue other goals, such as fulfilling consumer demand, providing adequate wages and working conditions, the relationship to the firm's social and cultural environment, the maintenance of a livable environment, and macroeconomic concerns.¹⁷³ Profits must be made in an amount that suffices to maintain the firm.¹⁷⁴

A contrarian movement developed only during the 1990s, apparently under the influence of US scholarship and an increasing significance of capital markets and institutional investors, as a result of which the idea of “shareholder value” became part of the debate.¹⁷⁵ Unsurprisingly, the proposition of a shareholder primacy goal¹⁷⁶ coincided with mounting criticism of codetermination.¹⁷⁷

¹⁷¹ Zöllner, *id.*, note 170, comment 136; Hopt, *supra* note 165, at 536-537; Klaus J. Hopt, *Übernahmen, Geheimhaltung und Interessenkonflikte: Problem für Vorstände, Aufsichtsräte und Banken*, 31 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 333, 359-360 (2002).

¹⁷² FRITZ RITNER, WIRTSCHAFTSRECHT § 9, note 15 (2nd ed. 1987); Mertens, *supra* note 134, § 76, comments 10, 22-23; Kort, *supra* note 170, § 76, comment 51; Hefermehl & Spindler, *supra* note 134, § 76, comment 61; Goette, *supra* note 170, at 127; THOMAS RAISER & RÜDIGER VEIL, DAS RECHT DER KAPITALGESELLSCHAFTEN § 14, comment 13 (4th ed. 2006) (mentioning the management board's duty to “increase” shareholder value as one of several tasks under a pluralist conception of the corporation); HÜFFER, *supra* note 134, § 76, comment 13. It is interesting to note that this interpretation of the law seems to correspond to John Kenneth Galbraith's descriptions of what managers in large firms do in fact. See GALBRAITH, *supra* note 61, at 153 *passim*.

¹⁷³ Mertens, *supra* note 134, § 76, comment 11.

¹⁷⁴ Mertens, *supra* note 134, § 76, comment 22-23; JOHANNES SEMLER, LEITUNG UND ÜBERWACHUNG DER AKTIENGESELLSCHAFT, comments 38, 48 (2nd ed. 1996); *contra* Peter Raisch, *Zum Begriff und zur Bedeutung des Unternehmensinteresses als Verhaltensmaxime von Vorstands- und Aufsichtsratsmitgliedern*, in STRUKTUREN UND ENTWICKLUNGEN IM HANDELS-, GESELLSCHAFTS- UND WIRTSCHAFTSRECHT, FESTSCHRIFT FÜR WOLFGANG HEFERMEHL 348, 352, 363 (Robert Fischer, Ernst Geßler, Wolfgang Schilling, Rolf Serick & Peter Ulmer eds. 1976) (suggesting that maintaining the firm's legal capital suffices).

¹⁷⁵ Manfred Groh, *Shareholder Value und Aktienrecht*, 42 DER BETRIEB 2153 (2000); Hefermehl & Spindler, *supra* note 134, § 76, comments 66-68; Peter O. Mülbart, *Shareholder Value aus rechtlicher Sicht*, 26 ZEITSCHRIFT FÜR GESELLSCHAFTS- UND UNTERNEHMENSRECHT 129 (1997); Friedrich Kübler, *Shareholder Value: Eine Herausforderung für das Deutsche Recht?* in FESTSCHRIFT FÜR WOLFGANG ZÖLLNER 321 (Manfred Lieb, Ulrich Noack & H.P. Westermann eds. 1998); Axel von Werder, *Shareholder Value-Ansatz als (einzige) Richtschnur des Vorstandshandelns?* 27 ZEITSCHRIFT FÜR GESELLSCHAFTS- UND UNTERNEHMENSRECHT 69 (1998); *contra* HÜFFER, *supra* note 134, § 76, comment 12a (rejecting shareholder value and espousing a pluralist conception).

¹⁷⁶ Kübler, *id.*; Groh, *id.* at 2158; Klaus J. Hopt & Markus Roth, in GROSSKOMMENTAR AKTIENGESETZ, § 111, comment 104 (4th ed. 24th installment, Klaus J. Hopt & Herbert Wiedemann ed. 2005); Holger

4.4. An unusual practical application: The Mannesmann case

The reception of the *Unternehmensinteresse* (“interest of the business”) doctrine by the courts can at best be called ambiguous. The courts use the concept or equivalent ones frequently, but without clearly defining them or striking a balance in shareholder-stakeholder conflicts of interest, e.g. when discussing when the exclusion of a preemptive right is justified in the interest of the firm,¹⁷⁸ or when defining the duties of board members.¹⁷⁹ Under the new takeover law enacted the 2004 EU directive, takeover defenses are permitted when they were approved by shareholders and permitted in the company’s charter,¹⁸⁰ and the supervisory and management must act in the “interest of the target company.”¹⁸¹ Hence, most likely these measures will have to conform to the *Unternehmensinteresse*.¹⁸² However, so far the courts have not had the opportunity to

Fleischer, in 1 KOMMENTAR ZUM AKTIENGESETZ, § 76, comment 34 (Gerhard Spindler & Eberhard Stiltz 2007).

¹⁷⁷ E.g. Axel von Werder, *Modernisierung der Mitbestimmung*, 64 DIE BETRIEBSWIRTSCHAFT 229 (2004); Eberhard Schwark, *Globalisierung, Europarecht und Unternehmensmitbestimmung im Konflikt*, 2004 DIE AKTIENGESELLSCHAFT 173; Michael Adams, *Das Ende der Mitbestimmung*, 2006 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1561.

¹⁷⁸ Under German case law, a substantive reason that is potentially subject to judicial review is required to deprive shareholder of their statutory preemptive right. See BGH March 13, 1978, II ZR 142/76, BGHZ 71, 40 (“Kali+Salz”); BGH April 19, 1982, II ZR 55/81, BGHZ 83, 319; BGH June 23, 1997, II ZR 132/93, BGHZ 136, 133 (“Siemens/Nold”); see also OLG Stuttgart 12.8.1998, 20 U 111/97, DB 1998, 1757; OLG Braunschweig July 29, 1998, 3 U 75/98, ZIP 1998, 1585; BGH November 21, 2005, 2006 WERTPAPIER-MITTEILUNGEN 432; BGH March 7, 1994, II ZR 52/93, BGHZ 125, 239 (discussing whether a company should seek a foreign stock exchange listing); see also BGH February 8, 1988, II ZR 159/87, BGHZ 103, 213, 217 (using the interest of the association as an argument why the company should be represented by the supervisory board instead of management board in a court procedure about the removal of members of the management board).

¹⁷⁹ BGH June 5, 1975, BGHZ 64, 325, 331, NJW 1975, 1412 (duty of confidentiality); see also BGH February 25, 1982, BGHZ 83, 144 (briefly mentioning that the board should remain operational in the interest of the business); see also BVerfG March 1, 1979, 1 BvR 532, 533/72, 419 and 41 BvR 21/71, BVerfGE 50, 290, 374 (Constitutional Court approving the 1976 codetermination regime and mentioning the obligation of board members to pursue the interest of the enterprise in passing).

¹⁸⁰ § 33a WpÜG.

¹⁸¹ § 3(3) WpÜG.

¹⁸² E.g. Kai Haakon Liekefett, *Bietergleichbehandlung bei öffentlichen Übernahmeangeboten*, 50 DIE AKTIENGESELLSCHAFT 802, 806-810 (2005) (discussing what the concept could imply in the takeover context).

explain that requirement. After all, takeover defenses have not attained great practical significance due to the scarcity of hostile bids.¹⁸³

The one recent case where it was at least of superficial significance was *Mannesmann*, which was the target of the first openly hostile takeover bid for a German company.¹⁸⁴ The bid was launched by Vodafone Airtouch plc. of the UK in 2000.¹⁸⁵ Mannesmann's management initiated a large number of costly full-space advertisements arguing against the takeover in leading newspapers (which were countered by the bidder) and by seeking a white knight. Ultimately, Mannesmann's management abandoned its defenses, the cost of which had gone into the hundreds of millions of German Marks,¹⁸⁶ after Vodafone had raised its bid price from € 240 to € 360.¹⁸⁷ The company's supervisory board then decided to grant "appreciation awards" to the members of the management board, most of all an amount of € 16 Million to CEO Klaus Esser, who had been in this position for less than a year, in addition to his contractual severance payment of € 15 Million.¹⁸⁸ Other management board members, some of whom had been members only for a few days and left the firm a few months after the decision, also received substantial awards "in recognition for their contribution to the firm's success." The awards had been suggested and endorsed by Hutchinson Whampoa, a Hong Kong firm that held 10% of Mannesmann's stock and subsequently benefited financially from the

¹⁸³ THOMAS STOHLMEIER, GERMAN PUBLIC TAKEOVER LAW 108-109 (2nd ed. 2007).

¹⁸⁴ E.g. Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 AM. J. COMP. L. 497, 502 (2001).

¹⁸⁵ Mannesmann had purportedly provoked the bid by attempting to acquire Orange, one of Vodafone's British competitors.

¹⁸⁶ Cf. Mark Binz & Martin Sorg, *Esser und Ackermann müssen Pyrrhussiege fürchten*, FRANKFURTER ALLGEMEINE ZEITUNG, May 6, 2004, at 12 (reporting costs of € 432 Million).

¹⁸⁷ See Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 460 (2007).

¹⁸⁸ Stefan Maier, *A Close Look at the Mannesmann Trial*, 7 GERMAN L. J. 603, 604 (2006).

takeover.¹⁸⁹ In fact, Hutchinson Whampoa had offered to make this payment out of its own pocket.¹⁹⁰

The bonus, which had come to light following disclosure by Vodafone under English law, sparked outrage in the press and among employees.¹⁹¹ In 2003, Mr. Esser and members of Mannesmann's supervisory board were indicted for *Untreue* (breach of trust), a criminal offense punishing the abuse of the power to dispose over someone else's property or to legally bind someone else.¹⁹² Defendants, including the former president of the board, Deutsche Bank CEO Josef Ackermann, claimed that such payments were in accordance with international practices. The employee representatives on the supervisory board, who had acquiesced to the payments without giving their assent, were also named as defendants.¹⁹³ The payments were compared to a bribe to let the deal go forward.¹⁹⁴ Law professors gave comment in the press, most prominently the corporate law veterans Marcus Lutter and Wolfgang Zöllner, who pointed out that "the management board must secure the corporation's position in the market and increase profits"; since the takeover defenses had cost the company a lot and resulted in a higher bid price, they argued that Mannesmann had clearly not benefited from them, only shareholders, a result that was not compatible with the board members' task to advance the

¹⁸⁹ Peter Kolla, *The Mannesmann Trial and the Role of the Courts*, 5 GERMAN L. J. 829, 833 (2004); CURTIS MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM* 70 (2008).

¹⁹⁰ Mark K. Binz & Martin Sorg, *Ackermann & Co.: Gutsherren oder Gutsverwalter?* BETRIEBSBERATER, February 6, 2006, at 1; MILHAUPT & PISTOR, *id.*, at 70.

¹⁹¹ Gevurtz, *supra* note 187, at 461; MILHAUPT & PISTOR *id.*, at 70-71.

¹⁹² § 266 Strafgesetzbuch (criminal code). A typical case of *Untreue* would be a property manager who uses rent payments to gamble instead of passing them on to the owner. But misuse of corporate funds may violate this criminal statute, too, e.g. when the manager and sole owner of a corporation pays a salary to his wife without her working for the company. For a brief description in the corporate law context see Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. COMPANY & FIN. L. REV. 491, 520 (2007).

¹⁹³ MILHAUPT & PISTOR, *supra* note 189, at 70-71.

¹⁹⁴ Kolla, *supra* note 189, at 833.

interest of the firm (instead of that of shareholders).¹⁹⁵ Others explained that the gains in stock price were only a temporary result of the takeover offer: The main beneficiary of the takeover defenses was Hutchinson Whaompa, whereas Vodafone subsequently had written off the purchase price (to the detriment of the German tax authorities), and thousands of jobs were lost.¹⁹⁶

After the initial trial had resulted in an acquittal, the German Federal Supreme Court (BGH) remanded the case, and ultimately the defendants reached a settlement with prosecutors, in the course of which they agreed to pay substantial fines without having to admit guilt.¹⁹⁷ In its opinion, the BGH paid lip service to the concept of *Unternehmensinteresse*, but actually solved the issue at hand by applying a statute according to which management compensation must be reasonable.¹⁹⁸ Appreciation awards granted ex post must either have a basis on the manager's contract of service, or (in the absence of an agreement ex ante) there must be corresponding advantages to the firm, such as an incentive effect on other managers. By contrast, a mere reward without any future benefit to the firm is considered waste and a violation of the duty of loyalty. In the case at hand, no such benefit was conceivable in light of the breakup of the firm.

In spite of its rhetorical embrace of a pluralist understanding of the corporation, in which it reiterated that the interests of the totality of shareholders, of creditors and the public are relevant for concept of the welfare of the “business”, the reference to a plural-

¹⁹⁵ Marcus Lutter & Wolfgang Zöllner, “Die Mannesmann-Prämien durften nicht gezahlt werden“, FRANKFURTER ALLGEMEINE ZEITUNG, February 10, 2004, at 12; see also FRANKFURTER ALLGEMEINE ZEITUNG, March 19, 2004, at 14 (explaining the opinion of the criminal law scholar Bernd Schönemann that the board's actions were punishable under criminal law).

¹⁹⁶ Binz & Sorg, *supra* note 190, at I.

¹⁹⁷ Bernard Black, Brian Cheffins, Martin Gelter, Hwa-Jin Kim, Richard Nolan, Mathias Siems & Linia Prava Law Firm, *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency)*, 2008 COLUM. BUS. L. REV. 1, 145-146.

¹⁹⁸ BGH December 21, 2005, BGHST 50, 331. The statute referred to is § 87(1), sentence 1 AktG.

ist conception of the firm was completely superfluous. While some commentators disagreed with the court's factual assertion that the share price had already increased at the time when the "bonus" was decided on,¹⁹⁹ assuming these facts to be right, one could have reached exactly the same result by reference to any definition of the best "interests of the company", including one of shareholder wealth maximization. The best analogy in US corporate would be the waste doctrine.²⁰⁰ It is maybe telling that even employee representatives on the board, who must have been very concerned about possible layoffs, did not object to the payment: At the time of the decision, the breakup of the company had become inevitable.²⁰¹

Furthermore, contradicting its professed adherence to a pluralist understanding of the corporation, the court also found that the payments actually would not have led to a criminal conviction if all shareholders had approved them ex ante; at the time of the payment, Vodafone was not yet the sole shareholder of the firm (but it held 98.6%), and at the time of the decision it held 9.8%.²⁰²

¹⁹⁹ E.g. Gerald Spindler, *Vorstandsvergütungen und Abfindungen auf dem aktien- und strafrechtlichen Prüfstand – Das Mannesmann-Urteil des BGH*, 27 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 349, 353 (2006); Gevurtz, *supra* note 185, at 464 (both suggesting that the court should have considered incentive effects for future board members or employees).

²⁰⁰ See also Gevurtz, *supra* note 187, at 464 ("Essentially, this is the same as a waste claim in the United States"). Gevurtz' suggestion conclusion that this shows that German courts are less deferential to business decisions therefore seems premature. Fleischer, *id.*, at 543. See also Maier, *supra* note 188 ("Contrary to popular opinion, the BGH's verdict in the Mannesmann trial makes no statement as to the appropriateness of executive remuneration.") and *id.*, at 606 (rejecting the argument that non-contractual appreciation awards could be justified by the extra effort of defending against hostile takeovers to achieve a high price).

²⁰¹ MILHAUPT & PISTOR, *supra* note 189, at 80.

²⁰² MILHAUPT & PISTOR, *supra* note 189, at 73; see Gevurtz, *supra* note 187, at 484

4.5. Conclusion: Institutionalism as an attempt to constrain shareholder power

In spite of recent criticism²⁰³ a pluralist or institutionalist understanding of the corporation is still alive in German law in the form of the doctrine of the *Unternehmensinteresse* and various synonym terms that trace their origin to the metaphysical interest of the business “as such”. Today, authors typically see it as a proxy for the interests of various groups that must be reconciled.²⁰⁴ Its practical significance is rather doubtful, given that courts are usually able to skirt clear definitions. It is, however, quite possible, that it exerts an indirect, hardly observable influence of corporate law analysts and judges.

Historically the debate around 1930 was not concerned with stakeholder interests on the surface, but rather with the institutional construction of the firm, which originated in conflicts of interest. The legal theory of the *Unternehmen an sich* was thus partly intended as a constraint on the conduct of shareholders, who were thought to be able to exert a detrimental influence on the firm. Other than in the US, managerial power could not simply be taken for granted given the complications in the corporate governance system created by non-atomistic share ownership patterns. Participants in the initial German debate were concerned with the opposite problem and sought to increase the power of managers in large corporations in order to stifle intra-shareholder conflicts. The *Unternehmen an sich* was intended to serve as a guideline for corporate conflicts of interest. With the temporary legislative enactment of corporate pluralism that was in fact intended to reduce the influence of capital, corporate stakeholders became more impor-

²⁰³ E.g. Fleischer, *supra* note 176, § 76, comments 30-31; see also Philipp Klages, *The Contractual Turn: How Legal Academics Shaped Corporate Law Reforms in Germany* 11-16, at <http://www.mpifg.de/people/kg/downloads/Contractual%20Turn.pdf> (identifying a development towards a contractual understanding of the corporation and a shareholder primacy objective in legal scholarship).

²⁰⁴ HÜFFER, *supra* note 134, § 76, comment 15.

tant. However, significant pro-stakeholders laws, such as codetermination, which were of greater practical significance, were passed only later under democratic rule.

5. A second continental contrast: French institutionalism

France shares two traits with Germany that are interesting for this article's thesis: First, France is also often said to have a corporate governance system oriented not primarily to serve shareholder interests, but also those of employees and others, and the public interest in general (even though France does not share codetermination, the most conspicuous pro-stakeholder element of German corporate law). Second, France is also by and large dominated by concentrated ownership firms. France also developed a strong "institutional school" of corporate law, which focused on the doctrine of the *intérêt social* or *intérêt de la société* (interest of the association or corporation), which is usually understood to take the interests of other non-shareholder constituencies into account.²⁰⁵

5.1. The origins of the French institutional school

The contemporary institutional school can trace its roots to the 1930s, but developed its vigor mostly during the 1960s. The first to develop an "institutional theory" of the corporation was Gaillard in his 1932 dissertation, observing the growing number of small investors, but at the same time the possibility that financial groups could easily obtain the majority of shares. Small shareholders would remain passive, while a financial group, if not restrained by the law, could use the power of the shareholder meeting to dominate the company.²⁰⁶ He suggested that a purely contractual theory could not adequately ad-

²⁰⁵ Cf. PHILIPPE MERLE & ANNE FAUCHON, *DROIT COMMERCIAL. SOCIÉTÉS COMMERCIALES* n° 52-1 (8th ed. 2001); Christiane Alcouffe, *Judges and CEOs : French Aspects of Corporate Governance*, 9 EUR. J. L. & ECON. 127, 133 (2000).

²⁰⁶ EMILE GAILLARD, *LA THÉORIE INSTITUTIONNELLE ET LE FONCTIONNEMENT DE LA SOCIÉTÉ ANONYME* 10-13 (1932).

dress abuses, as it presumed that minority shareholders had voluntarily submitted to majority control, and courts would hesitate to interfere with majority decisions, unless maybe under a theory of good faith in the execution of contracts.²⁰⁷ As a legal solution, he proposed an institutional theory of the corporation, in which it was to be understood as the subject of its own interest, the *intérêt social*; corporate decisions by managers, but also shareholder votes, should be subject to judicial review under this standard.²⁰⁸

The emergence of the institutional theory in the early 1930s may have been influenced by contemporary economic developments, as a result of which the significance of controlling shareholders had grown. As in Germany, multiple-vote shares had been increasingly used in French publicly traded during the 1920. Following a period of high inflation around 1926, French companies sought means to protect themselves against takeovers, particularly by foreign investors.²⁰⁹ Volatile majorities that created difficulties for management were increasingly seen as a problem,²¹⁰ and it was increasingly thought that anti-takeover protections were needed to keep French firms viable in international competition.²¹¹

Georges Ripert, a leading French business law scholar of the mid-20th century, also endorsed an institutional theory of the firm in his 1946 book, arguing that shareholders were abandoning their status as an owner, taking a position similar to that of a creditor. His book paints a picture of corporations resembling American firms with strong man-

²⁰⁷ GAILLARD, *id.*, at 14-20.

²⁰⁸ GAILLARD, *id.*, at 36-43. Gaillard's theory was not only normative, but to a large degree descriptive, as he attempt to explain the existing French case law on its basis. See GAILLARD, *id.*, at 33-36.

²⁰⁹ Muriel Petit-Konczyk, *Big changes in ownership structures – Multiple votes in interwar France*, WORKING PAPER 11, at <http://ssrn.com/abstract=944808>.

²¹⁰ ROQUEFORT-VILLENEUVE, LES ACTIONS A VOTE PLURAL AU POINT DE VUE ECONOMIQUE 33-58, 59-77 (1932).

²¹¹ *Id.*, at 78-92. Nevertheless, multiple-vote shares had been prohibited and were no longer allowed to be issued according to a 1931 law. Existing ones had to be transformed into regular shares in 1934. Petit-Konczyk, *supra* note 209, at 4.

agement and apathetic shareholders, whose passivity no corporate law reform has managed to overcome.²¹² Like American scholars of his period, he recognized the “enterprise” as a de facto entity, in spite of the law’s emphasis on shareholder democracy.²¹³ While Ripert did not ignore the concerns of workers, he did not consider them to be an issue of concern of corporate law, and argued that codetermination would imply confusion between the corporation and the enterprise.²¹⁴ Employment law, on the other hand, ensured that labor was no longer put to the service of capital and was, according to Ripert, already on the way towards giving employees, by virtue of legal limits to dismissals, in effect a property right in their jobs.²¹⁵

An increasing number of scholars emphasized the “institutional character” of the company during subsequent decades, and, in doing so, focused on majority-minority conflicts.²¹⁶ Despax, for example, argued in 1957 that the “enterprise” (not the corporation) had a separate interest from that of the entrepreneur,²¹⁷ and that it was developing more and more autonomy in the law. Effectively, it was on the way to having legal capacity on its own;²¹⁸ he also suggested that it was inevitably necessary to balance the

²¹² GEORGES RIPERT, *ASPECTS JURIDIQUES DU CAPITALISME MODERNE* 87-104 (1st ed. 1946). In particular, see RIPERT, *id.*, at 102 (“pendent toute la vie sociale, l’actionnaire se présente comme créancier de la société”). Interestingly, in spite of occasional references to German law, Ripert does not refer to American or German writers with similar ideas. For a summary of Ripert’s theory see Thierry Kirat, *The firm between law and economics*, in *THE FIRM AS AN ENTITY* 131, 138-141 (Yuri Biondi, Arnaldo Canziani & Thierry Kirat eds. 2007). Kirat, however, does not discuss Ripert’s ideas about employment.

²¹³ See Kirat, *id.*, at 141.

²¹⁴ RIPERT, *id.*, at 270.

²¹⁵ RIPERT, *id.*, at 296-300

²¹⁶ E.g. Jean Portemer, *Du contrat à l’institution*, 1947 *SEMAINE JURIDIQUE JCP*, doctrine, n° 586 (suggesting that an understanding of managers as agents of shareholders may no longer be adequate); Jean Leblond, *Les pouvoirs respectifs de l’assemblée générale, du conseil d’administration et du directeur général adjoint dans la doctrine institutionnelle*, 1957 *GAZETTE DU PALAIS*, I, doctrine, 29-32 (emphasizing the mandatory role of different company organs); see Jean Paillusseau, *La nouvelle société par actions simplifiée. Le big-bang du droit des sociétés*, 1999 *RECUEIL DALLOZ*, chronique, 333, at 344-345.

²¹⁷ MICHEL DESPAX, *L’ENTREPRISE ET LE DROIT* n° 178-198 (1957).

²¹⁸ DESPAX, *id.* n° 351-391.

interests of capital, labor, and costumers within the enterprise.²¹⁹ As in Germany, the discussion of this period was partly linked to an increasingly sociological understanding of the nature of the “enterprise” that was as more than just a business entity.

The heydays of the institutional school were the 1960s. Members of the so-called “School of Rennes”, who also stressed the social phenomenon of the “enterprise”, argued that it served as a focal point for economic activity, economic assets, and entrepreneurial decision-making, for which the corporation provided the organizational structure.²²⁰ The School of Rennes was later described by one of its main representatives, Claude Champaud, as a “realist” movement.²²¹ His 1962 book explored the concentration of corporations, focusing on legal instruments used to achieve concentration and to create corporate groups, and on the legal consequences. Other than American scholars such as Berle, to whom he sometimes referred in his work, he did not focus on the managerial power of large corporations, but developed a distinction between shareholders purely contributing funds and those taking a larger share, intending to exercise control over the firm.²²² Quite obviously, this raised much less concern about the protection of shareholders against management, but rather the protection of non-controlling shareholder and creditors.²²³ “Business activity”, he argued, “in large corporations is pro-

²¹⁹ DESPAX, *id.* n° 290.

²²⁰ JEAN PAILLUSSEAU, LA SOCIETE ANONYME, TECHNIQUE D’ORGANISATION DE L’ENTREPRISE 5 (1967); see Jean Paillusseau, *Le droit des activités économiques à l’aube du XXI^e siècle (suite et fin)*, 2003 RECUEIL LE DALLOZ 322, 322-324; see also Alain Couret, *Le gouvernement d’entreprise. La corporate governance*, 1995 RECUEIL DALLOZ SIREY, chronique, 163, 165; Géraldine Goffaux-Callebaut, *La définition de l’intérêt social*, 2004 REVUE TRIMESTRIELLE DE DROIT COMMERCIAL ET DE DROIT ECONOMIQUE 35, 36.

²²¹ See Claude Champaud, *Les fondements sociétaux de la « doctrine de l’entreprise »*, in ASPECTS ORGANISATIONNELS DU DROIT DES AFFAIRES. MELANGES EN L’HONNEUR DE JEAN PAILLUSSEAU 117, 149 passim (2003).

²²² CLAUDE CHAMPAUD, LE POUVOIR DE CONCENTRATION DE LA SOCIETE PAR ACTIONS 29-44 (1962); PAILLUSSEAU, *supra* note 220, at 49-52.

²²³ E.g. CHAMPAUD, *id.*, at 45.

foundly marked by the dominance of controlling shareholders,²²⁴ which of course raises the problem of abuse.²²⁵

Champaud seems not to have been particularly concerned with stakeholders or an institutional understanding of the firm. However, the emphasis on the two types of shareholders was picked up a few years later by Jean Paillusseau, who developed the legal theory of the *intérêt social*. He argued that the traditional contractual understanding of the corporation was not capable of explaining the increasing power of managers in large firms and the decline of the practical importance of shareholder meetings.²²⁶ In that point, his descriptive account is similar to that of the American authors of this period. Again, the crucial difference to the US that characterized his theory related to concentrated ownership.²²⁷ The reason of the decline of the shareholder meeting was therefore, in his view, not merely the absenteeism of contributors of capital, but the existence of controlling shareholders who were able to impose their will on the firm without any debate.²²⁸ His theory thus seems torn between the apparent necessity of centralized corporate decision-making on one hand, and the role of large blockholders on the other. Apparently assuming that controlling shareholders were typically represented on the board of directors, he observed that members of the board of directors typically were in the position to impose their will on other shareholders; the shareholder meeting must therefore not be allowed to authorize or approve acts contrary to the *intérêt social*.²²⁹ For the definition of the concept, while not explicitly emphasizing stakeholder issues, he

²²⁴ CHAMPAUD, *id.*, at 140.

²²⁵ CHAMPAUD, *id.*, at 145-146.

²²⁶ PAILLUSSEAU, *supra* note 220, at 239-245.

²²⁷ See PAILLUSSEAU, *id.*, at 49-52 (referring to the distinction between two types of shareholders emphasized by Champaud).

²²⁸ PAILLUSSEAU, *id.*, at 239.

²²⁹ PAILLUSSEAU, *id.*, at 194.

picked up Despax' theory of the institutional nature of the firm and argued that the firm's interest cannot be identified with the interest of shareholders, but that it includes all of the interests converging in the enterprise, the goal essentially residing in the life and growth of the economic organism.²³⁰ The interest of the firm was thus intended as a limiting shareholder power.

5.2. Institutionalism, the law, and the courts

Institutional theories of the corporation apparently did have some background in the development of legislation, albeit not a particularly strong one. The legal concept of the *intérêt social* can in fact be traced to the 1930s, when France, like many other countries, was suffering from the global economic crisis and political instability. In the wake of economic crisis, the Laval government had been given the power to take emergency measures in June 1935 in order to “ensure the defense of the currency and to fight speculation.”²³¹ Among other things, the government used this power to pass a decree-law in August 1935 without seeking parliamentary approval or debate.²³² The law introduced a number of business crimes, among others *abus de biens sociaux*, which remains in the law until today²³³ and is quite important in practice.²³⁴ It penalized directors' misuse of the company's property and credit in bad faith, “when directors knew that it was contrary

²³⁰ PAILLUSSEAU, *id.*, at 196-200.

²³¹ PAUL PIC, *ÉVOLUTION RECENTE DU DROIT DES SOCIÉTÉS 1930-1943*, 8 (2nd ed. 1943).

²³² Décret-loi du 8 août 1935. See HENRY SOLUS, *LA RÉFORME DU DROIT DES SOCIÉTÉS PAR LES DÉCRETS-LOIS DE 1935 ET 1937*, 2 (1938).

²³³ In the [former] Code des Sociétés of 1966, the criminal provision was in art. 425(4) and 437(3). The current provision is C. COM. art L. 242-6. See PAILLUSSEAU, *supra* note 220, at 189-191; Alcouffe, *supra* note 205, at 133; EVA JOLY & CAROLINE JOLY-BAUMGARTNER, *L'ABUS DE BIENS SOCIAUX À L'ÉPREUVE DE LA PRATIQUE* 8 (2002); Nicole Stolowy, *Company-Related Offenses in French Legislation*, 2007 J. BUS. L. 1, 3 (2007).

²³⁴ Conac et al., *supra* note 192, at 518-519 (citing statistics reporting several hundreds of convictions between 2000 and 2006).

to its interest.”²³⁵ While the provision did not explicitly use the wording *intérêt social*,²³⁶ the concept was used to refer to the offense.²³⁷ Even early commentators pointed out that the interest of the company was not identical to that of shareholders, but that, for example, an actual damage to the corporate patrimony was required and that a decrease in the stock price did not suffice.²³⁸

However, attempts to strengthen management vis-à-vis shareholders may have played a role as well. In fall 1940, only months after the German invasion, the Vichy government hastily passed a reform of the structure of the firm’s leadership without a debate or a clarification of its motives²³⁹ that had to be amended in early 1943 due to shortcomings in legislative craftsmanship.²⁴⁰ However, there was also a substantive aspect to this reform, which further increased the concentration of power: In 1940, the president of the board was by default the CEO at the same time, but he was still permitted to designate another person to take that position. The 1943 reform made the identity

²³⁵ See SOLUS, *supra* note 232, at 88; PIERRE BAUDOIN-BUGNET & GILLES GOZARD, LA DIRECTION DES SOCIÉTÉS PAR ACTIONS EN FRANCE ET EN ALLEMAGNE 35 (1941); PIC, *supra* note 231, at 73. In fact, Baudouin-Bugnet and Gozard report that the provision merely codified an already existing development in the case law deriving from the more general crime of *abus de confiance* (breach of trust). Solus reports that this provision was not considered sufficiently specific and that it was thought to combat the tendency among directors to treat the corporation as if it were their own.

²³⁶ According to the exact wording, the law penalized “managers who, in bad faith, have made use of the company’s property or credit in a way which they knew was contrary to the interest of it, for personal purposes or to favor another association in which they had a direct or indirect interest” (“les gérants qui, de mauvaise foi, ont fait des biens ou du crédit de la société un usage qu’ils savaient contraire à l’intérêt de celle-ci, dans un but personnel ou pour favoriser une autre société dans laquelle ils étaient intéressés directement ou indirectement”).

²³⁷ E.g. JOSEPH HAMEL & GASTON LAGARDE, 1 TRAITE DE DROIT COMMERCIAL, n° 660 (1954).

²³⁸ SOLUS, *supra* note 232, at 92-93.

²³⁹ Loi du 16 novembre 1940. This law replaced the prior loi du 18 septembre 1940 before it could come into force, which was suffering from even greater legislative problems. See Paul Cordonnier, *Loi du 16 novembre 1940*, 1941 DALLOZ CRITIQUE, legislation, 1, 1-2; MICHEL GERMAIN, 1/2 TRAITE DE DROIT COMMERCIAL n° 1367 (G. Ripert & R. Roblot, 18th ed. 2001).

²⁴⁰ Loi du 4 mars 1943. See RIPERT, *supra* note 212, at 116-117; HAMEL & LAGARDE, *supra* note 237, n° 652 (both citing low legislative quality as a reason for the amendment); see also Paul Esmein, *L’Administration des Sociétés anonymes d’après la loi du 16 novembre 1940*, 1940 GAZETTE DU PALAIS, II, doctrine, 90, 93-94 (describing that the president legally responsible for the actions of the *directeur*).

of the two functions mandatory,²⁴¹ introducing the *Président Directeur-General* (PDG) – CEO and president of the board – as the dominating figure in French corporations.

In that respect, the law remained largely unchanged until the “nouvelles réglementations économiques” reforms of 2001,²⁴² until when the functions of president of the firm’s board (*président*) and CEO (*Directeur-General*) always had to be joined.²⁴³ Some contemporary writers attributed this development to a “transposition of the German theory of the *Führerprinzip*” in France.²⁴⁴ After the end of the German occupation, a growing number of scholars objected to this interpretation of events and argued out that these enactments had been intended to identify a clear responsibility within the firm and were a reaction to prevailing monitoring problems, as the members of the board (particularly the president) did not take a sufficient interest in what the firm’s managers did.²⁴⁵ Yves Bouthillier, the finance minister of the Vichy government, later explained that the motivation was to appease the working class by showing that the government took action by linking responsibility to personal liability of the PDG, while at the same time avoiding the

²⁴¹ See PIC, *supra* note 231, at 79; Joseph Hamel, *Les pouvoirs du président et du directeur général des sociétés anonymes d’après la loi du 4 mars 1943*, 1943 GAZETTE DU PALAIS, II, doctrine, 59, 60.

²⁴² Loi no 2001-420 du 15 Mai 2001 relative aux nouvelles réglementations économiques (JO 16 mai 2001, p. 7776) [hereinafter: NRE law].

²⁴³ After 1967, firms were able to opt out by implementing a two-tier board structure inspired by German law. However, the latter never took root in France. See Alcouffe, *supra* note 205, at 129 (reporting that less than 3% had opted for a two-tier structure).

²⁴⁴ BAUDOIN-BUGNET & GOZARD, *supra* note 235, at 53 (“one could not achieve a more complete application of the *Führerprinzip*...” [own translation]); LOUIS CZULOWSKI, LA NOTION DE DIRECTION DANS LES SOCIÉTÉS ANONYMES ET LA LEGISLATION DE 1940, 133-134 (1943) (agreeing with this assessment); PAUL PIC & JEAN KREHER, 2 DES SOCIÉTÉS COMMERCIALES, n° 2018 (3rd ed. 1948) (“the reform of the Vichy government seems like a rather servile imitation of the ‘führer prinzip’ [sic!] of the German law of 1937”); See DESPAX, *supra* note 217, n° 249; see also the references provided by PAILLUSSEAU (*supra* note 220, at 154-155), who seems to give a mixed assessment; Esmein, *supra* note 240, at 90-91 (stating that the draftsmen’s intention was to ensure that the company had a “veritable boss”).

²⁴⁵ HAMEL & LAGARDE, *supra* note 237, n° 652; CLAUDE BERR, L’EXERCICE DU POUVOIR DANS LES SOCIÉTÉS COMMERCIALES n° 109-110 (1961); GEORGES RIPERT & RENE ROBLOT, TRAITE ELEMENTAIRE DE DROIT COMMERCIAL n° 1268 (5th ed. 1963); see also RIPERT & ROBLOT, *id.* n° 981 (pointing out that politicians subsequently remained opposed to large firms, which resulted in nationalizations). This possible rationale is described in more detail by PIC, *supra* note 231, at 74.

populist option of state ownership.²⁴⁶ By contrast, a book comparing French and German law published in 1941 (by a former and a future center-left parliamentarian) identified strong German influence on the enactment and concluded that “understanding German law sheds light on French legislation and facilitates its comprehension.”²⁴⁷ While all of these reasons may have jointly motivated the reform, post-war writers may have felt compelled to create a distance between French law (and themselves) and German influence.²⁴⁸ Given that French law, other than German law, concentrated power in the hand of one person – the PDG – one could even argue that the principle was implemented in purer form west of the Rhine.²⁴⁹

The law was not reverted after World War II. As one author of that period notes, the reason may have been post-war state involvement in the economy.²⁵⁰ A 1963 textbook points out that political authorities took a hostile stance towards great corporations, a large number of which were nationalized. Reforms were characterized by a “spirit of struggle against financial capitalism.”²⁵¹ The “hierarchical” view of the firm was subsequently espoused also by the French Supreme Court (*Cour de Cassation*) that prohibited the shareholder meeting from interfering with the board’s competences.²⁵² Contem-

²⁴⁶ YVES BOUTHILLIER, *LE DRAME DE VICHY II: FINANCE SOUS LA CONTRAINTE* 298-303 (1951); see also JEAN PEYRELEVADE, *LE GOUVERNEMENT D’ENTRPRISE* 30-34 (1999) (summarizing Bouthillier’s justification).

²⁴⁷ BAUDOIN-BUGNET & GOZARD, *supra* note 244, at 144 (own translation).

²⁴⁸ The two motivations are not necessarily a contradiction, as the German *Führerprinzip* was also defined as a combination of personal authority and responsibility. See e.g. Wilhelm Kißkalt, *Reform des Aktienrechts*, 1 ZEITSCHRIFT DER AKADEMIE FÜR DEUTSCHES RECHT 20, 26 (1934).

²⁴⁹ See CZULOWSKI (*supra* note 244, at 124, 134 n4) (correctly pointing out that the German law does not fully implement the principle, as it left the possibility of having several management board members of equal rank (other than French law); FRANÇOIS BLOCH-LAINE, *POUR UNE REFORME DE L’ENTREPRISE* 66 (1963) (“Believing to imitate the Germans during an embarrassing period, one made us adopt, under the name of the ‘führer prinzip’ [sic!], that formula of the ‘président-directeur général’ that the Germans have never known”).

²⁵⁰ See Leblond, *supra* note 216, at 29 (attributing the maintenance of the reform to a “post-war statist tendency”).

²⁵¹ RIPERT & ROBLOT, *supra* note 245, at 474-475.

²⁵² Cass. civ., 4 juin 1946, 1947 LA SEMAINE JURIDIQUE (JCP), II, no. 3518 (“arrêt Motte”).

porary observers suggested that the law of 1940 had effectively turned the relationship between the shareholder meeting, directors, and the PDG on its head.²⁵³

As described in the previous subsection, the 1960s are often thought to be the period when the institutional view of the corporation finally defeated the contractual view not only in legal theory, but also in the law. The 1966 reform has been described as endorsing it by creating a largely mandatory corporate law (the “institution”) that would protect minorities, creditors, and employees.²⁵⁴ Maybe more importantly, the core role of the *intérêt social* in the case law took root during the 1960s. Besides its role in corporate criminal law already described, there are various contexts in which it comes up. Among other things, it is used as the standard to which managerial decisions are held in liability suits, and it is also a component of the *abus to majorité* and *abus de minorité* doctrines, which are used to assess the validity of shareholder resolutions (i.e. resolutions found to violate the *intérêt social* can be voided).²⁵⁵

Nevertheless, the leading case that connects the notion of *intérêt social* to a purported shareholder-stakeholder conflicts, *Fruehauf*²⁵⁶, was decided in 1965 and is at least as unusual the sparse US cases on the shareholder primacy norm. Fruehauf-France had entered into a contract to deliver sixty trucks to a customer who would ulti-

²⁵³ E.g. D. Bastian, *Case note*, 1947 LA SEMAINE JURIDIQUE (JCP) II, 3518 (describing how different observers, in their interpretation of the law, either sought to expand or to limit its consequences).

²⁵⁴ Jean Paillusseau, *La modernisation du droit des sociétés commerciales*, 1996 RECUEIL DALLOZ SIREY, chronique, 287, 289.

²⁵⁵ MAURICE COZIAN, ALAIN VIANDIER & FLORENCE DEBOISSY, *DROIT DES SOCIETES* 167 (17th ed. 2004). Interestingly, for an abuse to found, the courts generally require two conditions to be met cumulatively, namely (1) that a decision was taken with the exclusive purpose to favor the majority (and harm the minority), and (2) that this decision does not respect the *intérêt social*. See C. cass. 18 avril 1961, 1961 SEMAINE JURIDIQUE (JCP), ED. G., II, n^o 12164; Cass. com. 22 avr. 1976, 1976 REVUES DES SOCIETES 479; Cass. com. 30 mai 1980, 1981 REVUE DES SOCIETES 311 (note by Dominique Schmidt); cf. Dominique Schmidt, *De l'intérêt commun des associés*, 1994 SEMAINE JURIDIQUE (JCP), EDITION GENERALE, I, 440, 441; Pirovano, *supra* note 259, at 194; COZIAN ET AL., *id.*, at n. 354; see also Conac et al., *supra* note 192, at 501. In other words, when a resolution is found to conform to the *intérêt social*, but favors the majority, it is shielded from nullification, which has led to some criticism in recent years. See particularly SCHMIDT, *id.*, at 318, 330-331, 339-340.

²⁵⁶ CA Paris, 22 mai 1965, JCP 1965, II, no 14274bis; D. 1968, Jur. p. 147 (note by Raphaël Contin).

mately have exported them to the People's Republic of China, which apparently caused some difficulty for its American majority shareholder at home. The majority voted to cancel the deal, but the minority of board members (representing French minority shareholders) objected and asked the competent local court to appoint a preliminary administrator for the company. The Paris Court of Appeal confirmed the lower courts' decision to that end, stating that the cancellation would have resulted in the ruin of the company because of the alienation of a major customer, and ultimately in the loss of 650 (French) jobs. Thus, the decision was found to violate the *intérêt social*. Even though the decision became quite famous²⁵⁷ and is still cited for introducing a new criterion into the evaluation of management decisions, no other cases with a similar shareholder-employee conflict followed.²⁵⁸ It is easy to argue that the case was much more a majority-minority conflict than a shareholder-stakeholder one.²⁵⁹

In spite of the significance of the criminal provisions drawing upon the idea of *intérêt social*, which are said to be of some relevance to the protection of creditors, commentators assert that it has not been all that important with respect to potential conflicts of interest between shareholders and other constituencies. Most of all, the *Fruehauf* case, in which the court explicitly referred to the dangers to employees, remained largely without further jurisprudential consequences beyond the case itself, as it did naturally not result in lawsuits being brought by unions to challenge management decisions on behalf of employees.²⁶⁰ Pirovano criticizes that the emphasis on the corporation's social interest

²⁵⁷ Cf. Raphaël Contin, *Note*, 1968 RECUEIL DALLOZ SIREY 148, 150.

²⁵⁸ Claude Ducouloux-Favard, *Actionnariat et pouvoir*, 1995 RECUEIL DALLOZ SIREY, chronique, 177, 180; Philippe Bissara, *L'intérêt social*, 117 REVUE DES SOCIÉTÉS 5, 15 (1999) (both pointing out that the case remained isolated).

²⁵⁹ See PAILLUSSEAU, *supra* note 220, at 199 (describing the case); see also Antoine Pirovano, *La "boussole" de la société. Intérêt commun, intérêt social, intérêt d'entreprise ?* 1997 RECUEIL DALLOZ 190 (pointing out the political ramifications of the case).

²⁶⁰ Pirovano, *supra* note 259, at 190.

may have been largely due to managerial ideas of the 1970s, when the *intérêt social* was used as “a curtain of fume behind which managers had ultimately considered the enterprise their own, however with a frequently ridiculous financial participation,” and that the legal order had been built around the protection of the dominance of the dominant stockholder.²⁶¹ On the other hand, Bissara emphasizes that the only function of this standard is to restrain actions that deliberately harm the corporation: It does not say anything about business decisions, such as how to best finance the company, which supplier to use, or how to organize the firm.²⁶²

The nationalization of many large French firms seems not to have played a significant role in the institutionalist movement in French thought about the corporation,²⁶³ as authors developing the theory rarely discuss it.²⁶⁴ Nationalized firms such as Renault were often directly run as an economic unit of the government and not as corporations. In other cases, the state was the only shareholder.²⁶⁵ Where minority shareholders remained, their relationship with the state majority may not be all too different from that of a minority in a family-owned firm if the government used the firm to advance goals at

²⁶¹ Pirovano, *id.*, at 195.

²⁶² Bissara, *supra* note 258, at 16.

²⁶³ While the Third Republic (up to World War II) was described as anti-labor up to the rise of the left-wing Popular Front in 1935 (ROE, *supra* note 5, at 70), the state began to play a major role in the French economy after World War II. Nationalizations began in 1936/37 with industries crucial for the military and transportation. See HAMEL & LAGARDE, *supra* note 237, n° 893. After the war, all firms “with the character of a public national service or of a natural monopoly” followed, as did some firms such as Renault whose owner was (possibly falsely) being accused of collaboration. See HAMEL & LAGARDE, *id.* n° 894; JEAN-FRANÇOIS ECK, HISTOIRE DE L'ÉCONOMIE FRANÇAISE DEPUIS 1945, 13 (4th ed. 1994). Some firms were nationalized to aid the government's planned reconstruction efforts, which succeeded and resulted in “Les Trente Glorieuses”, 30 years of economic growth after the war. See James A. Fanto, *The Transformation of French Corporate Governance and Institutional Investors*, 21 BROOK. J. INT'L L. 1, 32 (1995). Much later, the socialist government under President Mitterrand took a number of large firms under the wing of state ownership in 1981/82. Fanto, *id.*, at 33; Michel Berne & Gérard Pogorel, *Privatization Experiences in France*, CESIFO WORKING PAPER NO. 1195, 1, at <http://ssrn.com/abstract=553952> (2003). On nationalization and privatization during the 1980s see also ECK, *id.* at 50-51.

²⁶⁴ DESPAX (*supra* note 217, at 164-169) discusses nationalizations, but focuses on the legal aspect of nationalizations laws leaving the structure of the “enterprise” as such intact.

²⁶⁵ HAMEL & LAGARDE, *supra* note 237, n° 902, 914. In the *économie mixte* the government merely took a majority share, but it was usually made sure that directors were appointed by the state. HAMEL & LAGARDE, *id.*, n° 932; Fanto, *supra* note 263, at 34.

odds with purely financial shareholder interests. However, managers in public-sector firms are usually thought to have comparatively large powers to act independently, even from the government,²⁶⁶ which would have put them in the position to advance an agenda centering on the “interests of the firm”, however, defined.

5.3. Dismissal *ad nutum*

There is another aspect of French law that may explain why the “interests of the firm” as a guiding legal standard is less important than it might seem at first glance. In spite of the establishment of the institutional theory in French corporate law in the 1960s, shareholders were always in the position to remove directors by a simple majority vote before their stipulated term of office. Ducouloux-Favard, writing in 1996, describes this revocation *ad nutum* as a characteristic of the contract of agency and a pillar of corporate law that remains indestructible.²⁶⁷ True, the 2001 NRE law²⁶⁸ resulted in some changes to the relationship between shareholders and managers. Previously, shareholders could directly remove the *Président Directeur-General* (PDG, i.e. CEO) by revoking the appointment to the board of directors, given that he had to be its president.²⁶⁹ Now, shareholders can now only remove board members,²⁷⁰ while the managing directors are appointed, and can be removed by the board at any time.²⁷¹ While the PDG may traditionally have enjoyed a particularly authoritative position during the day-to-day management

²⁶⁶ JEAN KERNINON, *LES CADRES JURIDIQUES DE L'ÉCONOMIE MIXTE 88-90* (2nd ed. 1994); Fanto, *id.* at 34-37.

²⁶⁷ Claude Ducouloux-Favard, *Les déviations de la gestion dans nos grandes entreprises*, 1996 RE-CUEIL DALLOZ SIREY, chronique, 190, 191. In fact, several early proponents of the French institutional theory had recognized that the revocation *ad nutum* principle was untenable under the contrary position and called for legislative reform. See GAILLARD, *supra* note 206, at 120-123; RIPERT, *supra* note 212, at 119.

²⁶⁸ *Supra* note 242.

²⁶⁹ GERMAIN, *supra* note 239, n° 1685.

²⁷⁰ Art. L. 225-18 al. 2 C. com.

²⁷¹ Art. L. 225-55 C. com. These rules are considered mandatory law. See MERLE & FAUCHON, *supra* note 205, n° 386; GERMAIN, *supra* note 239, n° 1653.

of the firm,²⁷² Hansmann and Kraakman therefore point out that “the shareholder majority nevertheless holds the PDG at the end of a short leash by virtue of the majority’s removal power.”²⁷³ The NRE law may in fact have slightly strengthened the position of managers by providing that premature removal from office may give rise to damages under certain circumstances.

5.4. Conclusion: Another attempt to constrain shareholders through institutionalism

As we have seen, French corporate law indeed shares its pluralist and institutionalist ideology with German corporate law. The development began timidly in the 1930s and blossomed in the 1960s. French law shared many aspects of its historical development with German law, such as the rise of multi-vote shares as the result of inflation, and later a debate focusing on the institutional nature of the firm that was characterized by the intention to defend the firm against conflicts of interest among shareholders, an issue that was not of much significance in the US given in light of dispersed ownership of large firms. Again, the historical overview illustrates how the economic background variable of ownership structure influenced the debate.

6. Comparative patterns

6.1. A transnational history of the debate

What larger patterns can be identified on the basis of the country-specific histories? The ultimate trigger of the debate seems to have been the development of the “great corporation”, characterized by a large capital basis, specialized management, and an in-

²⁷² E.g. Alcouffe, *supra* note 205, at 129 (2000). On the import of the Nazi *Führerprinzip* in France, see *supra* note 242-249 and accompanying text.

²⁷³ Hansmann & Kraakman, *supra* note 72, at 41.

creased detachment from its owners. Rathenau was among the first to recognize this when he spoke of the “substitution of the reason” (*Substitution des Grundes*) for the existence and role of corporations in 1917.²⁷⁴ Rathenau argued that the “enterprise” was essentially turning into an institution resembling the state,²⁷⁵ a passage that was later cited by Berle and Means.²⁷⁶ With his involvement in the New Deal, Berle similarly began to sympathize at least to some degree with a public function of corporations and directors, although he thought that the shareholder primacy norm was necessary to curb managerial power. Rathenau pointed out that the development of large firms was already more advanced in the US and in Germany than in other countries including the UK and France, which may explain why these countries were the earliest to develop a debate.²⁷⁷

The rise of the large firm was a phenomenon common to the US and Germany, but apart from that point, the debates diverged between the two countries. Rathenau’s position seems to have been characterized by his personal experience on the board of what we would today call a Berle-Means firm, while most German firms had controlling shareholders, an issue that was picked up by subsequent legal commentators. Concentrated ownership may in fact have increased after World War I due to inflation (as it did in France in the late 1920s). Berle and Means, on the other hand, identified a prevailing pattern of powerful management and dispersed shareholders that had already solidified. The distinction characterized the debates in these two countries: In the US, scholars were concerned by the quasi-political, agency-cost driving power of managers, while in

²⁷⁴ See RATHENAU, *supra* note 83, at 8.

²⁷⁵ RATHENAU, *supra* note 96, VON KOMMENDEN DINGEN, at 143; RATHENAU, *supra* note 96, IN DAYS TO COME, at 121.

²⁷⁶ BERLE & MEANS, *supra* note 3, at 352.

²⁷⁷ RATHENAU, *supra* note 83, at 10.

the Germany legal scholars picking up Rathenau's ideas were concerned with the position of large shareholders in corporations and their interference with the proper functioning of management.

Mark Roe suggested that American populist politics directed against the power of large financial institutions kept them small and unable to become major shareholders, as they did on the European continent. Economic crises and corporate governance scandals led to the New Deal reforms, which helped to further enshrine dispersed ownership.²⁷⁸ By the time of the economic crisis of the 1930s, this structure was firmly entrenched (at least in the mind of the public debate shaped by Berle and Means). The political response was the New Deal, most of all the 1933 and 1934 acts, which partly addressed the concern about excessive power of managers by providing extensive disclosure. Most stakeholder concerns that might have arisen were overshadowed by the fact that the enshrinement of managerial power ensured the protection of legal capacity from shareholder influence and thus protected stakeholders' expectations, while it exacerbated agency problems in the shareholder-manager relationship. In the following decades, scholars observed the power of managers and debated and whether and how to constraint it, and whether political and regulatory intervention was necessary to ensure that firms directed their minds towards the public policy concerns that their powerful position entailed.

In Germany, by contrast, managers were not seen as sufficiently insulated from the possibilities of blockholders to interfere. The 1937 corporate law reform, in spite of many ideological overtones, was ultimately pragmatic, as even hardened ideologues had to realize that large business could not operate without tapping capital markets. Possibly

²⁷⁸ MARK J. ROE, STRONG MANAGERS – WEAK OWNERS 51-123 (1994).

drawing some inspiration from US corporate governance, the law intended to shield managers from shareholder influence and enshrined a pluralist corporate objective norm. Still, in spirit it was skeptical towards capital, and it was intended to foster managerial power. A similar motivation may partly have been behind the French reforms that followed in 1940/43, but these did not create truly independent managers, either. Concerns were raised not primarily by the power of managers, but by the power of capital.²⁷⁹ The attempt to contain it was maybe a logical reaction. Blockholders persisted and continued to exert a strong influence on large German firms, which prohibited the rise of a truly strong management. Nevertheless, the reforms helped to solidify a pluralist, institutional view of the firm that intended centralize power within the firm – quite the opposite from what was debated in the US. Codetermination, in particular its enhancement in 1976, was another reaction against capital before the background of raising political power of labor.²⁸⁰ At the same time, it strengthened the institutional view of the firm, which, however, remained overshadowed by concentrated ownership. Until the 1990s, when the importance of capital markets began to rise again, this view remained mostly unopposed.

The French debate resembled the German one. French populism in the 1930s was directed against powerful families.²⁸¹ Like their Eastern neighbors, French firms saw entrenchment through shares carrying a disproportional number of votes (which were pro-

²⁷⁹ See FRIEDRICH KLAUSING, GESETZ ÜBER DIE AKTIENGESELLSCHAFTEN UND KOMMANDITGESELLSCHAFTEN AUF AKTIEN 56 (1937) (report to the 1937 act stating that “fundamental decisions regarding the fate of the corporation are made by the majority of the providers of funds, who are personally not responsible, who usually lack precise and competent insight into business and the firm’s operations, and who typically emphasize the concerns of capital.”)

²⁸⁰ Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, in 102 YALE L. J. 1927, 1970 (1993).

²⁸¹ Antoin E. Murphy, *Corporate Ownership in France*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 185, 188 (Randall K. Morck ed. 2005) (referring to prime minister Edouard Daladier’s famous criticism of the alleged two hundred “grandes familles” in 1930).

hibited in France in 1931/1934 and in Germany in 1937). However, only after World War II and a period of nationalization, French institutionalist theory solidified in the 1960s, with the pluralist goal intended as a balancing technique to resolve conflicts among shareholders. The debate was initially hardly characterized by shareholder-stakeholder conflicts; by contrast, adherents of the institutional school of corporate law were preoccupied with the protection of the firm from influence by shareholders that was seen as a danger to a prosperous development. As in Germany, the increased need to tap capital markets made the pendulum swing back in the other direction in the 1990s.

6.2. Defending the firm against its shareholders

Why was institutionalist pluralism brought forward as an answer to interference of shareholders with management or from strife between shareholders groups? There are a number of possible explanations. First, it could be a pattern of rent-seeking attempts by managers to stave off attempts by shareholders to improve monitoring or other devices that reduce agency cost. This is the classical argument against American constituency statutes that help managers to stave off hostile takeovers.²⁸² In the American context, it seems reasonable to believe that this is at least part of the story, as managerial power reached an unparalleled degree with the rise of the “modern corporation.”

There may be more to this. Economic analysis has brought forward reasons why full shareholder control may not be a good thing for firms, many of which resonate with arguments brought forward in the historical debate. Tight monitoring may stifle managerial initiative.²⁸³ Discord among shareholders, particularly when they are heterogeneous,

²⁸² Lucian A. Bebchuk & Allan Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999).

²⁸³ Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholders, Monitoring, and the Value of the Firm*, 112 Q. J. ECON. 693 (1997).

may hamper decision-making,²⁸⁴ which is a more significant issue in a firm with various blockholders than in an “atomistic” structure where each shareholder will most likely be primarily interested in making a return on his or her investment. Table 1 summarizes the argument: Shareholder influence may increase the agency cost of debt, as managers are more likely to engage in risk enhancement.²⁸⁵ The going-concern value of the firm is more strongly protected if it is harder for shareholders to force the disgorgement of funds.²⁸⁶ And finally, shielding corporations from shareholders allows commitment of capital to the firm, which in turn may allow stakeholders to commit to their relationship due to lower risks for their specific investment.²⁸⁷

Ownership structure	Effective controller of the firm	Main problem(s)	“Reformist” response in historical debates	Defense of the status quo
Dispersed ownership	Directors and officers	<ul style="list-style-type: none"> • Managerial agency cost 	shareholder primacy	institutional theory of the firm / stakeholders
Concentrated ownership	Controlling shareholder or coalition	<ul style="list-style-type: none"> • Controller’s private benefits • disruptive conflict between shareholders • holdup of stakeholders 	institutional theory of the firm / stakeholders	shareholder primacy

Table 1

²⁸⁴ Bainbridge, *Shareholder Disempowerment*, *supra* note 19, at 1744-1751; Anabtawi, *supra* note 20, at 577-593.

²⁸⁵ See Hollis Ashbaugh-Skaife, Daniel W. Collins & Ryan B. LaFond, *The effects of corporate governance on firms’ credit ratings*, 42 J. ACCT. & ECON. 203 (2006) (finding a correlation between block ownership and higher cost of debt, and a negative one for takeover defenses); on the debate in finance see also Roman Inderst & Holger Müller, *Ownership Concentration, Monitoring, and the Agency Cost of Debt*, WORKING PAPER (1999), at <http://ssrn.com/abstract=190497>; Michael Bradley, Dong Chen, George Dallas & Elisabeth Snyderwine, *The Relation between Corporate Governance and Credit Risk, Bond Yields and Firm Valuation*, WORKING PAPER (2007), at <http://ssrn.com/abstract=1078463>.

²⁸⁶ See Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1348-1350 (2006) (discussing the protection of the going concern value from liquidation).

²⁸⁷ Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizations in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003).

In a dispersed ownership setting, managerial agency problems and the strong position of management in general were considered to be the main problem. The “reformist” position was therefore to constrain managers tightly, for which a shareholder primacy position seemed to offer the best option. An institutional or stakeholder theory focusing on the board of directors was typically a defense for incumbent managers. By contrast, in a concentrated ownership system, the main problem is the disruptive influence of shareholders on the firm (either of an actual controlling shareholder, or of the disruptive effect of disputes between shareholders). Thus, an institutional theory that reduced shareholder control seemed appealing as a way of shutting out the power of capital and as a guideline for the resolution of conflicts. For several decades, the “reformist” position was therefore the one asserting the independence of the firm. The point of my argument is not that the managerial agency problem is not important in general, or in concentrated ownership systems specifically. The point is rather that the problems of shareholder decision-making power brought forward in the contemporary debate increase when a firm’s ownership structure does not resemble an atomistic Berle-Means structure, where everybody has merely a small financial interest, but when there are larger blocks, where the interests of blockholders, controlling or not, are heterogeneous. Before the backdrop of concentrated ownership structures, institutional theories are therefore more appealing.

Without doubt, the restrictions institutional theories, imposed on controlling shareholders remained relatively small, even when legislators and courts followed them. In shareholder/employee conflicts of interests, there were certainly more important regulatory incursions that limited shareholder power, most of all codetermination in Germany,

and much stronger employment protection laws in Western Europe than in the US.²⁸⁸ These differences may explain why shareholder primacy seemingly has long had the greater appeal to scholars in the US, whereas institutional theories have more often appealed to Continental European scholars.

6.3. Meanwhile, back in the US: When do pro-stakeholder arguments emerge?

Of course, “stakeholder” or “institutional” arguments have often also emerged in the US. In spite of the important role of dispersed ownership firms in the academic and public discourse, these have always only remained an important subset even of publicly traded firms.

The most important example of a situation where such arguments place a defensive role are of course hostile takeovers. The result of a hostile takeover is the replacement of the typical Berle-Means ownership structure by one dominated by the successful bidder as the controlling shareholder, who will often reorganize the corporation's business activities or break it up. Unsurprisingly, the takeover wave of the 1980s has led to law that is (at least superficially) pro-stakeholder. Most important among these is probably the Delaware Chancery Court's Unocal decision, which enacted a two-prong test in 1985.²⁸⁹ First, the board has to identify a threat, and second, its response must be reasonable in relation to the threat posed. Regarding the evaluation of the existence of a threat by the target board, the court explained that the following elements are to be considered when identifying and evaluation a threat:

“inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on *"constituencies" other than shareholders (i.e., creditors, customers,*

²⁸⁸ See Gelter, *supra* note 8, at 168-173.

²⁸⁹ Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

*employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange” (emphasis added).*²⁹⁰

When it specified the Unocal standard in subsequent opinions, at least during the 1980s, the Delaware Supreme Court maintained its view that the interests of other constituencies are to be considered as objects of a threat which the board may resist.²⁹¹ The *Unitrin* decision of 1995²⁹² has given even more latitude to the board by finding that defensive measures will only be prohibited if the court finds them to be draconian, i.e. “coercive” or “preclusive”. Similarly, in more than half of all states,²⁹³ a statute explicitly allows or requires directors to take the interests of other constituencies into account, with Delaware and California being the most prominent absentees. Groups mentioned apart from shareholders are employees, creditors, bondholders, suppliers and communities; some statutes mention broader societal interest²⁹⁴ or even officers of the corporation.²⁹⁵

Hostile takeovers are of course the situation where corporations are transferred from dispersed to concentrated ownership, and the two functions of uses of “stakeholder arguments” both apply: From the perspective of analysts favorably disposed to takeovers, they help to entrench management and therefore help corporate insiders. From the perspective of opponents of takeovers, they help to defend the corporation against a prospective corporate insider, namely the hostile bidder intending to “slice and dice” the

²⁹⁰ 493 A.2d 955.

²⁹¹ *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1342 (1987); *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 68 (1989); *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 (1989)

²⁹² *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995).

²⁹³ Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and High Fears*, 1999 ANN. SURV. AM. L. 85, 125-128 (listing a total of 32 statutes, among those 30 constituency statutes and 2 statutes explicitly allowing to consider the directors to consider the corporation’s continued independence as optimally serving the corporation’s and shareholder interest). However, Nebraska’s statute was repealed in 1995. Springer, *id.*, at 95.

²⁹⁴ JAMES D. COX & THOMAS LEE HAZEN, *COX & HAZEN ON CORPORATIONS* 172 (2nd ed., 2003).

²⁹⁵ Springer, *supra* note 293, at 125-128.

firm. A hostile takeover threat thus confronts the firm with the potential of replacing weak dispersed owners with a determined single acquirer. With control of the firm transferring from management to a controlling shareholder, the “pluralist” defense of the firm transforms from an argument in favor of entrenchment against one defending the corporations against shareholder intervention.

Outside of the takeover context, the significance of both the “shareholder primacy norm” and stakeholder arguments has remained small. Most Delaware cases plainly state that directors and officers hold a fiduciary duty to the corporation and its shareholders, and have to act in the best interests of both.²⁹⁶ The fact that the corporation is mentioned in addition to shareholders might indicate some kind of “entity” understanding of corporate law, and might even imply that the term corporation should be understood as a proxy for the interests of its stakeholders as a whole,²⁹⁷ although this might be a matter of contention.²⁹⁸ Otherwise “shareholder primacy” has only come up in some fairly odd cases that are nevertheless frequently cited in the literature.

The more known one was of course *Dodge v. Ford Motor Co.*²⁹⁹, which followed a disagreement between Henry Ford, the majority shareholder and director, and the Dodge brothers, who held a minority stake in Ford Motor Co., which was not a publicly

²⁹⁶ E.g. *Guth v. Loft*, 5 A.2d 503, 510 (1939), *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984); *Smith v. van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

²⁹⁷ See Rutheford B. Campbell, Jr. & Christopher W. Frost, *Managers' Fiduciary Duties in Financially Distressed Corporations: Chaos in Delaware (and Elsewhere)*, 2007 J. CORP. L. 491, 494.

²⁹⁸ An entity view is supported by recent the case law on fiduciary duties of Delaware directors to creditors, about which Chancellor Allen speculated in *Credit Lyonnais Bank Netherlands, N.V. v. Pathe Communications Corporation*, 1991 Del. Ch. LEXIS 215 at n. 55 (Dec. 30, 1991). According to *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 2007 Del. LEXIS 227, directors do not have direct fiduciary duties to creditors; however, the case suggests that creditors may bring derivative claims on behalf of the corporation. This suggests that the goal of Delaware law is the maximization of the total value of the corporation to both shareholders and creditors, with enforcement rights of either shareholders or creditors as residual claimants, depending on whether the firm is near insolvency or not.

²⁹⁹ *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

traded firm.³⁰⁰ At the time of the dispute, the company held excessive funds, while the Dodge Brothers were trying to set up a competing operation and needed the money.³⁰¹ Whereas Henry Ford was planning to expand the company, ultimately to bring down the price of cars produced, the plaintiffs wanted him to declare a larger dividend.³⁰² Ford argued that he was well within his rights to pursue his strategy, which he professed was motivated by “social and altruistic reasons.”³⁰³ The Michigan Supreme Court resolved this purported conflict between managerial altruism and shareholder interest by the now famous statement that

“[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the nondistribution of profits among stockholders in order to devote them to other purposes.”³⁰⁴

Proponents of shareholder wealth maximization have often pointed to this case as the seminal early formulation of shareholder primacy. Ford later bought the Dodge brothers’ share, continued to pay high wages and produce many cars, and as a result made the company even more profitable.³⁰⁵ Maybe the most remarkable characteristic was the fact that it grew out of a majority-minority conflict in a privately held form with several large shareholders. The actual issue of dispute – whether management must declare a dividend – was a typical issue of the academic and policy debates in Germany

³⁰⁰ For a list of Ford shareholders in 1908, see M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old is New Again*, in CORPORATE LAW STORIES 37, 49 (J. Mark Ramseyer ed. 2009).

³⁰¹ Henderson, *id.* at 57.

³⁰² For a detailed account of the facts see D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 315-320 (1998).

³⁰³ ROBERT CHARLES CLARK, CORPORATE LAW 603 (1986).

³⁰⁴ 170 N.W., at 684.

³⁰⁵ Henry G. Manne, *The Limits and Rationale of Corporate Altruism: An Individualistic Model*, 59 VA. L. REV. 708, 713 (1973).

and France. Henry Ford attempted to use a stakeholder argument defensively against other blockholders, but failed.

However, just as a small aside, the fact that the dispute was about a dividend payment is interesting from a comparative perspective, as it was an important issue in the German debates of the 1920s and 1930s whether shareholders should be able to force directors to pay a dividend. The German Aktiengesetz of 1937 transferred the authority to approve the annual accounts from shareholders to the management and supervisory boards, thus allowing these two bodies to jointly decide to create retained earnings in the balance sheet, and thus to curb shareholders' "hunger for dividends."³⁰⁶ It is also a significant issue in French *abus de majorité* (abuse of majority power) cases when the majority shareholder votes to retain earnings. While the power to decide about this issue has always remained with shareholders in France, the courts tend to find against the plaintiff minority, as judges usually consider the retention of earnings to be in the interest of the firm.³⁰⁷ While French law retained the standard-type solution, the German reform of 1965 partly reversed the 1937 enactment by requiring 50% of profits to be distributed.³⁰⁸ True, retention of profits within the firm is only beneficial if it has good projects to invest in, but scholars in the historical German debates feared the possibility of changing majorities among shareholders, and thus the risk of management being forced to make

³⁰⁶ Hefermehl, *Die Rechnungslegung im neuen Aktiengesetz*, 66 JURISTISCHE WOCHENSCHRIFT 503, 503 (1937) ("In other firms, the shareholder meeting confirmed financial statements that stood in blatant contrast to the proposals of the administration. This did not come to pass for the reason that shareholders considered different financial statements to be correct because of their better expertise, but exclusively from the point of view of personal advantage, whereas they remained indifferent towards the fate of the firm, which played a secondary role at best"); see Fischer, *supra* note 113, at 99; KALSS ET AL., *supra* note 141, at 318. On the debate before the 1965 act, when the concern was the lack of capital of German firms, see Kropff, *supra* note 158, note 65.

³⁰⁷ See MERLE & FAUCHON, *supra* note 205, n^o 580; COZIAN ET AL., *supra* note 255, n^o 362.

³⁰⁸ § 58 AktG.

a distribution at an inconvenient time, which can surely be disruptive for business planning.

The other prominent US case is *Shlensky v. Wrigley*, decided in Illinois in 1968.³⁰⁹ The directors of a baseball team actually defended their decision not to install lights at the baseball field (which would have allowed evening games and arguably would have resulted in a higher spectator turnout and higher profits) by saying "that baseball is a 'daytime sport' and that the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood."³¹⁰ The court bought into the contestable argument that this would ultimately hurt the firm, thus resulting in a long-term decline of shareholder wealth. In doing so, it effectively deferred the decision to the directors' business judgment in the absence of any personal conflict of interest. The gist of the story would seem to be that, as a practical matter, shareholder primacy is not enforced, and that it is less important what managers do than how they rationalize their decision. It would have been equally possible to find a reason why installing lights would have been preferable.

It is not surprising that analysts have often questioned the legal significance of the shareholder primacy norm. Merrick Dodd was among the first to note that the Dodge court cautiously avoided an "unqualified acceptance of the maximum-profit-for-stockholders formula."³¹¹ Gordon Smith has argued that the shareholder primacy norm is in fact irrelevant in publicly traded corporations,³¹² suggesting that modern courts would rather employ a duty of loyalty and minority oppression rhetoric in similar situations to-

³⁰⁹ *Shlensky v. Wrigley*, 237 N.E. 2d. 776 (Ill. App. 1968).

³¹⁰ 237 N.E. 2d. 778.

³¹¹ Dodd, *supra* note 44, at 1157-1158 n. 31.

³¹² Smith, *supra* note 302, at 277.

day.³¹³ Similarly, Robert Clark points out that Henry Ford's mistake was not his failure to declare a dividend, but to openly declare to be motivated by social concerns,³¹⁴ while in fact he intended to expand the company and, most of all, suppress the Dodge brothers' nascent competitive venture by impeding the financing of their plan to start their own automobile company, and by forcing them to sell him their shares at a low price.³¹⁵ Ford's purported philanthropic inclination was rather a cover for the abuse of his power to the detriment of other shareholders, without stakeholder or public interest – in spite of the language – being of actual significance. Notably, the court refused to enjoin plant expansions which, according to the Dodge brothers, would have been unprofitable.³¹⁶ Lynn Stout has gone even further and argues that *Dodge v. Ford* is not even good law: The case hails from a jurisdiction that is not important for setting corporate precedents, the famous shareholder primacy statement is essentially a dictum in a majority-minority conflict, and it is somewhat dated, but not actually used much by courts.³¹⁷ While neither corporate charters nor state corporate laws (which often include constituency statutes) reiterate the shareholder primacy view, corporate case law does it only rarely and hardly ever in an affirmative fashion.³¹⁸

While the doctrinal question is ultimately left to courts to answer, commentators seem to agree that the shareholder primacy norm does not normally set any important incentives or constraints for managerial decision-making. While some analysts assent to

³¹³ *E.g.* Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928); Donahue v. Rodd Electrotype, 328 N.E.2d 505 (Mass. 1975). See Smith, *supra* note 302, at 320-322.

³¹⁴ *Cf.* CLARK, *supra* note 303, at 138, 603; see also Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 VA. L. & BUS. REV. 177, 182 (2008).

³¹⁵ *Cf.* CLARK, *id.*, at 604; see also Nathan Oman, *Corporations and Autonomy Theories of Contract: A Critique of the New Lex Mercatoria*, 83 DENV. U. L. REV. 101, 135 (2005) (providing a similar account of *Dodge v. Ford*).

³¹⁶ See FRANLIN A. GEVURTZ, *CORPORATION LAW* 308-309 (2000); Oman, *id.*, at 136.

³¹⁷ Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 168-172 (2008).

³¹⁸ Stout, *id.*

the view that corporate law generally does not stipulate a duty to maximize shareholder wealth,³¹⁹ others, including some who are generally committed to shareholder primacy from a normative perspective, concede that, as an argument of shareholder interest prevailing over other concerns, shareholder primacy is of little practical relevance.³²⁰ Even if shareholder primacy is good law, the business judgment rule makes the shareholder primacy “rhetoric largely unenforceable.”³²¹ According to the debate among legal scholars, it largely suffices for managers (or, as in the case of Henry Ford, the controlling shareholder), to frame the reason why a particular policy measure should be taken within the requirements of the business judgment rule and the prevailing rhetoric. Since this is not a difficult exercise, it hardly seems to matter whether the corporate objective is shareholder primacy or something else. In practice, of course, social norms applying to directors and managers play an important role; it is a matter of contention whether top managers are subject to a shareholder wealth maximization social norm,³²² or rather to pluralist norms.³²³

For the thesis of this paper, it suffices to say that stakeholder arguments remain relatively unimportant in these cases. In *Shlensky*, the court was able to avoid taking sides

³¹⁹ Henderson, *supra* note 301, at 34 (“[shareholder wealth maximization] was not and is not the law.”).

³²⁰ E.g. Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 651 (2006) (“no modern court has struck down an operational decision on the ground that it favors stakeholder interests over shareholder interests”); WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 298 (3rd ed. 2009).

³²¹ Stephen M. Bainbridge, *Means and Ends*, *supra* note 19, at 582; see also Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 775 (2005) (“So even Dodge, the high-water mark for the supposed duty to profit-maximize, indicates that no such enforceable duty exists.”); Macey, *supra* note 314, at 181, 190.

³²² E.g. Bainbridge, *Means and id.* at 582 (considering shareholder primacy “central to director socialization”); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1416 (1993) (describing the influence of the principal-agent metaphor on MBA students).

³²³ Blair & Stout, *supra* note 26, at 438-441 (asserting that directors share a common socialization with workers).

on the issue; in *Dodge*, the decision came out against what we today consider a stakeholder argument, but obviously because of a majority-minority conflict.

6.4. A detour to the UK: Can another dispersed ownership system provide support of the theory?

The British debate was the last to get into full swing. Economic historians have sometimes suggested that (in spite of England's head start in the industrial revolution) the large, public corporation arrived in Britain only later than in the United States and Germany, namely after the First World War.³²⁴

Like the US, the UK has a reputation as a shareholder-oriented corporate governance system, and the UK today has dispersed ownership. Unlike the US, Germany, and France, the UK seems not to have had a "famous" historical exchange that set the scene for further debate about the nature and purpose of the corporation, or a school of thought that emphasized the institutional character of the corporation. The episode that comes closest is the UK's flirtation with worker codetermination that came about as a result of the discussion about "industrial democracy" during the 1970s. In the late 60s and early 70s, part of the Labour movement had pressed for company law reform and for the introduction of "industrial democracy."³²⁵ When the Labour Party came to power in 1974, it commissioned a report to study the implication of introducing representation of employees on the board of directors.³²⁶ The "Bullock report" of 1977³²⁷ recommended

³²⁴ E.g. LESLIE HANNAH, *THE RISE OF THE CORPORATE ECONOMY* 7 (2nd ed. 1984); Andrew Gamble & Gavin Kelly, *The Politics of the Company*, in *THE POLITICAL ECONOMY OF THE COMPANY* 21, 34 (John Parkinson, Andrew Gamble & Gavin Kelly eds. 2000).

³²⁵ See Ben Clift, Andrew Gamble & Michael Harris, *The Labour Party and the Company*, in *THE POLITICAL ECONOMY OF THE COMPANY* 51, 67-73 (John Parkinson, Andrew Gamble & Gavin Kelly eds. 2000).

³²⁶ HERMAN KNUDSEN, *EMPLOYEE PARTICIPATION IN EUROPE* 53 (1995).

³²⁷ LORD BULLOCK (CHAIRMAN), *REPORT OF THE COMMITTEE OF INQUIRY ON INDUSTRIAL DEMOCRACY* (1977). The "Bullock Report" was in fact the majority report signed by labor and independent (academic) representatives on the committee, to which the business representatives objected. See e.g. David Marsh

a radical form of codetermination comparable to the one in the largest German firms, with union representatives having equal representation.³²⁸ In addition, a number of neutral representatives would have been co-opted by capital and labor. The reasons why the report recommended these reforms were predominantly political ones. First, it suggested that the development of large firms has led to the development of large firms and a much greater distance between the localities where decisions affecting workers were made, and where they were felt. Although the managerial revolution had concentrated corporate power in the hand of managers also in the UK, these were still only accountable to shareholders.³²⁹ Second, it argued that there had been social changes (such as better education) that had led to a greater desire of workers to control their working environment, a more significant role of unions, and legislative changes, which jointly had led to greater employee involvement on many levels of the corporate decision-making, with the notable exception of the board of directors.³³⁰ By contrast, some later observers suggested that the purpose of industrial democracy would have been to reduce industrial conflict, which was still pervasive in Britain at that time, while Germany and the Scandinavian countries, whose labor codetermination regimes had been studied by the committee, enjoyed peaceful labor relations.³³¹

Unsurprisingly, the Bullock Report was strongly criticized by business lobbyists. Furthermore, the Labour movement was not able to fully shed its longstanding skepticism. The proposal did not even enjoy unanimous support among the unions, who feared be-

& Gareth Locksley, *Capital in Britain: Its Structural Power and Influence over Policy*, WEST EUR. POL., March 1983, at 36, 49.

³²⁸ However, the report advised against the introduction of a two-tier board. See Kahn-Freund, *supra* note 73, at 65-66.

³²⁹ BULLOCK, *supra* note 327, at 20-21.

³³⁰ BULLOCK, *id.* at 22-24.

³³¹ KNUDSEN, *supra* note 326, at 53-54.

ing drawn into management responsibilities and losing their independence from capital.³³² In fact, even some members of the government were skeptical about some elements of the plan, as was the Liberal Party, on whose support Labour depended. Finally, the government depended on the support of the City of London for its economic policy.³³³ The unions did not want to jeopardize legislative projects they considered more important, such as employment protection statutes.³³⁴ The government produced a more moderate White Paper in 1978, but could not resolve to pass a law in the face of sustained opposition.³³⁵ The debates dragged on until 1979, when the reinstated Conservative Party finally shelved the project.

All that remained of the project was a statute enacted by the newly elected Conservative government as part of the 1980 Companies Act (subsequently it was consolidated as § 309(1) the Companies Act of 1985):³³⁶

“The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.”

Other than under one of the Labour Party's proposals, there was no way for employees to enforce employee interests.³³⁷ The statute was finally abrogated in the course of the Companies Act 2006, whose section 172(1) enumerates various interests to take

³³² *E.g.* Marsh & Locksley, *supra* note 327, at 49-50; KNUDSEN, *id.*, at 54. There were a number of issues of dispute, such as the appointment process which would have been channeled through the unions in the absence of mandatory works councils in the UK. See Kahn-Freund, *supra* note 73, at 67-68. For a more detailed history of the debate in the late 1970s after the Bullock report, see Clift et al., *supra* note 325, at 79-80.

³³³ Marsh & Locksley, *id.*, at 50.

³³⁴ LORD WEDDERBURN OF CHARLETON, *THE WORKER AND THE LAW* 837 (3rd ed. 1986).

³³⁵ Marsh & Locksley, *supra* note 327, at 50.

³³⁶ *Cf.* Wedderburn, *id.* In the Companies Act of 1980, the provision was in § 46(1). D.D. Prentice, *A Company and its Employees: The Companies Act 1980*, 10 *INDUS. L. J.* 1, 2 (1981).

³³⁷ See Lord Wedderburn of Charlton, *Employees, Partnership and Company Law*, 31 *INDUS. L. J.* 99, 107 (2002).

into account by directors (among these those of employees), but ultimately decrees them to be purely instrumental to the benefit of shareholders.³³⁸

One of the reasons why section 309 never gained any real significance, was most likely the City Code on Takeovers and Mergers, which the board to maintain strict neutrality regarding hostile bids. When facing a bona fide offer, the board may not “take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits.”³³⁹ The only permissible countermeasures are so-called “defence documents”, such as strong public criticism of the bid’s terms of the bid, and seeking out an alternative transaction, e.g. by bringing in a “white knight” to defeat the hostile offer or a management buyout.³⁴⁰ Commentators often pointed out that UK takeover regulation gives directors “a greater incentive to focus on returns to shareholders” than US corporate law does.³⁴¹ The Takeover Code’s neutrality rule is very specific and intended to benefit shareholders in particular, and no other group.³⁴² Naturally, the threat of hostile takeovers therefore impinges on any inclination managers might have to advance the interests of other groups.

³³⁸ E.g. DAVIES, *supra* note 27, no. 16-25; BRENDA HANNIGAN & DAN PRENTICE, THE COMPANIES ACT 2006 – A COMMENTARY 31 (2007). An important reason was the familiar “too many masters” argument, according to which a pluralist approach leaves directors accountable to no one. MORSE ET AL., *id.*, at 166.

³³⁹ Rule 21.1.(a). Before the 2006 amendments to the Code, this general clause was not part of Rule 21, but General Principle 7 of the Code. For a discussion of these amendments see Geoffrey K. Morse, *Proposed Amendments to the Takeovers Code to Implement the 13th EC Directive*, 2006 J. BUS. L. 242 (2006). True, before the amendments, the Takeover Code required directors to consider not only shareholders’ interests, but also those of employees of directors (General Principle 9), and its rule 24.1 still requires the bidder to disclose its long-term plans and intentions with regard to the firm’s employees. However, as Deakin et al. point out, “these provisions do little to counter-balance the specific duties owed to shareholders under the Code.” See Simon Deakin, Richard Hobbs, David Nash & Giles Slinger, *Implicit Contracts, Takeovers and Corporate Governance: In the Shadow of the City Code*, in IMPLICIT DIMENSIONS OF CONTRACTS 289, 299 (David Campbell, Hugh Collins & John Wightman eds. 2003).

³⁴⁰ STEPHEN KENYON-SLADE, MERGERS AND TAKEOVERS IN THE US AND UK para. 10.07 (2004).

³⁴¹ John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation*, 95 GEO. L. J. 1727, 1739 (2007); SIMON DEAKIN & FRANK WILKINSON, THE LAW OF THE LABOUR MARKET 337 (2005).

³⁴² Deakin & Slinger, *id.*, at 137; see also DEAKIN & WILKINSON, *supra* note 341, at 336-337 (pointing out the absence of a requirement to consult employee representatives during a bid).

The British unions clearly missed an opportunity to steer British corporate law to a path involving labor on the board of directors, close to the German model. The reason for their reluctance – concern about closeness to management that would have undermined their ability to represent employee interests – illustrates that the group perceived to be in “charge” were managers (as in the US), and not controlling shareholders (although it is not clear which ownership structure dominated large UK firms in the 1970s). The Bullock report on “industrial democracy” of 1977 refers to the “managerial revolution”, which concentrated power in the hand of the board of directors, while “shareholders are too numerous to effectively act as a body ... It is only when there is a financial crisis or dissension within the board that shareholders are called upon to exercise power and take decisions.”³⁴³ While this was surely not the only reason for the British industrial democracy movement,³⁴⁴ to some degree it seems that the motivation coincides with the one of the American debate of the post-war decades.

Some scholars have therefore suggested that shareholders are more often conceived as individual owners of the firm than elsewhere.³⁴⁵ Longstanding provisions of company law, such as shareholders power’s to remove directors³⁴⁶ seem to be aligned with this vision. The former British pluralist statute was a byproduct of a number of labor-oriented reforms, of which “corporate democracy” was intended to be a centerpiece.

³⁴³ BULLOCK, *supra* note 327, at 21.

³⁴⁴ See e.g. Kahn-Freund, *supra* note 73, at 73 (suggesting that the reason was that collective decisions were increasingly taken on the firm level instead of the national level).

³⁴⁵ Wedderburn of Charlton, *Companies and Employees: Common Law or Social Dimension?* 109 L. Q. REV. 220, 236 (1993).

³⁴⁶ Under § 168(1) Companies Act 2006, and (formerly) § 303 Companies Act 1985 a company may by ordinary shareholder resolution “remove a director before the expiration of his period of office, notwithstanding anything in any agreement between it and him.” This right of shareholders is considered a key provision of UK company law. See PALMER’S COMPANY LAW 8.032 (loose-leaf, as of March 2001); Paul Davies, *Shareholder Value, Company Law, and Securities Markets Law: A British View*, in CAPITAL MARKETS AND COMPANY LAW 261, 265-266 (Klaus Hopt & Eddy Wymeersch eds. 2003) (arguing that the possibility of removal allows control by the majority of shareholders).

Maybe it was not a historical accident that it emerged shortly after the appearance of a wave of hostile takeovers and shareholder-oriented takeover law in the UK in 1968.³⁴⁷

Financial economists so far do not agree whether the UK already had dispersed ownership by the middle of the 20th century, or whether it developed only before the 1980s.³⁴⁸

If the UK already had dispersed ownership early in the 20th century, as claimed by Mayer, Rossi, and Wagner,³⁴⁹ then this period may have signified increased shareholder influence on managers, which would have increased pressure for countermeasures to benefit labor.

7. Conclusion

In this article, I have attempted to take a “grand tour” through the history of the debates about the proper goal of corporate law and the usually related legal objective of directors in the US, Germany, France, and the UK. The main insight is that pluralist goals were intended to serve different goals in the debate in these countries, depending on the underlying economic structure. The most important concern under dispersed ownership is largely the unconstrained power of managers. Even scholars such as Adolf Berle, who was initially skeptical about managerial power, accepted that a broader duty might be acceptable if it were combined with government intervention, which, however, is not seen as a desirable roadmap for policy today. On the other hand, under corporate governance structures with blockholders, pluralist and institutionalist goals of the firm were intended as a measure of resolving conflicts between shareholder groups that were a

³⁴⁷ Takeovers began in the 1950s, and the 1960s saw a major merger wave. See e.g. Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L. J. 422, 426 (2007). The City Code was established in 1960s, but its predecessor – the Queensberry rules – was enacted in 1958. See Armour & Skeel, *supra* note 341, at 1256-1264.

³⁴⁸ *Supra* note 4.

³⁴⁹ Franks et al., *supra* note 4.

lesser, if any concern in the large American firms that were thought to be typical in the academic debate. Continental “giant corporations” therefore did not need to be tamed, but rather needed to be protected from their own shareholders in the minds of many analysts. To some extent, the pluralist objective should have served as a means of asserting managerial power vis-à-vis shareholders. Stakeholder interests and institutional aspects of corporate structure therefore needed to be addressed more explicitly by the law, for which the corporate objective could in theory have played a role.