CENTRAL EUROPEAN UNIVERSITY
LEGAL STUDIES DEPARTMENT
INTERNATIONAL BUSINESS LAW

S.J.D. DISSERTATION

Shareholder Rights, Executive Compensation and Stakeholder Protection: A Comparative Overview of United States of America and chosen European Union Jurisdictions.

(For the fulfillment of the S.J.D. status)

Supervisor: Prof. **Stefan Messmann** S.J.D.

Worked By: **Arnisa Gorezi** LL.M.

Budapest, September 10th, 2011.

Acknowledgements

My gratitude goes to my supervisor, professor Stefan Messmann S.J.D., without the guidance and constant support of whom, this dissertation would not have been possible. I am also very grateful to the professors and staff of the Legal Studies Department of Central European University, for their valuable support. Thanks go also to the professors and staff of Berkeley School of Law, University of California, for their help and advice during my research period spent there.

Table of Contents

ABSTRACT 5
LIST OF ABBREVIATIONS 6

INTRODUCTION 12

A. THE SCOPE OF RESEARCH 12
B. CORPORATIONS VS. COMPANIES? 18
C. STRUCTURAL AND METHODOLOGICAL ASPECTS 25
D. EXPECTED CONTRIBUTIONS AND LIMITATIONS 27

CHAPTER I

SHAREHOLDER RIGHTS 29

1.1 INTRODUCTION TO THE AGENCY CONFLICT 29
1.2 HISTORY AND REASONS FOR SHAREHOLDER ACTIVISM 30
1.2.1 History of Shareholder Activism in the U.S. 34
1.2.2 History of Shareholder Rights in Germany 37
1.2.3 History of Shareholder Rights in CEE? 40
1.3 SHAREHOLDER RIGHTS IN THE U.S. 46
1.3.1 Election of Directors 46
1.3.1.1 Board 'Supremacy' in courts? The CA v. AFSCME case 51
1.3.1.2 Changes in Proxy Voting 53
1.3.1.2.1 The Broker Discretionary Rule 54
1.3.1.2.2 Proxy Voting and Shareholder Nominees 55
1.3.2 Shareholder Fundamental Transactions in the U.S. 58
1.3.2.1 Fundamental Transactions Including Takeovers 60
1.4 SHAREHOLDER RIGHTS IN THE CHOSEN EU JURISDICTIONS 63
1.4.1 Election of Board Members in the Chosen EU Jurisdictions 64
1.4.2 The EU Shareholder Rights Directive 69
1.4.3 Shareholders' Vote on Fundamental Transactions in the Chosen EU Jurisdictions 72
1.4.3.1 Shareholder Fundamental Transactions in Germany 72
1.4.3.2 Shareholder Fundamental Transactions in the Chosen CEE Jurisdictions 75
1.4.3.3 The Directive on Takeover Bids: Giant Step or False Compromise of Harmonization? 78
1.4.3.3.1 Harmonization of the EU Directive on Takeover Bids? 84
1.5 A FINAL NOTE ON THE TWO TAKEOVER REGIMES 87
1.6 CONCLUSIONS 89

CHAPTER II

DIRECTORS` FIDUCIARY DUTIES 92

2.1 INTRODUCTION 92
2.2 THE DUTY OF CARE AND LOYALTY IN THE U.S 94
2.2.1 The Duty of Care 96
2.2.2 The Duty of Loyalty 102
2.2.3 The Disney and Lyondell Cases: Defining 'Bad Faith' and Gross Negligence? 104
2.2.4 Directors` Liability for Failure to Act 107
2.3 DIRECTORS` FIDUCIARY DUTIES IN THE CHOSEN EU JURISDICTIONS 112

2.3.1 Fiduciary Duties in Germany *112*
2.3.1.1 Duty of Care and the Business Judgment Rule 114
2.3.1.2 Duty of Loyalty and Conflicts of Interests 118
2.3.1.3 Failure to Act 122
2.3.1.4 A Note on Shareholder Derivative Suits 124
2.4 Directors` fiduciary duties in CEE 126
2.5 Conclusions 130
CHAPTER III
REGULATION OF EXECUTIVE COMPENSATION 133
3.1 Introduction 133
3.2 Historical Overview of Executive Compensation 135
3.2.1 History of Regulating Executive Compensation in the U.S.: *135*
From Berle and Means to the Financial Crisis *135*
3.2.2 History of Regulating Executive Compensation in the chosen EU jurisdictions *146*
3.2.2.1 History of Regulating Executive Compensation in Germany 149
3.2.2.2 'History' of Regulating Executive Compensation in the chosen CEE jurisdictions? 154
3.3 Executive Compensation in the U.S. 158
3.3.1 The Role of Sarbanes-Oxley and Stock Options *163*
3.3.1.1 Imprisoning executives 165
3.3.1.2 The Clawback Provision of Sarbanes-Oxley and the Passivity of the SEC 167
3.3.1.3 The SEC Sharpens Its Claws: No-Fault Liability of Executives? 171
3.3.1.4 Prohibiting Personal Loans and "Freezing" Excessiveness? 173
3.3.2 The Disney case: Where Fiduciary Duties End? *180*
3.3.3 Angry America? Reactions to the Financial Crisis. *184*
3.3.3.1 A Time of Pay Czars? 186
3.3.3.2 Say-on-Pay 187
3.4. Executive Compensation in the Chosen EU Jurisdictions 190
3.4.2 The Mannesmann Case: Judging Excessiveness? *196*
3.4.3 Reforming Executive Compensation in Germany *206*
3.4.4 Executive compensation in the chosen CEE jurisdictions *212*
3.5 Conclusions 217
CHAPTER IV
STAKEHOLDER PROTECTION 220
4.1 Introduction 220
4.2 Stakeholder Protection in U.S. Corporations 223
4.2.1. Corporate Law: CSR as a Paradox? *226*
4.2.1.1 Stakeholders and Fiduciary Duties? 226
4.2.2 Fiduciary Duties to Creditors: From Footnote 55 to Trenwick? *228*
4.2.2.1 Different Concepts, Same Results? 231
4.2.3 A Note on Employees in American Corporations *233*
4.2.4 Corporate Charity? *235*
4.2.5 Takeovers and Stakeholders *237*
4.2.5.1 Cases Affecting Stakeholders? 240
4.3 Stakeholder Protection in the Chosen EU Jurisdictions 243
4.3.1 Stakeholder Protection in German Companies *244*
4.3.1.2 Empowered Employees? 248
4.3.1.3 Protection of Creditors in German AGs 252
4.3.2 Stakeholder Protection in CEE *256*
4.3.2.1 Fiduciary duties and Stakeholders in CEE? 257
4.3.2.2 Employees as Stakeholders in CEE Companies 260
4.3.2.3 Creditors as Stakeholders in CEE companies 265

4.4 Conclusions..269

CONCLUSIONS 274

Bibliography...280

ABSTRACT

The intensity of debates on corporate governance has increased significantly in the past decades. Problems deriving from the classical agency conflict in publicly held corporations, amongst which, most notably, the risk of low shareholder protection, violation of fiduciary duties, and regulation of executive compensation, have been persistent. Apart from this, the relation between the corporation and its stakeholders, a notion derived from a wider perception of corporate governance, opens up numerous related questions, from the definition of the 'interest of the corporation', to the dilemma as to whom are the agents` fiduciary duties owed in a stakeholder model.

It is amidst these debates that this thesis analyzes, compares and critically assesses three inextricably linked, key aspects of corporate governance, namely: shareholder rights, executive compensation and stakeholder protection, in publicly held corporations in the U.S. and chosen EU jurisdictions. The research analyzes how these aspects are regulated so far, it finds the commonalities and differences in the approaches followed by the selected jurisdictions, and discovers the pertaining dilemmas, with regards to each of them.

LIST OF ABBREVIATIONS

ABA	American Bar Association
ADHGB	German General Commercial Code, [*Allgemeines Deutsches.Handelsgesetzbuch*]
AFSCME	American Federation of State, County and Municipal Employees Pension fund**.**
ALI	American Law Institute
AG	Public limited company in Germany [*Aktiengesellschaft*]
AktG	German Stock Corporation Act [*Aktiengesetz*]
ARRA	American Recovery and Reinvestment Act.
Art.	Article (provision of law or regulation).
AS	Public limited Company in Czech Republic [*Akciova Spolecnost*]
BetrVG	German Works Council Constitution Act [*Betriebsverfassungsgesetz*]
BT-Drs	German Parliament Printed Collection [*Bundestagsdrucksache*]
BGBI	Federal Law Gazette [*Bundesgesetzblatt*].

BGH	German Federal Supreme Court [*Bundesgerichtshof*]
BGHZ	German Federal Law Reporter on Civil Cases [*Entscheidungen des Bundesgerichtshof in Zivilsachen*].
BörsG	German Exchange Act [*Börsengesetz*]
CalPERS	California Public Employees Retirement System.
CalSTRS	California State Teachers Retirement System.
CEE	Central Eastern Europe
CEO	Chief Executive Officer
CFO	Chief Financial Officer
C.F.R.	Code of Federal Regulations
Coll.	Czech Law Collection
Co.	Company
Corp.	Corporation
CSR	Corporate Social Responsibility.
CZK	Czech Koruna
DGCL	Delaware General Corporation Law
DrittelbG	One Third Participation Act [*Drittelbeteiligungsgesetzes*].
EBRD	European Bank for Reconstruction and Development.
ECGI	European Corporate Governance Institute

EESA	Emergency Economic Stabilization Act
ERISA	Employee Retirement Income Security Act
EU	European Union
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FMStG	German Act on the Stabilization of the Financial Markets, [*Finanzmarktstabilisierungsgesetz*]
FTSE	Financial Times Stock Exchange
FR	Final Rule of the Securities and Exchange Commission
GCGC	German Corporate Governance Code.
GmbH	Limited Liability Company in Germany [*Gesellschaft mit -beschrankter Haftung*].
HGB	German Commercial Code [*Handelsgesetzbuch*]
Inc.	Incorporated
InsO	Isolvency Statute [*Insolvenzordnung*]
IRC	Internal Revenue Code
IMF	International Monetary Fund
KonTrag	German Law On Control and Transparency [*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*].
L.L.C.	Limited Liability Company
MBCA	Model Business Corporation Act

MEBO	Management and Employee Buyout
MitbestG	German Co-determination Act [*Mitbestimmungsgesetz*].
Montan-MitbestG	The Mining, Iron and Steel Industry Codetermination Act in Germany.
NASD	National Association of Securities Dealers
NJW	New Legal Weekly Periodical in Germany [*Neue Juristische Wochenschrift*].
No.	Number
NYSE	New York Stock Exchange
NASD	National Association of Securities Dealers
OECD	Organization for Economic Cooperation and Development.
OG	Official Gazette
plc.	Public Limited Company.
RGBI	Imperial Law Gazette [*Reichsgesetzblatt*].
RMBCA	Revised Model Business Corporation Act
ROSC	Report on Observance of Standards and Codes
SA	Public limited company in Romania [*Societa pe Actiuni*].
S.A.	Public limited company in France [*Société anonime*].
SEC	Securities and Exchange Commission.
Sec.	Section
SEE	South Eastern Europe

SOX	Sarbanes – Oxley Act
SSRN	Social Science Research Network
Stat.	United States Statutes at Large
TARP	Troubled Asset Relief Program
UK	United Kingdom
USA	United Stated of America
U.S.C.	United States Codes
VorstAG	German Act on Appropriateness of Executive Compensation [*Gesetz zur Angemessenheit der Vorstandsvergütung*].
VorstOG	German Law on Board Member Monetary Compensation Disclosure [*Vorstandsvergütungs-Offenlegungsgesetz*].
WphG	German Securities Trading Act *[Gesetz über den Wertpapierhandel*].
WpÜG	German Securities Acquisition and Takeover Act [*Wertpapiererwerbs und Übernahmegesetz*].
ZIP	Journal of Business Law in Germany [*Zeitschrift für Wirtschaftsrecht*].
$	United States Dollars
€	Euro

INTRODUCTION

A. The Scope of Research

For many, corporate scandals of the recent past, market crashes and excessive executive compensation packages, are all, one way or the other, related to, '*caused*' by and potentially capable of being solved by, one concept that is *corporate governance*.[1] Defining corporate governance is not easy, for strict definitions, or even definitions that are not open-ended, might be insufficient to encompass the full spectrum of issues that fall, or touch upon it.

Regarding the focus of corporate governance, classical literature will state that it is concerned with resolving the principal-agent problem[2] between shareholders and managers, where the key issue is how to monitor and align the interests of managers with those of the shareholders.[3] This definition points therefore to one of the central problems encountered mostly in *publicly held corporations* or *public limited companies*[4] with dispersed ownership.[5] Others

[1] *See* Zingales Luigi, Corporate Governance, in: Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, [497, 503], Macmillan, New York, 1998.

[2] *See* for a definition of the main agency problem of corporate governance, Meckling W.H. & Jensen M., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.* July 1, 1976, 3 Journal of Financial Economics 4, [305, 360], 1976, available at: http://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf, (last visited January 15th 2011), at 310-311.

[3] Id.

[4] From a definitional perspective, the terms 'corporation', 'business corporations', 'publicly held corporation' and 'public limited company, are not unproblematic. Furthermore, the non- U.S. trend of using the term 'company', as opposed to 'corporation', complicates the terminological aspect of the discussion. *See* Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976, at 124 et. seq. The difficulties in defining what a 'corporation' is and how to distinguish between its various forms, its differentiation from the term 'company', and the importance of the terminological differences, have warranted a special section in this introduction. For such elaboration, *see infra* sec. B of the Introduction.

[5] Berle A. & Means G., The Modern Corporation and Private Property, (rev.ed.) Transaction Publishers, New Brunswick-London, 1968.

have claimed that corporate governance encompasses a broader "*set of legal, cultural and institutional arrangements*,"[6] that not only provides how a corporation is directed and controlled, but also covers the interests of stakeholders.[7]

This thesis does not aim to solve the problems inherent in the definitional conception of corporate governance, however, it uses the positions offered on both ends of the spectrum, to situate the topic and built a structure.

The narrow and broad *definitions* of the scope of corporate governance can be visualized as pertaining to two extremes of a spectrum.[8] One end of the spectrum is taken by the *shareholder primacy theory* advocates, who purport that a corporation should be run for the benefit of shareholders.[9] The other end is taken by those who believe that a corporation should be run for the interests of stakeholders, including the community at large.[10] Yet, in between the two, one can find hybrid forms, according to some of which, shareholder value maximization remains the objective of the company, but that does not necessarily mean an opposition against all the actions and forms of protection undertaken, which also give due consideration to stakeholders' interests.[11] This approach would clearly not favor *a stakeholder theory of the firm,*

---

[6] Blair Margaret, Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century, Brookings Institution Press, Washington DC, June 1995, at 19.
[7] Id.
[8] *See* for a review of the works of main academic proponents on both sides of the debate Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007, *available* at: http://ejbo.jyu.fi/pdf/ejbo_vol12_no1_pages_5-15.pdf, (last visited February 23rd 2011), at 6.
[9] *See* Friedman Milton, *The Social Responsibility of Business is to Increase its Profits*, *The New York Times Magazine*, September 13, 1970; *See also* Levitt Theodore, *The Dangers of Social Responsibility*, 33 Harvard Business Rev. 5, [41-50], 1958.
[10] *See* Freeman Edward R., A Stakeholder Theory of the Modern Corporation, in: Pincus Laura (ed.), Perspectives in Business Ethics, [171, 181], McGraw-Hill, Singapore, 1998.
[11] *See* for contemporary authors who defend shareholder value maximization, but do not necessarily oppose the social responsibility actions undertaken by companies, Coelho, P. R. P., McLure, J. E. & Spry, J. A., *The Social Responsibility of Corporate Management: A Classical Critique*, 18 Mid-American Journal of Business 1,[15, 24], 2003; *See* also Sternberg Elaine, *The Defects of Stakeholder Theory*, 5 Corporate Governance: An International Review 1, [3, 10], 1997.

yet, it does realize that corporate governance discussions go beyond the narrow agency conflict.[12]

The above brief discussion serves as a frame for positioning the very core of this thesis, the focus of which is to analyze, compare and critically assess three inextricably linked, key aspects of corporate governance, namely shareholder rights, executive compensation and stakeholder protection in publicly held corporations, in the United States (hereinafter U.S.) and chosen European Union (hereinafter EU) jurisdictions. The purpose of the research is to compare the above three aspects, how they are regulated so far, find the commonalities and differences in the approaches followed by the selected jurisdictions, and discover what are the pertaining dilemmas with regards to each one of them.

The centrality and importance of shareholder rights, regulation of executive compensation and protection of stakeholders in corporate governance discussions, are undeniable. First, shareholder rights have been at the center of attention for a long time.[13] Based on the classical agency concept, due to the dispersion of ownership, there is a separation between *the owners*, the principals from the agency perspective, and those who are in control of the firm, or *the agents*.[14] As a result of this separation of ownership and control, which in turn has produced the risk of *agents* pursuing their own interests, as opposed to those of the shareholders, protecting the rights of the latter has gained increased importance.[15]

As the analyses will show, the rights of shareholders remain often very limited, be it with regards to the election of directors, concerning their vote on fundamental transactions or in

[12] For a definition of the stakeholder theory of the firm, s*ee* Freeman in supra note 10.
[13] *See* Velasco Julian, *Taking Shareholder Rights Seriously*, 41 UC Davis Law Rev. 2, [605, 682], 2007, available at SSRN: http://ssrn.com/abstract=886340 ,(last visited January 20th 2011).
[14] Berle A. & Means G., The Modern Corporation and Private Property, (rev.ed.) Transaction Publishers, New Brunswick-London, 1968.
[15] *See* Bebchuk Lucian, *The Case for Increasing Shareholder Power,* 118 Harvard Law Rev. 3, [833, 914], January 2005, available also online at: http://ssrn.com/abstract=387940 , (last visited January 18th 2011)

takeover situations.[16] Despite the divergences in terms of what aspects of these rights are considered more important on both sides of the Atlantic, analyzing the jurisdiction-specific problems pertaining to the lack of proper protection of shareholders, is essential from a corporate governance perspective.

Second, there is almost no other issue in the realm of corporate governance that has garnered as much attention as executive compensation.[17] The process followed by boards in setting executive pay and the problem of what is appropriate compensation, are central to the principal-agent conflict of corporate governance. Given the presumed potential that executive compensation provides for aligning the inherent conflicting interests under an agency conflict, given also the pertaining *moral* and legal dilemma as to what is *excessive* executive compensation, this aspect constitutes another central element of corporate governance.[18]

Third, with regards to stakeholders` protection, discussing the problems pertaining to this aspect is also crucial, because it represents the relationship of the corporation with interest groups that influence its activity.[19] Stakeholders have entered the corporate realm, irrespective of whether their entrance is viewed with skepticism or enthusiasm.[20] Problems such as, defining the

---

[16] *See* infra sections 1.3 and 1.4.

[17] *See* Bebchuk L. A. & Fried J., *Executive Compensation as an Agency Problem*, 17 Journal of Economic Perspective 3, [71, 92], September 2003, *available at*: http://www.law.harvard.edu/faculty/bebchuk/pdfs/2003.Bebchuk-Fried.Executive.Compensation.pdf, (last visited February 10th 2011).

[18] *See* Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Rev. 3, [138, 153] 1990.

[19]*The OECD Principles of Corporate Governance recognize the role of stakeholders in corporate governance. See* OECD Principles of Corporate Governance, 2004, *available at*: http://www.oecd.org/dataoecd/32/18/31557724.pdf (last visited February 11th, 2011), at sec. IV; For a strong stakeholder theory approach, *see* Freeman, R. E. & Reed David. L., *Stockholders and Stakeholders: A new perspective on Corporate Governance,* 25 California Management Rev. 3, [88, 106], 1983.

[20] For instance, although Bainbridge is considered as a supporter of shareholder value maximization, he has realized the importance in discussing (albeit rejecting a stakeholder theory) stakeholder related - issues in numerous articles. *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February 22nd 2011); *See* also Bainbridge Stephen M., *In Defense of the Shareholder Wealth Maximization Norm: A Reply to*

corporate interest,[21] dilemmas on whether fiduciary duties are owned to stakeholders,[22] the scope of constituency statutes, and antitakeover defenses,[23] not only fuel and complement the discussion with regards to shareholder rights and executive compensation, but analyzing them, also gives a fuller and new perspective as to what constitutes good corporate governance.[24]

Having discussed the topical components of the thesis, we now turn to the jurisdictional choice. The main jurisdictions chosen for this research are Germany and the U.S. However, two other *auxiliary* jurisdictions will also be included within the group of *chosen EU jurisdictions*, namely Czech Republic and Romania.[25] The choice of the primary jurisdictions, respectively Germany and the U.S., is done in order to be able to compare the approaches of two *advanced* countries that have traditionally been referred to, as representing two distinct models of corporate governance: a shareholder model in the case of U.S., and a stakeholder model in the case of Germany.[26] The comparison is also important from the perspective of the difference in the corporate governance approaches taken by a common-law country, versus a civil-law country.[27]

The choice of Czech Republic and Romania as secondary jurisdictions is done in order to be able to give a better view on the corporate governance differences that exist within the EU.

Professor Green, 50 Washington & Lee Law Rev., [1423, 1447], 1993, *available* at SSRN: http://ssrn.com/abstract=303780 (last visited February 22nd 2011).

[21] *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007.

[22] Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims*, 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008.

[23] *See* Coffee John J. Jr., *The Uncertain Case for Takeover Reform: An Essay on Stock- holders, Stakeholders, and Bust-Ups,* Wisconsin Law Rev., [435, 447], [vol. and issue no. omm],1988.

[24] Albeit not favoring a normative stakeholder theory approach, corporate governance as a field of study has evolved, so as to understand the necessity and importance of research that goes beyond the narrow agency concept. See for the importance of stakeholder – related discussions in corporate governance, Orts E.W.& Strudler A., *Putting a Stake in Stakeholder Theory*, 88 Journal of Business Ethics, [605, 615], 2009.

[25] For the Czech accession, *See* Final Act to the Treaty for Accession to the European Union, 46 OJL 236/ 2003, 23.09.2003, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:236:0957:0988:EN:PDF (last visited January 7th, 2011).

[26] *See* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3,[497, 539], 2001.

[27] Id. Referring to the possibilities if Germany to reform and become more 'Americanized', Cheffins gives an account of the factors fostering and deterring change. The analysis is done in view of the comparison between the shareholder model prevalent in common law, and the stakeholder one prevalent in Continental Europe. .

While an ideal situation would be to be able to compare the approaches in each and every EU Member State, limitations inherent in a doctoral thesis do not permit for such a broad task. To remedy this, *representative* jurisdictions have been chosen. Czech Republic is selected with the rationale that it represents a *bridge* between the early, *advanced* EU Member States and the newest EU entries. If EU accession is taken as a symbolic indicator of a country`s standing in terms of a rather general legal and economic development, then Czech Republic represents exactly the point between the old and the newest Member States. Gradually then, in order to be able to complete the EU picture, Romania is chosen as a representative of the latest accession group.[28]

In between the two, Romania and Czech Republic also demonstrate some similarities in view of the fact that both have undergone privatization in the 1990s and both have been captured by a similar necessity to reform their laws and modernize their corporate governance approaches.[29]Furthermore, both countries have presented similar weaknesses pertaining to judicial enforcement capabilities.[30]

On a last jurisdictional note, due to thesis length limitations, Romania and Czech Republic are chosen as *auxiliary* jurisdictions, meaning that although they will have special sections devoted to them, such sections will be comparatively shorter than the ones devoted to the main jurisdictions. Thus, the central focus of the thesis remains the analyses and comparison of shareholder rights, executive compensation and stakeholders` protection in the two main jurisdictions, Germany and the U.S.

---

[28] For the accession of Romania, *See* Final Act to the Treaty for Accession to the European Union, 48 OJL 157/ 2005, 21.06.2005 available at: http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2005:157:SOM:EN:HTML, (last visited January 11th 2011).

[29] *See* Berglöf, E. & Pajuste, A., Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in: Cornelius, P.K., Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003.

[30] Id. at 298-304.

Having discussed the topical and jurisdictional elements of this thesis, we now turn to some terminology, structure and method related concerns.

B. Corporations vs. Companies?

Defining the term *corporation*, categorizing its sub-groups and distinguishing them, resembles closely to the task of defining and categorizing the term '*creature'* or '*being'* in a precise, definite way. It is a task that, by its very nature, is prone to limitations, linguistic misunderstandings[31] and a journey that, in itself would require elaborations of lengthier standards. Nevertheless, a view on the meaning of *corporation*, *business corporation* and *company*, is necessary in order to set some explanatory guidelines before the use of such terms in the following chapters.

The meaning of *corporation* is much broader than the typified version of big "*aggregations of manpower and money*"[32] or big business organizations. Although nowadays the word is very often used to refer to merely one of its own subcategories,[33] explaining it by a popular version of itself, is like defining every creature as a human being. The biggest complication with tracing the origin of the term *corporation* is the variety of names used to identify it.[34] Despite the fact that the term looks like an English version of the word *corporatio*,[35] the key corresponding word in the Corpus Juris was *universitas.*[36] *Universitas* was a "*generic term for colleges, bodies and sodalities*"[37] with capacities to hold property, be heard in courts

[31] *See* Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976, at 124 et. seq.
[32] Id. at 124.
[33] Id. at 135.
[34] 132
[35] Id.; *See also id.* at note 34 where the author states that the word *corporatio* can not be found at all in Latin law dictionaries.
[36] Id.
[37] Id. at 127.

and decide on the matters of admitting or expelling their own members. Some forms of *universitas* were for instance bodies of priests and trade guilds.[38]

Later on, canonists revived Roman law by developing a conceptual framework where a "*collection of persons was deemed in law to be a single person*",[39] hence the concept of legal entity.[40] On the other hand, while business associations existed, they were called *societies* or *societates* in Roman times, a term which is the predecessor of the French modern word *société*. However, these Roman *societates* did not in general bear rights and duties separate from those of its members and, as a rule, were not corporations or *universitates*.[41]

The passing from the word *universitas* to the word *corporation* has been somewhat vague as well.[42] While, as mentioned earlier, references to predecessors of *corporations* point to *universitas,* according to English sources, the earliest use of the word in the mid-15th century, equals *corporation* to the process of *incorporation*, meaning basically the creation of a legal entity.[43] The entities or organizations created via this process had at first no generic name, but by the beginning of the 16th century, the word used to describe the process, became the word describing the thing created. Even in such cases however, charitable foundations, religious organizations and the like, were more prominent than business corporations.[44]

[38] Id.
[39] Id. at 128
[40] Id.
[41] Id. at 129. There were however exceptions of *societates* that enjoyed the legal entity status, such as societies created to collect taxes and societies that distributed the governmental portions of bread. However, even if the latter were to resemble to business corporations, Roman societies lacked at least two fundamental components of the business corporation. The first was the absence of a way of selecting and removing managers via "*fitness rather than ownership*" and the other was the absence of a way of getting back investments without having to subtract parts of capital. Id. at 129 - 130.; Later on in the 14th and 15th century, some Italian financiers, while managing loans to Italian city states, developed funds ruled by governors, whose shares were divided into freely tradable units, known in Italian as *azioni*, in German as *Aktien* and in French as *actions*. Id. at 130.
[42] Id. at 133-134.
[43] Id. at 134.
[44] Id. at 135.

When finally an American book was written on the specific problems of business organizations, the latter were called *private corporations* and this may have been one reason that the word *corporation* started to be used to refer to business organizations in the U.S.,[45] while the term *company* prevailed in the rest of the English-speaking world.[46] The adjective used to qualify corporations as private, was however dropped by many writers in the 20th century, remaining thus simply *corporations*.[47]

The American '*origin*' of referring to business organizations as *corporations* has been reflected also on the disparity between the use of the word mostly in the U.S., while other Western countries use the word *company*.[48] Although both words refer to similar phenomena, they are also different in what they connote. While *corporation* emphasizes the idea of unity stemming from plurality, evoking the fiction of a legal entity, and reflecting the similarities between business organizations and municipalities and churches, the word *company* emphasizes the human relationship between the members.[49] Despite the fact that most commonly the term *company* refers to business organizations, it was also used to include a social gathering or other kinds of groupings.[50] The emphasis put on the element of companionship appears also clearly in the terminologies used by different Western countries, all of which employ words which come

[45] Id. at 135, *see also* note 53 referring to the book of Angell J.K. & Ames S., A Treatise on the Law of Private Corporations Aggregate, Boston, 1832.
[46] Canada is divided as to the choice between the word corporation or company. Id. at 136; *See also for instance* Penington Robert R., Company Law (8th ed.), Butterworths, London, 2001; *See also* O'Hair J. & Keans J., Australian Company Law, (4th ed.), Mcgraw-Hill Book Company, Sydney, 1985.
[47] Note however that most U.S. textbooks nowadays refer to corporations *and* other business organizations, distinguishing corporations due to their main characteristics such as limited liability, perpetual life, transferability of ownership, capacity to contract and centralized management. Schneeman Angela, Law of Corporations and Other Business Organizations, (5th ed.) Delmar, N.Y., 2010, at 246-248, at 253 et. seq.; See also Eisenberg Melvin A., Corporations and Other Business Organizations Cases and Materials, (9th ed.), West, 2005.
[48] Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976, at 137.
[49] Id.
[50] Id.

closer in meaning to *company* rather than *corporation*.[51] For instance, France uses the word *société*, while Germany uses the word *Gesellschaft*, which etymologically refers to fellowship.[52]

A corporation can be said to refer to "*an organization which has complied with the rules –largely formal- which the legislature and courts have laid down for acquiring this status.*"[53] Some of the common attributes of corporations are the power of litigation, the right to hold property, the separation of the members` property from the corporate or group property, as well as the separation of their debts from the group debts.[54] However, these characteristics can not be used to define and distinguish corporations, since other associations which are not corporations can have the same attributes.[55] Therefore, the division between corporations and other associations does not necessarily connote bigger differences in social and economic stances, but it is rather an artificial creation of American law, based mainly on what papers have been filed or attempted to be filed.[56]

Moreover, whether a corporation is a private nonprofit one, a municipal one or a business corporation, it all comes down to the law that it has conformed to, or tried to conform to.[57]The character of the papers filed serves to distinguish between business corporations (often referred to as simply corporations) and other corporations.[58] In sum, a business corporation "*is an*

[51] Id.
[52] Id.
[53] Id. at 149.
[54] Id. at 150.
[55] Id. Organized groups can now be parties to a suit, partnerships can hold property, business trusts and limited partnerships can confer limited liability on some of their members.
[56] Id.
[57] 149
[58] While non-business corporations might at times pursue profit and incur taxes, they may become behaviorally business enterprises, but not business corporations, since the latter serves as a legal designation rather than a behavioral one. Id. at 151.

organization which has been organized under a corporation act designed for organizations with business purposes".[59]

On the other hand, the continental European approach to the term *company*, different from the U.S. term *corporation*, appears to cover other forms of associations, given that *société*, *Gesellschaft* and other closely corresponding words, are used as a common umbrella for all the different species, with or without *corporation status,* such as, joint ventures, general and limited partnerships, limited partnerships with joint stock, close corporations and negotiable share corporations.[60] This solution however is claimed to obscure the close relationship between business corporations on one hand, and nonprofit corporations, municipal corporations and sole proprietorships on the other.[61]

The importance of the difference between these words rests in the probability of influencing legal thinking about business organizations. For instance, while French jurists have emphasized the concept of *jus fraternitas* in relations within companies,[62] American judges have emphasized duties owned to the corporation (the unity) rather than its members.[63] The emphasis put on the *unity* rather than *the brotherhood* within a company, might have some bearing on explaining certain differences in the philosophy behind defining the corporate interest, the way that directors` fiduciary duties are treated on both sides, as well as the treatment of stakeholders.[64]

[59] 151. Business corporations should be distinguished also from unincorporated business enterprises on the basis that corporate enterprises have filed papers to declare themselves so, while non-corporate enterprises have not. Two main legal consequences from this difference are the limited liability and the taxation regime. Id. at 147-149.
[60] Id. at 150. Note here that the term *corporation status* in this particular instance is used to refer to the separateness of the legal entity, having rights and liabilities distinct from those of its members.; See also Andenas M. & Wooldridge F., European Comparative Company Law, Cambridge University Press, UK, 2009.
[61] Id.
[62] Id. at 138. *Jus Fraternitas* refers to the right of brotherhood. Another difference can be seen in the European objection on one person companies, given the argument that one person can not be a *société.*
[63] *See* Crowell v. Jackson, 53 N.J.L. 656, 23 Atl. 426 (1891).
[64] See infra related discussion in chapters 2 and 4.

Despite the above, one important caveat is due here: whatever the past role of the etymological divergence, it is also true that the terms *corporation* and *company* have largely submerged in the present.[65] While some philosophical differences might be traced to the specific meanings of the words used, whether it is better to use corporation instead of company, it largely depends on the audience addressed. To international, non-U.S. audiences, the use of the word *company* might be better suited given its closer correspondence to *société*, *Gesellschaft* and their synonyms across jurisdictions.[66] At the same time, the use of *corporation* is deeply rooted in the U.S. and it is now *stamped* in the naming of corporate governance, which has the potential to become an internationalized phrase in its English version.[67] The impact of the latter, as well as the increased popularity of the use of the word corporation in some non-U.S., English-speaking jurisdictions,[68] might bring a scenario of practical uniformity in the terminological choice.

For the purpose of this thesis and for the sake of adequacy, the term *corporation* will be used to refer to American business corporations and the word *company* will be used when dealing with the chosen EU jurisdiction *counterparts.* However, when single conclusions or affirmations are made as a result of the comparative overview, considering the above caveat, considering also the closer terminological resemblance of the word *corporation* to *corporate governance*, and in order to serve the brevity of expression, the term corporation will be used, with the understanding that it refers to the *corresponding* version in the concrete jurisdictions.

Furthermore, this thesis cannot and will not deal with all types of business corporations or companies, it will instead focus on what in the U.S. are called '*publicly held corporations*' or

[65] Id. at 138.
[66] Id.
[67] See for instance that the German version of the Corporate Governance Code is titled *Deutsche Corporate Governance Kodex*, German Commission on Corporate Governance, 26 May 2010, *available* in German *at* http://www.ecgi.org/codes/documents/cg_code_germany_may2010_de.pdf, (last visited on June 24th 2010).
[68] See for instance the English *Corporation Tax* dealing with taxes imposed on companies, The Finance Act of 1965, 13 & 14 Eliz. 2, c.25, sec. 49.

'*publicly traded corporations*', referring to those corporations in which anyone who wants to buy or sell its securities can do so, be it through listings or otherwise.[69]

In the chosen EU jurisdictions, it refers to what can be called '*public companies*' or '*public limited companies*' referring to companies with freely negotiable shares.[70] Specifically, the German corresponding term is *Aktiengesellschaften,* (hereinafter AG), the Czech one, *Akciova Spolecnost* (hereinafter AS), while the Romanian version, *Societa pe Actiuni*, (hereinafter SA).[71] Furthermore, due to the stricter character of corporate governance standards for listed publicly held corporations or public limited companies,[72] the latter will compose most of the examples chosen and cases dealt with by this thesis. Certainly, while examples of unlisted publicly held corporations, and even examples of limited liability companies, might be brought if

[69] Note here again that the American Bar Association (hereinafter ABA), Committee on Corporate Laws, Revised Model Business Corporation Act (hereinafter RMBCA) 2010, (uses the term public corporation, as a form of abbreviation of publicly traded corporations. According to it, 'public corporation' means "a corporation that has shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national securities association". RMBCA, 2010, available electronically at: http://www.abanet.org/buslaw/ (last visited February 17th 2011), § 1.40 (18 A); There are several previous versions of the 2010 edition of the Model Business Corporation Act (hereinafter MBCA), such as MBCA 2005 rev. 2006, 2010).
This can however create ambiguities in the terminology used if we refer to public corporations as municipal government corporations, as it was common at the beginning of the 20th century in order to avoid confusion with business corporations. Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976, at note 56 referring to Elliot Charles B., The Principles of the Law of Public Corporations, (2d. ed.), (pub.omm.) 1910. The spine of the book had however an imprint by the publisher with the title Municipal Corporations.
[70] Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976, at 77.
[71] *See* Stock Corporation Act *[Aktiengesetz (AktG)]*, of 06.09.1965, published in Federal Law Gazette [*Bundesgesetzblatt BGBT]* I 1089, (hereinafter AktG). The AktG entered in force on the 1st January 1966. For a translation of the Act in English, *See* Peltzer M. & Hickinbotham, A.G. *German Stock Corporation Act and Co-Determination Act*, Otto Schmidt, Köln, 1999, § 1(1).
See also Czech Commercial Code *[Obchodní zákoník]*, Act. No. 63/2001published in Law Collection (hereinafter Coll.) 63 of 01.01.2001, as most recently amended by Act 409/201 Coll.1.01.2011.
(hereinafter Czech Commercial Code). The full text of the 2001 Code is *available* in English at: http://www.sec.cz/export/EN/Legal_Regulations/get_dms_file.do?FileId=1223 (last visited January 18th 2010), s. 56 (1).; *See also* Romanian Company Law, Law No. 441, of 31.10.2006, On Amending and Supplementing the Provisions of Law No. 31/1990 On Commercial Companies and of Law No. 26/1990 On the Register of Commerce Registration Procedures *[Lege pentru Modificarea Legii nr. 31/1990 Privind Societãtile Comerciale, Republicata, si a Legii nr. 26/1990 Privind Registrul comertului, Republicata, Nr. 441, 31.10. 2006,]*, published in OG No. 955, 31.10.2006.(hereinafter Romanian Company Law). English translation of the 2006 amendments of the Law are *available* at: http://www.sova.ro/documente/Draft%20Law%20%20-%20Company%20Law%20-%20December%202006.pdf (last visited on March 12th, 2010), art 2.
[72] *See for instance* the OECD Principles of Corporate Governance, 1999, (changed since then into the 2004 version) *available at*: http://www.oecd.org/dataoecd/32/18/31557724.pdf (last visited February 11th, 2011) focusing on listed companies, Foreword at 11.

relevant to the point under discussion, the main focus will remain the above specified types of corporations or companies.[73]

C. Structural and Methodological Aspects

The structure of the thesis also follows the substantive approach, with chapters corresponding respectively to shareholder rights, executive compensation and stakeholder protection. Another additional chapter on directors` fiduciary duties is also provided after the first part on shareholders` rights. Given that fiduciary duties have been essential in addressing all the three aspects chosen, discussion on them will not be limited simply to this chapter. Indeed, the discussion on fiduciary duties pertaining to stakeholders will be treated separately in the fourth chapter, while other cases related to executive compensation that also involve discussions on fiduciary duties, will be addressed in the third chapter covering executive compensation.

For all the three central aspects of this thesis, there will be a comparative analyses of the chosen jurisdictions divided structurally as per the aspects analyzed.

The thesis employs micro-comparative methods[74] based on a substantive, issue-specific approach. The basic methodological principle of legal comparison followed is that of functionality, given that *"…in law the only things which are comparable are those which fulfill the same function*."[75] The analysis of statutory provisions and case law pertaining to each of the selected aspects, constitutes a central method of comparison.

[73] On a last terminology note, in order to avoid confusion and maintain consistency, without compromising adequacy, specific names and abbreviations will be used in their original language.

[74] For micro-comparative legal methods, *see De Cruz Peter*, Comparative Law in a Changing World, Cavendish, London, 1995, at 224-226.
[75] Zweigert K. & Kötz H., An Introduction to Comparative Law, (translated by Weir Tony) (original title: *Einführung in die Rechtsvergleichung),* (3rd ed.) Klarendon Press, Oxford - New York, 1998, at 34.

Moreover, despite the differences between the sources of law in the common law and civil law systems,[76] case law in the U.S. and court cases in the chosen EU jurisdictions are scrutinized in a topic specific manner. Certainly, case law discussions are more prevalent in the parts related to the U.S., however, the thesis gives an overview of the relevant available cases in the chosen EU jurisdictions as well. Given the importance associated with some German cases, the outcomes of which have affected (or have had the potential to affect) fundamental concepts of the German corporate governance system, they have been included in the analyses as well.[77] Nevertheless, realizing that concepts *created* under American case law cannot be found in the same fashion in the civil law jurisdictions, relevant sources of the concepts compared are scrutinized, such as corresponding statutory provisions. Especially with regards to fiduciary duties, the categorization provided in the U.S. has been taken as a standard for the discussion in the other jurisdictions as well. Although strict equivalents were not found in all cases, due to the jurisdiction-specific differences, or due to the fact that in the auxiliary jurisdictions, such duties had been recently introduced, the discussion in this part uses the provisions provided by statutory laws and the guidance offered by the Codes of Corporate Governance to deal with the European version of such duties.[78]

Principles and Codes of Corporate Governance have been analyzed whenever relevant to the issue under scrutiny. The focus on the latter has been stronger in the case of CEE jurisdictions, given the weakness of alternative sources, such as court cases and scholarly work

[76] *See* René D. & Brierly J.E.C.,, Major Legal Systems in the World Today, (3d ed.), Stevens, London, 1985.
[77] *See* for instance, Arag/Garmenbeck Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997; *See* also Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW (New Legal Weekly Periodical, Neue Juristische Wochenschrift, hereinafter NJW), 522/2006.
[78] This has been more so the case in the chosen CEE jurisdictions, where the concept of fiduciary duties, albeit introduced, remains yet a legal creation of little understanding. For this discussion, see infra section 2.4.

on several of the problems analyzed. Commentaries and Reports on Observance of Codes are also employed, again, more so in the case of the CEE jurisdictions.

The array of statutory laws chosen varies in the form of company laws, commercial codes, labor laws, capital market regulations and insolvency laws (the latter especially with regards to the chapter on stakeholder protection). Also, EU Regulations, Directives and Recommendations that have provided valuable insight for the discussion have been included in the analyses.

D. Expected Contributions and Limitations

Lastly, a note on the contributions and limitations of this thesis is due at this point. The thesis contributes to the existing literature on corporate governance by analyzing, comparing and pointing to the pertaining problems related to shareholder rights, executive compensation and stakeholders` protection in the selected jurisdictions. It also critically asserts the gaps in the legal solutions offered, *bridges* these solutions via the comparative methodology and evidences the need for further corporate governance reforms. The choice of the two main jurisdictions is illustrative of the big framework of comparison between a shareholder-oriented model of corporate governance and a stakeholder one.

In the meantime, the inclusion of the two auxiliary jurisdictions and the rationale behind it, also contributes in providing a less isolated view with regards to corporate governance developments in the EU. The thesis analyzes *newly introduced* corporate governance concepts and also points to the weaknesses of the approaches in the auxiliary jurisdictions.

Certainly this work has its own limitations, some typical of most legal comparative endeavors, some due to length restrictions and lack of literature for the auxiliary jurisdictions.

In parts, the comparative analyses might run less smoothly due to divergences in the philosophies behind the development of certain corporate governance concepts, or differences in the character of the source of such concepts. Yet, the functional methodological approach helps to mitigate the comparative friction and assure a certain ground level of comparativeness. It is true also that other corporate governance issues would have been of interest to the discussion, such as the role of capital markets in shaping corporate governance, yet, scope and length restrictions of a doctoral dissertation have been the main constraints in this regard. Lastly, with regards to the auxiliary jurisdictions, there has been a lack of a consolidated body of literature and court cases on corporate governance, which evidences the need for future research.

CHAPTER I

SHAREHOLDER RIGHTS

1.1 Introduction to the Agency Conflict

Classical corporate governance literature states that corporate governance is concerned with resolving the principal-agent problem.[79]As a result of this separation of ownership and control, there has always been a question as to the appropriate role of shareholders.[80] The latter, as *the owners* of the corporation[81] have certain rights, amongst which the appointment of the Board of Directors, which in turn acts as their agent and is under the duty of monitoring the managers' performance.[82] The main concern therefore is that principals, who are interested in maximizing their investment, might oppose their agents, when the latter follow the enhancement of their own individual interests. Thus, agency theory scholars have consistently tried to understand and explain how investors can get the agents to give them back their *money* and

[79] *See* for a definition of the main agency problem of corporate governance, Meckling W.H. & Jensen M., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.* July 1, 1976, 3 Journal of Financial Economics 4, [305, 360], 1976, available at: http://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf, (last visited January 15th 2011), at 310-311; *See also* Zingales Luigi, *Corporate Governance*, in: P. Newman, ed., *The* New Palgrave Dictionary of Economics and the Law, [497, 503], Macmillan, New York, 1998.

[80] Berle A. A. & Means G. C., The Modern Corporation and Private Property, (rev.ed.) Transaction Publishers, New Brunswick-London, 1968.

[81] On ownership in public corporations around the world, *See* the contributions of La Porta, Lopez-de Silanes, Shleifer & Vishny, *Corporate Ownership Around the World*, 54 *Journal of Finance* 2, [471, 517], 1999. Here, they provide analyses on structures of large corporations in 27 wealthy economies, trying to identify the ultimate controlling shareholders. According to their findings, dispersion of ownership is not a matter as clear cut as one would expect in an ideal Berle & Means world and indeed, except in societies with high level of shareholder protection, other countries present more concentration of ownership. They continue to redefine the agency problem as one of expropriation of minority shareholders from controlling ones, rather than as a conflict between shareholders and incumbent management; *See* also for an analyses on agency theory, Eisenhardt Kathleen M., *Agency Theory: An Assessment and Review*, 14, The Academy of Management Rev. 1, [55, 74], January 1989.

[82] Meckling W.H. & Jensen M., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.* July 1, 1976, 3 Journal of Financial Economics 4, [305, 360], 1976, available at: http://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf, (last visited January 15th 2011), at 311.

therefore, minimize agency costs.[83] Agency theory research has often focused on outlining the incentives of agents and principals, finding ways of aligning them and identifying market mechanisms capable of mitigating potential agency costs.[84]

Clearly, the potential for protecting shareholders arises when the Board of Directors has not performed satisfactorily and has failed in its monitoring capacity.[85] The latter in turn furnishes the basis for shareholder activism,[86] the basic goal of which is the protection of shareholder rights. Some definitional concerns[87] and a short history of shareholder activism will be addressed in the following section. The analyses in this chapter will then be followed by an overview of shareholder rights on election of directors, voting on fundamental issues and takeover regulations in the U.S. and chosen EU jurisdictions.

1.2 History and Reasons for Shareholder Activism

Shareholder activism is basically a reaction to the potential profits stemming from addressing the agency conflict in companies with dispersed ownership and almost no

[83] Id.; *See* also Zingales Luigi., *Corporate Governance*, *in*: Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, [497, 503], Macmillan, New York, 1998.
[84] *See* Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How*, 68 Harvard Business Rev. 3, [138, 153], 1990; *See also* Jensen Michael C., *Self Interest, Altruism, Incentives, and Agency Theory*, 7 Journal Of Applied Corporate Finance 2, [40, 45], 1994, available at SSRN: http://ssrn.com/abstract=5566, (last visited January 15th 2011); *See also*, Becht, Bolton, & Röell., *Corporate Governance and Control*, (European Corporate Governance Institute, hereinafter ECGI), ECGI - Finance Working Paper No. 02, October 2002, *available* at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343461, (last visited January 15th 2011).
[85] Gillan, S. & Starks L.T., *Relationship Investing and Shareholder Activism by Institutional Investors,* 57 Journal of Financial Economics, [275, 305], 2000, available at: http://old.nhh.no/for/courses/spring/eco420/gillan-starks-05.pdf, (last visited January 15th 2011), (numbering of pages in these citations of the article, hereinafter referred to as per the authors`own numbering in the electronic version accessed) at 3-5.
[86] Id. at 5.
[87] Id. at 3-5.

participation from small owners.[88] It can be considered as a group of continuous *responses* to corporate performance.[89]

In most large publicly held corporations, decision-making is delegated to managers whose interests can diverge from the interests of the shareholders. As previously stated, when the Board of Directors fails to control the agency problem, there is a demand for protecting shareholder rights and this is the main purpose of shareholder activism.[90] In cases of conflicts, shareholders will mainly have three choices: sell their shares, also known as, "*vote with their feet*"[91], hold their shares and "*voice*"[92] the dissatisfaction or concern, or hold their shares and be passive.[93] *Hirschman* named these three activities: "*exit, voice and loyalty". * [94]

In terms of forms that shareholder activism can take, on one hand, individuals or entities simply buying and selling shares could be considered as *active* shareholders. Through their purchase and the resulting change in ownership, they can be viewed as influencing the activity and performance of the corporation.[95] On the other hand, the market for corporate control, often used interchangeably with the takeover market, can also be a representation of active

---

[88] Id. at 3.
[89] Id.; *See* also for a similar discussion a later work by the same authors Gillan, S. & Starks L.T., *The Evolution of Shareholder Activism in the United States,* 29 Journal of Applied Corporate finance 1, [55-73], 2007, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=959670, (last visited January 15th 2011), (numbering of pages in these citations of the article, hereinafter referred to as per the authors` numbering in the electronic version accessed), at 5. Debates on definitional concerns regarding shareholder activism have been more prominent in the US, due to the fact that shareholder activism itself has been more intense in this jurisdiction, as the following of this chapter will show. *See infra* section 1.2.2 and related discussion.
[90] Meckling W.H. & Jensen M.C., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal of Financial Economics 4, [305, 360], July 1976, at 308.
[91] Gillan, S. & Starks L.T., *Relationship Investing and Shareholder Activism by Institutional Investors,* 57 Journal of Financial Economics, [275, 305], 2000, available at: http://old.nhh.no/for/courses/spring/eco420/gillan-starks-05.pdf , (last visited January 15th 2011), at 2.
[92] Id.
[93] Id.
[94] Hirschman Albert O., Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States, Harvard University Press, 1971, at 7.
[95] Gillan, S. & Starks L.T., *Relationship Investing and Shareholder Activism by Institutional Investors,* 57 Journal of Financial Economics, [275, 305], 2000, available at: http://old.nhh.no/for/courses/spring/eco420/gillan-starks-05.pdf , (last visited January 15th 2011), at 3; *See also* Bethel, Liebiskind, & Opler, *Block Share Purchases and Corporate Performance,* 53 Journal of Finance 2, [605, 635], 1998, at 610.

shareholders.[96] The shareholders that buy into the firm through takeovers have an opportunity to change control patterns and bring significant alterations to the structure of the corporation.[97] Another in-between case of shareholder activism is that of *blockholders* who purchase minority control, with the intent to influence decision-making in a corporation.[98]

More often than not however, when referring to a shareholder activist, the idea is that of *"[a]n 'investor' who tries to change the stat*us *quo through 'voice', without a change in control of the firm."*[99] The voice choice as the most common form of shareholder activism includes a wide spectrum of activities, amongst which, shareholder proposals to the proxy statement, negotiations with management, and public revealing of a corporation's activity to inform investors about related issues.[100]

Definitional ambiguities arise from the fact that shareholder activism is often referred to as relationship investing,[101] however the latter implies *"[a] cooperative association between a corporation and one or more institutional investors, with both sides working together to achieve changes in the firm."*[102] Shareholder activism is a broader concept, since not all of its forms are of a compromise style. Therefore, relationship investing refers actually to only one form of shareholder activism.[103]

Even within the shareholder activist groups, there is a distinction between those who want governance reforms concerned mostly with the election of directors, takeover policies and

[96] Id. (referring to Gillan & Starks' work 2000) at 3.
[97] Id.
[98] Id. (referring to Bethel, Liebiskind, & Opler`s work 1998) at 610-612.
[99] Id. (referring to the work of Gillan & Starks 2000), at 3-4, *[emph. add.]*.
[100] Id.
[101] Id.
[102] Id.
[103] Id.

issues of executive compensation, and those who advocate broader social issues.[104] This chapter will focus more on the shareholder activism that impacts the reforms pertaining to the first group.

One last point to be noted here is that forms of *institutional investors` activism*[105] differ significantly, especially depending on the legal environment regulating their activity, their clientele, and details of processing information.[106] These differences imply a variance in the institutions' motives and monitoring capabilities.[107] However, the debate on the motivational and monitoring differences within institutional investor activism goes beyond the purpose of this chapter. The purpose here is to analyze how shareholder rights are protected, and shareholder activism has this protection as its very purpose. Tracing historically the influence of shareholder activism in protecting shareholder rights, will therefore give an insight on the evolution of some shareholder protection forms and the intensity with which the debate has evolved over time. The following sections of the chapter will first analyze the role of shareholder activists in the U.S. from a historical perspective, the history of protecting shareholder rights in the chosen EU jurisdictions, and lastly, the relevant legal provisions, case law and standards on shareholder rights.

[104] Marens Richard, *Inventing Corporate Governance: The Mid-Century Emergence of Shareholder Activism*, 8 Journal of Business and Management 4, [365, 389], 2002, at 366.
[105] *See* for relationship investing of major institutional investors, Martin J. & Kensinger J. W., Relationship Investing: What Active Institutional Investors Want from Management, Financial Executives Research Foundation Publication, New Jersey, 1996.
[106] Gillan, S. & Starks L.T., *The Evolution of Shareholder Activism in the United States*, 29 Journal of Applied Corporate finance 1, [55-73], 2007, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=959670, (last visited January 15th 2011), at 12.
[107] Id. at 12-13. It is suggested that companies in which independent investment groups and mutual funds have holdings tend to put more attention on pay for performance and generate higher returns on capital, while institutional investors, such as corporate pension funds and insurance companies, might be generally less willing to go against other corporations which do business with the sponsoring company. Id.; *See also*, Black Bernard S., Shareholder Activism and Corporate Governance in the United States, *in:* Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, [459, 465], Macmillan, New York, 1998.

1.2.1 History of Shareholder Activism in the U.S.

The first phase of shareholder activism in the U.S. can be traced back to the late '30s[108] till the mid '50s,[109] with the time in between marked by an increased interest and activity of minority shareholders, in the form of higher attendance of annual meetings, or bigger interest in matters related to corporate management.[110]

Later on, in the early 1970s, a case decided by the U.S. Court of Appeals for the District of Columbia Circuit, provided some guidance on the issue of including shareholder proposals that involved social impacts.[111] Taking into consideration the request of a shareholder group asking for restrictions on Dow Chemical Company's sale of napalm, the court ordered the Securities and Exchange Commission (hereinafter SEC), to reconsider its previous decision, which concurred with the management's choice to not include the interested shareholders` proposal.[112] The decision gave rise to movements by social activists, who started to take advantage of the outcome and tried to make good use of the proxy process.[113]

A new form of shareholder activism emerged with the increase of institutional investor holdings and the creation of the Council of Institutional Investors in 1985.[114] Its creation was

[108] Id. at 6. Based on Talner`s evidence, (*See* Talner Lauren, The Origins of Shareholder Activism, Investor Responsibility Research Center Inc., Washington D.C, 1983), they trace roots of shareholder activism back to the 1932 annual meeting of New York City's Consolidated Gas Co: *"Consolidated Gas's chairman read through the company's annual report and then, without recognizing stockholders who raised their hands to ask questions from the floor, adjourned the meeting and invited everyone present to proceed to another room for lunch. Lewis Gilbert, then a young owner of 10 shares who was attending his first annual meeting, was appalled by the lack of communication between the company's management and its owners"*.(cited from Talner 1983) Id at 6.
[109] The period between 1943 and 1953 witnessed a rise in the number of shareholders proposals submitted by stockholder proponents, with around 607 proposals submitted by 92 "opposing" stockholders. Id.
[110] Id.
[111] SEC v. Medical Committee for Human Rights, 404 U.S. App. D.C. 403 (1972).
[112] Id. at 23.
[113] Talner Lauren, The Origins of Shareholder Activism, Investor Responsibility Research Center Inc., Washington D.C, 1983, at 7-12.
[114] Monks, R. A., & Minow N., Corporate Governance, Blackwell Publishers, Cambridge, MA, 2003, at 276.

prompted as a reaction by the California State Treasurer[115] to the receipt of over $ 130 million in premium over the market price by the Bass Brothers Enterprises Inc., involving a share sale back to Texaco Inc., and the fact that such an offer was not extended to other shareholders.[116]

Two years later, large pension funds started to submit shareholder proxy proposals raising major issues of corporate governance, such as changes in voting rules, intensified board independence and concerns related to antitakeover amendments.[117]Pension funds did not simply reform the concept of shareholder activism through governance proposals, but they also contributed in changing the way they approached activism. Two major contributions in this regard were related to favoring dialogue with corporations over more governance proposals, and using the media to attract the attention of investors and activists.[118]

Apart from public pension funds and union funds, other interested individuals or groups have contributed in shareholder activism. In the early '90s, there was the creation of the United Shareholders Association[119] and an increase in the role of non-affiliated individuals or money groups, also known as *gadflies.*[120] During this period, some of the major *problems* caused to several high-profile company executives in the U.S., were indeed initiated by the so-called

[115] Id.; Jesse Unruh was the State Treasurer at the time. He was responsible for the California Public Employees Retirement System (CalPERS), as well as for California State Teachers Retirement System (CalSTRS). CalPERS and CalSTRS had considerable investments in Texaco Inc. Id. at 8.

[116] Id.

[117] Gillan, S. & Starks L.T., *The Evolution of Shareholder Activism in the United States*, 29 Journal of Applied Corporate finance 1, [55-73], 2007, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=959670, (last visited January 15th 2011), at 7.

[118] Choi, S. J. & Fisch, J. E., *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 Vanderbilt Law Rev. 2, [315, 352], 2008, *available* at SSRN: http://ssrn.com/abstract=1010330 (last visited January 17th 2011), at 330-333. The authors of the article report that public pension fund participated in shareholder litigation more than in other governance related strategies, although empirical evidence suggests that their type of action varies remarkably dependent on motivations and relations with the controlling shareholders of a company. Id. at 330-341.

[119] *See* Strickland, Wiles, & Zenner, *A Requiem for the USA (United Shareholders Association): Is Small Shareholder Monitoring Effective?*, 40 Journal of Financial Economics 2, [page no. omm.], 1996, available at SSRN: http://ssrn.com/abstract=5424 (last visited on January 17th 2011). The authors describe the United Shareholders Association's actions and examine its impact on targeted corporations, finding that the association`s sponsored activity has ultimately enhanced shareholder value.

[120] Marens Richard, *Inventing Corporate Governance: The Mid-Century Emergence of Shareholder Activism*, 8 Journal of Business and Management 4, [365, 389], 2002, at 365.

money managers, most notably Fidelity Investments, which had a role on the removals of some CEOs of giant American corporations.[121]

Lastly, the Institutional Shareholder Services[122] and the Investor Responsibility Research Center Institute[123] have both continued to provide analyses and research on issues related to governance, corporate performance and proxy voting.

To sum up, shareholder activism in the U.S. has been characterized by the participation of different actors, in the form of activist groups or individuals, centers, major shareholders, and especially so institutional investors. Some of the main forms of activism aimed at increasing responsiveness towards shareholder rights, consisted of putting pressure through proxy proposals related to changes in voting rules, increasing dialogue with corporations and 'shaming' executives.[124] Variances in the strategies pursued were only reasonable, depending on the motivation behind activism, the relationship with shareholders and management, the financial ability to pursue these activities and certainly, depending on the institutions` analyses on the potential profitability of such actions.[125] While the efficiency of some shareholder activism

[121] Myerson Allen, *The New Activism at Fidelity*, New York Times, August 1993, at 3. Fidelity Investments was reported to be involved in the removal of Robinson as chairman of American Express Co. as well as the removal of Whitmore, the CEO of Eastman Kodak. Id.

[122] Institutional Shareholder Services, founded in 1985 now operates as a subsidiary of RiskMetrics group, and it provides amongst others, investment research and voting, investment portfolio screening, proxy distribution, corporate governance advisory services to financial institutions and corporations. *See* for more information, the official webpage of RiskMetrics group, *available* at: http://www.riskmetrics.com/ (last visited January 17th 2011).

[123] Established in 2006, the Institutional Responsibility Research Center Institute provides research on corporate governance and social responsibility for corporations. The Center has sponsored corporate governance academic research venues such as the Corporate Governance Network. For more information on its mission and activity, *See* its official website, *available at:* http://www.irrcinstitute.org/ (lat visited January 17th 2011).

[124] Black Bernard S., Shareholder Activism and Corporate Governance in the United States, in: Newman Peter, (*ed.*), The New Palgrave Dictionary of Economics and the Law, [459, 465], Macmillan, New York, 1998, at 460-464.

[125] Id.

groups is yet questionable, one evident contribution has been to bring the topic of shareholder rights back at the center of the corporate governance debate.[126]

1.2.2 History of Shareholder Rights in Germany

Historically speaking, shareholder activism has been more prominent in the U.S. as compared to European jurisdictions, although recent trends show an increasing interest in it.[127] In Germany, the debate on protecting shareholder rights has not been significantly shaped by the role of organized shareholder activist groups, as seen in the U.S. Instead, its history shows a traditional focus of legislators on jurisdiction-specific concerns pertaining to protecting minority shareholders and regulating proxy-holding by banks.[128]

The German corporate governance started taking some of the features that continue to this day in the mid-19th century,[129] when the dual-board structure with the *Aufsichtsrat* (Supervisory Board) and *Vorstand* (Management Board), was created to protect small shareholders from management`s pursuit of self-dealing interests.[130]

---

[126] *See* for a critique on over-emphasizing the role of institutional investors as activists, Bainbridge Stephen M., *Shareholder Activism and Institutional Investors*, UCLA School of Law, Law and Economics Research Paper No. 05-20, September 2005, *available* at SSRN: http://ssrn.com/abstract=796227, (last visited January 18th 2011).

[127] *See* for a comprehensive view of major shareholder activism forms in the EU (as compared to the U.S.) Santella, Baffi, Drago, & Lattuca, *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the* US, July 2009, electronic article available at SSRN: http://ssrn.com/abstract=1137491 (last visited January 17th 2011).

[128] Morck R.,& Steier L., The Global History of Corporate Governance - An Introduction, National Bureau of Economic Research, Working Paper No. 11062, January 2005, available at: http://www.nber.org/papers/w11062.pdf, (last visited January 18th 2011), at 8-10.

[129] The creation of the dual board structure dates back to the German General Commercial Code, [Allgemeines Deutsches Handelsgesetzbuch**,** (ADHGB)] of 31 May 1861, (publication gazette info omitted). The Act was made compulsory in 1870. *See*, Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 119, note 52.

[130] Baums Theodor, *Company Law Reform in Germany*, Paper Presented at the University of Cambridge Conference on Company Law Reform, July, 2002, *available* at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=329962, (last visited January 18th 2011), at 5.

In the years preceding World War I, firms listed in the Berlin Stock Exchange were willing to readily replace management for poor performance, this seen as an early version of disciplinary measures aimed at correlating management turnover to firm performance.[131]

The typical bank proxy-voting in Germany stemmed from the increased role of banks in placing new securities and lending with shares.[132] Requirements of minimum turnout at the first shareholders` meeting of a company, as well as restrictions in exchange trading which designed big banks as the only venue for share trading, made the role of banks important in terms of proxy-holding for small shareholders and monitoring trading activities.[133]

During the Weimer Republic (1919-1933),[134] the dispersion of ownership increased, causing fears of *hostile* takeovers and the latter prompted the use of multiple voting shares and voting caps.[135] In cases of big family ownerships, the voting rights of non-family owners were capped, without considering the respective percentages of their ownerships.[136]

The National Socialist Government reformed the corporate governance structure, although for purposes that were not directly focused on better performance or enhanced disclosure, by introducing the "*Fuhrerprinzip*", meaning the Leader Principle.[137] In 1937 the fiduciary duty towards shareholders was abolished, to be substituted by a duty towards all stakeholders, including undoubtedly the *Reich*. All voting by mail was banned and shareholders

[131]Morck R.,& Steier L., The Global History of Corporate Governance – An Introduction, National Bureau of Economic Research, Working Paper No. 11062, January 2005, *available* at: http://www.nber.org/papers/w11062.pdf, (last visited January 18th 2011), at 9.
[132] *See* Dunlavy Colleen A, *Corporate Governance in Late 19th-Century Europe and the United States: The Case of Shareholder Voting Rights, in:* Hopt, Kanda, Roe, Wymeersch, & Prigge (eds.), Corporate Governance: The State of the Art of Emerging Research, [5-39], Clarendon Press, Oxford, 1998.
[133] Mann F.A., *The New German Company Law and Its Background*, 19 *Journal of Comparative Legislation and International Law* (3rd Series) 4, [220, 238}, 1937, at 220.
[134] For an interesting analyses on judicial reviews during the Weimer Republic, *See* Stolleis Michael, *Judicial Review, Administrative Review, and Constitutional Review in the Weimar Republic,* 16 Ratio Juris 2, [266, 280], June 2003.
[135] Supra note 131, at 9-10.
[136] Id.
[137] Id. at 9.

had to register their holdings with banks and provide them with proxies, if they couldn`t vote in person. This in turn gave major voting control to banks, which were later on taken under the control of the *Reich*.[138]

The last half of the 20th century witnessed an increase in the use of pyramids.[139] Given the banning of voting caps and multiple voting, pyramid structures provided a means of gaining control.[140] Shortly after the reunification of Germany, there were once again concerns regarding the controlling role of banks in German companies.[141] New laws were enacted in order to redefine the role of banks, such as the 1998 Law on Control and Transparency (hereinafter KonTrag),[142] the Act on Integrity of Companies and Modernization of Stock Corporation Law [143] and the Law on Transparency and Disclosure.[144] One of the most important effects of these reforms was to impose a duty on banks to inform the shareholders, for whom they held proxies, on their right to revoke authorization and the right to alter representation.[145] Preparation of voting plans had to be decided separately from other divisions of the bank, especially from the lending division, creating thus a formal separation of voting control from lending services

---

[138] Id. at 9-10.

[139] Hansmann, H. & Kraakman, R. H., *The End Of History For Corporate Law*, Yale Law School Working Paper No. 235, January 2000, *available* at SSRN: http://ssrn.com/abstract=204528 (last visited January 18th 2011), at 23-42.

[140] Id. at 23-25.

[141] Morck R.,& Steier L., *The Global History of Corporate Governance – An Introduction*, National Bureau of Economic Research, Working Paper No. 11062, January 2005, *available* at: http://www.nber.org/papers/w11062.pdf, (last visited January 18th 2011), at 9-10.

[142] Law On Control and Transparency [*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*] 27.07.1998, published in the Federal Law Gazette [*Bundesgesetzblatt* hereinafter (BGBl)} I S.786.

[143] Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], 15.06.2005, published in the Lower House of the Parliament of the Federal Republic of Germany [*Bundestag*] Official Printed Bulletin [*Bundestagsdrucksache* (hereinafter BT – Drs.)]. 15/5693.

[144] Law On Transparency and Disclosure [*Transparenz und Publizitätsgesetz*], 19.06. 2002, BGBl I. S.2681.

[145] Morck R.,& Steier L., *The Global History of Corporate Governance – An Introduction*, National Bureau of Economic Research, Working Paper No. 11062, January 2005, *available* at: http://www.nber.org/papers/w11062.pdf, (last visited January 18th 2011), at 9-10.

offered to corporations.[146] Despite reforms on shareholder voting and information rights, the German model remains often referred to, as a model where *widely* held companies are effectively controlled by large banks through proxies.[147]

1.2.3 History of Shareholder Rights in CEE?

When analyzing the case of Central Eastern European (hereinafter CEE) countries, one cannot talk of shareholder activism, at least as referred to in the case of the U.S. Protecting shareholders` rights is a relatively new concept in the region and the debates on the topic have been only recent.[148] These debates have focused mostly on the protection of minority shareholders, due to the special agency conflict between majority and minority shareholders, resulting from the high level of ownership concentration.[149] After 1990, most publicly held companies in CEE have been characterized by the predominance of large shareholders and the accumulation of control and shareholdings in the same hands.[150] Given the privatization process happening only two decades ago, the long absence of disclosure of ownership levels, and the yet unconsolidated capitalist financial architecture, the main conflict in CEE companies will remain the one between controlling shareholders and minority investors. [151] Furthermore, since a class of

---

[146] Morck R.,& Steier L., *The Global History of Corporate Governance – An Introduction*, National Bureau of Economic Research , Working Paper No. 11062, January 2005, available at: http://www.nber.org/papers/w11062.pdf, (last visited January 18th 2011), at 9-10.

[147] *See* for a detailed role of banks in German public corporations, Franks J. & Mayer C., *Ownership and Control of German Corporations*,, 14 Rev. of Financial Studies 4, [943, 977], 2001.

[148] See Berglöf, E. & Pajuste, A., Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, *in*: Cornelius, P.K. & Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003.

[149] Id. at 268-275.

[150] *See* Stulz Rene M., *Financial Globalization, Corporate Governance, and Eastern Europe*, The National Bureau for Economic Research (NBER), Working Paper No. 11912, January 2006.

[151] *See*, VliegenthartIn Arjan, *Corporate Governance in Eastern Central Europe, The State of the Art*, Working Paper Political Science, No. 04, 2005, *available* at http://www.arccgor.nl/uploads/File/wpps200405.pdf (last visited January 17th 2010). According to the author, in the immediate post-privatization phase, problems with the financial architecture of CEE countries have been attributed often to the lack of proper institutions to provide a well-defined

professional managers is yet under formation, CEE companies continue to rely on the role of large shareholders involved in the management of the firm, and on a strong presence of predominantly foreign banks.[152]

The privatization of enterprises as part of the transition from planned to market economy, would somehow limit the history of protecting shareholders` rights to the post-communist era, although studies that attribute a strong role to the pre-communist legal heritage, will also be scrutinized in this section.[153]

The legal reforms aimed at restructuring enterprises and adapting them to the new free market economy, tried to outline shareholder and investor protection, at least from a law-on-the-books perspective, which was always confronted with enforcement problems.[154] It is evidenced that at the outset of legal reforms, the protection of shareholders and creditors in all the transition economies, was below world average.[155]

Studies focusing on the legal reforms undertaken by transition economies with regard to shareholder and creditor rights, suggest that, while these countries tried to implement a substantial change in the ownership structure and governance of firms, they failed to provide effective *ex ante* protection of minority shareholders.[156] The main problem was considered the

---

set of principles governing the transfer of property and to regulate corporate control and activity in the newly privatized companies. Without well designed underlying corporate governance mechanisms, the problem of having well-identified owners who actually control these privatized enterprises, cannot be solved.

[152] *See* Berglöf, E. & Pajuste, A., Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in: Cornelius, P.K., Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003.

[153] See for example Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004, *available* at: SSRN: http://ssrn.com/abstract=214654, (last visited January 18th 2011).

[154] *See* McGee, R. W. & Preobragenskaya, G. G., *Corporate Governance in Transition Economies: The Theory and Practice of Corporate Governance in Eastern Europe*, 2004, electronic article available at SSRN: http://ssrn.com/abstract=538582 (last visited January 19th 2011).

[155] Pistor K., Raiser M., & Gelfer S., *Law and Finance in Transition Economies*, 8 Economics of Transition 2, [325, 368], 2000, at 328-331.

[156] Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004, *available* at: SSRN: http://ssrn.com/abstract=214654, (last visited January

time discrepancy between economic changes and the passing of laws aimed at regulating them. Many economic changes started early and the formation of ownership structures had already commenced before the new laws were passed.[157] The result was therefore a set of rules aimed at regulating ownership structures that had already been established, meaning in most cases, already *concentrated.*[158]

The pattern of economic reforms preceding legal reforms came to mean that those who held prior, *de facto* control rights, were better off compared to new title holders. Law reform came too late to deal with proper reallocation of these rights, so it continued to secure the rights of the existing control-holders.[159] One of the claimed reasons for such consequences has been the recognition that policy-choice actors and law-makers had a tendency to react, rather than pro-act to economic change.[160]

Due to the concentrated ownership structures and the weakness of legal reforms, investors began to lose confidence and this in turn was disadvantageous for the securities market.[161] It is claimed that during this period, CEE countries did not devise pre-existing governance structures with the aim of achieving well thought objectives, to the contrary, *"[t]he initial level of shareholder and creditor rights protection was the result of historical accident rather than clear policy choice."*[162]

18th 2011), (references to page number in the citations of the article here refer to the electronic version accessed), at 4-5.

157 Id.

158 Id.

159 Id.; *See also* Gray Cheryl W., et.al, *Evolving Legal Framework for Private Sector Development in Central and Eastern Europe*, World Bank Publication, Washington D.C., July 1993.

160 *Supra* note 156, at 25; *See* also for a comprehensive analyses on economic and social transformation in transition CEE economies, Frydman R. & Rapaczynski A., *Markets and Institutions in Large Scale Privatization: An Approach to Economic and Social Transformation in Eastern Europe*, New York University Economic Research Report No. 90-42, September 1990.

161 Pistor Katharina , Law Meets the Market: Matches and Mismatches in Transition Economies, World Bank Publication, Washington DC, 1995, at 12.

162 Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies,* 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004, *available* at: SSRN: http://ssrn.com/abstract=214654, (last visited January

Even within CEE, there has been a differentiation between countries with rapid mass privatization and countries with slower, gradual privatization.[163] However, countries that pursued less drastic and more gradual economic reforms were not necessarily slower, or less efficient, in reforming their legal systems.[164] What they might have missed in terms of reform timing, they might have gained in foregoing the side negative effects that the alternative choice would have provided in a context of weak institutional infrastructure.

Both CEE countries used as *auxiliary* jurisdictions in this work, namely Czech Republic and Romania, followed a rapid mass privatization.[165] However, there were differences in their respective levels of shareholder protection in the first years after the beginning of privatization, which, some have claimed, came as path-dependence effects, due to characteristics pertaining to their pre-communism legal heritage.[166]

Pistor subgroups CEE transition countries into three categories based on their pre-socialist legal heritage.[167] First, there is the group of German legal heritage countries, which belonged to the Austro-Hungarian Empire or '*inherited*' their laws from Germany in the period between World Wars.[168]

18th 2011),(The references to the numbering of pages as provided by the author in the electronic version accessed) at 25.

[163] Id. at 25-26.

[164] Id. at 25-26.

[165] Berglöf, E. & Pajuste, A., Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in: Cornelius, P.K. & Kogut, B. (*eds*.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003, at 273.

[166] Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004, *available* at: SSRN: http://ssrn.com/abstract=214654, (last visited January 18th 2011), at 3-8.

[167] Id.; *See also* Dunlavy Colleen A, Corporate Governance in Late 19th-Century Europe and the United States: The Case of Shareholder Voting Rights, in*:* Hopt, Kanda, Roe, Wymeersch, & Prigge (eds.), Corporate Governance: The State of the Art of Emerging Research, [5-39], Clarendon Press, Oxford, 1998.

[168] Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004, *available* at: SSRN: http://ssrn.com/abstract=214654, (last visited January 18th 2011), at 6. This group was composed of Hungary, Czech Republic, Poland, Baltic States, Croatia, Slovenia and the Slovak Republic.

The second group is composed of countries that were under the Ottoman occupation (although some of the countries in the first group were under the Ottoman invasion as well), and later, during the mid 19th century, became '*recipients*' of French law.[169]

The third final group is comprised of the former Soviet Union Republics, leaving out the Baltic States that belong to the first Germanic group.[170] Their legal history embodies various influences and the group is not homogenous, with Russia being influenced by Roman and Byzantine law, and with some Central Asian countries being governed in the past by Islamic law and different customary rules.[171]

The classification into these groups is presumed to serve the purpose of tracing similarities or differences in terms of shareholder protection and to explain the governance paths followed in the post-privatization period, despite the common communist heritage.[172]

Agreeing on a significant decisive role of history and legal heritage before communism is not very easy. First, the communist regime's influence in '*neutralizing*' significant remnants of legal culture is a factor that would have mitigated the determinative influence of pre-communist legal heritage.[173] Second, other factors have played a very strong role in shaping the reforms of CEE countries. Such factors consist of, amongst others, the availability and source of foreign

[169] Id. at 6-7. The group includes the South Eastern European *(SEE)* countries Albania, Bosnia, Bulgaria, the Federal Republic of Macedonia, and Romania.
[170] Id.
[171] Id.
[172] Pistor evidences that while all transition countries immediately after the reforms had a low level of shareholder protection, the Germanic and South Eastern European (hereinafter SEE) countries had close levels of low protection in 1992 with an increase till 1998, although by 1998 French origin SEE countries were behind in absolute terms to most other transition economies, explained perhaps by the late introduction of reforms in the ex-Yugoslavian countries and the effects of war. Regarding the third group of countries, by 1998, their laws offered better shareholder rights protection on average compared to the other two groups of transition economies. Id. at 6-7.
[173] *See for instance*, Berglöf E. & Von Thadden E.L., The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries, in: Proceedings of the Annual Bank Conference on Development Economics, The World Bank, Washington DC, 1993.

help and considerations of what were viewed as '*best models*' to be followed, which in turn could have also been influenced by foreign help.[174]

Lastly, the convergence that these countries faced towards better law-on-the-books protection of shareholders, irrespective of the pre-communist tradition, makes a long-lasting impact of the latter questionable.[175] In this context, one important factor that has influenced a more unified approach towards shareholder rights has been the EU membership, or the push for accession in cases of potential candidate countries.[176] The EU recommendations and directives covering minority shareholder protection, facilitation of shareholder votes and better access to information, have brought the regulatory frameworks of CEE countries closer to each other.[177]

The above discussion has given a historical perspective to the debate on shareholder rights, in order to be able to better understand the current approaches taken in this regard. In the U.S., we saw the increasing role of shareholder activism from the early 1920s till nowadays. In Germany, we saw a history of early laws passed to protect minority shareholders, then stakeholders and later on, laws that limited the role of banks. In CEE, we saw the post-privatization '*history*' with some of the pertaining problems behind legal reforms, and we questioned the merits of a strong impact of the pre-communist legal heritage. The purpose of this historical analyses however, was to give a background within which we can better understand the

[174] *See* Berglöf Eric, Corporate Governance in Transition Economies: The Theory and Its Policy Implications, Corporate Governance in Transitional Economies, World Bank Publication, Washington DC, 1995.

[175] For an empirical analyses of shareholder and creditor protection in CEE , *See* Pajuste Anete, *Corporate Governance and Stock Market Performance in Central and Eastern Europe: A Study of Nine Countries, 1994-2001*, Center for the Study of Economic and Social Change in Europe Working Paper No. 22, January 2002, *available* at http://eprints.ucl.ac.uk/17556/1/17556.pdf (last visited January 17th 2011).

[176] *See for instance*, Communication from the Commission to the Council and the European Parliament - Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, COM (2003) 284, 21. 05.2003, *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN:EN:PDF (last visited on March 10th 2010).

[177] For country reports on implementation of the Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies, OJL 184/17, 14.07.2007, *See* RiskMetrics Group Report, Implementation of Shareholder Rights Directive, January 2009, *available* at: http://www.riskmetrics.com/events/2009briefings/shareholder_rights (last visited January 17th 2011).

current approaches of protecting shareholder rights. This in turn is going to be the focus of the next sections.

1.3 Shareholder Rights in the U.S.

In the U.S., shareholders have various rights, the most important of which are the right to vote and the right to sell their shares.[178] On these crucial rights, Delaware Corporate Law provides that, amongst others, shareholders vote to elect directors and they have to approve certain fundamental corporate matters, such as mergers and charter amendments.[179]

In reality however, shareholder rights appear far more limited.[180] First, they merely represent default rules and are subject to modifications based on contractual agreements through the corporate charter or other arrangements.[181] Second, these default rules are often subject to legal limitations, which on their part were not necessarily intended to limit the impact of shareholder rights.[182] In many respects, starting from the right to vote on election of directors, fundamental transactions or proxy rules, to their right to sell shares or use takeover defenses, many legal regulations have a net effect of restricting the rights of shareholders.[183]

1.3.1 Election of Directors

After the 1980s the voting rule on election of directors was changed from a majority to a plurality vote, meaning that simply more affirmative votes *cast* for a nominee than for other

[178] Velasco Julian, *Taking Shareholders Rights Seriously*, 41 U.C. Davis Law Rev. 2, [605, 682], 2007, *available at* http://ssrn.com/abstract=886340 (last visited on January 15th 2011), at 609-610.
[179] Delaware Code Annotated (hereinafter Del. Code. Ann.), tit. 8 Corporations, Sub VII to X, (2009), electronic copy *available* at: http://delcode.delaware.gov/title8/ (last visited January 17th 2011).
[180] *See* Bebchuk Lucian, *The Case for Increasing Shareholder Power,* 118 Harvard Law Rev. 3, [833, 914], January 2005, available also online at: http://ssrn.com/abstract=387940 , (last visited January 18th 2011).
[181] Supra note 178 at 609.
[182] Supra note 180 at 850-856.
[183] Id.

nominees, without regard to votes against or not cast, were sufficient to elect a director.[184] The main rationale behind such change was to prevent what were called failed elections, where no candidate was elected to fill the position of a director, or an election in which incumbent directors failed to be reelected. The majority voting rule would bring scenarios in which no candidate would be elected, especially so in contested elections, since there was a chance that no candidate would receive a majority vote.[185] The plurality rule would therefore provide a solution, since those who got the most votes, or sometimes any votes, would win.[186]

However, given the fact that the candidate was very often a shareholder entitled to vote, his election became a matter of mere formality.[187] Even nowadays, the majority of director elections are uncontested and in most cases the candidates are directors who are seeking reelection, an outcome easy to achieve under the plurality rule.[188] In these cases, shareholders have no simple means to reject the candidates which, at this point, are almost immune to the results of a shareholder vote.[189]

It was therefore not unexpected that a change from plurality voting became the focus of shareholder activists as a way of enhancing accountability of boards.[190] However, changing

[184] *See* Comments on Corporate Laws, American Bar Association (hereinafter ABA) Section of Business Law, *Changes in the Model Business Corporation Act - Proposed Amendments to Chapters 8 and 10 Relating to Voting by Shareholders for the Election of Directors*, 61 Business Law 399, 404, 2006.
[185] On majority voting for election of directors, *See* Garner C.G.,, Jacqueline L. & Walkling, R. A., *Democracy or Disruption: An Empirical Analysis of Majority Elections for Directors, October 2009,* available at SSRN: http://ssrn.com/abstract=1491627 (last visited January 19th 2010).
[186] For directors contested and uncontested elections, *See* Sjostrom W.K. Jr. & Kim Y.S., Majority *Voting for the Election of Directors* 40 Connecticut Law Rev., 2, December 2007, *available at* SSRN: http://ssrn.com/abstract=962784 (last visited January 15th 2010).
[187] Velasco Julian, *Taking Shareholders Rights Seriously*, 41 U.C. Davis Law Rev. 2, [605, 682], 2007, *available at* http://ssrn.com/abstract=886340 (last visited on January 15th 2011), at 609-610.
[188] Bebchuk, L. A., Cohen A, & and Ferrell A., *What Matters in Corporate Governance?* 22 Rev. of Financial Studies 2, [783, 827], February 2009, at 790-794.
[189] Id.
[190] *See Recent Developments Regarding Majority Voting in Directors Elections*, Transactional and Securities Update, Foley & Lardner Information Bulletin, Electronic Update, December 2005, *available* at : http://www.foley.com/files/tbl_s31Publications/FileUpload137/3123/LegalNews-Transactional&Securities-December2005.pdf (last visited January 18th 2011).

default rules on voting standards was not an easy process, especially so due to the *necessity* of director cooperation to establish these standards.[191]

Before discussing the changes brought in 2006,[192] it is necessary to state the basic rules on the election of directors. The default standard for electing directors has been and remains a plurality standard.[193] Section 216(3) of the Delaware Code[194] and section 7.28(a) of the Model Business Corporation Act (hereinafter MBCA),[195] provide specifically for such a plurality rule. Under MBCA, a corporation could opt for a majority or some other standard via a charter amendment.[196] However the latter would require first board approval and then shareholder approval.[197]

Different from this, the Delaware Code allows a change to the plurality vote either through charter amendment or bylaw amendment.[198] For charter amendments, similarly to the MBCA, board and shareholder approval are required.[199] For bylaw amendments, shareholders can proceed without board approval, but at the same time, if provided for in the charter, as mostly the case, the board can do the same without an approval by shareholders.[200] So, as a matter of principle, shareholders could adopt a majority voting rule against the will of the board. However there was an open question as to whether the board of directors could afterwards adopt

---

[191] Sjostrom W. K. Jr., & Kim Y.S., *Majority Voting for the Election of Directors* 40 Connecticut Law Rev., 2, December 2007, *available at* SSRN: http://ssrn.com/abstract=962784 (last visited January 15th 2010), at 471-475.
[192] Id. at 475- 480.
[193] Id.
[194] Del. Code Ann. tit. 8, § 216 (3) (2006). This section provides: "*Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors…".*
[195] ABA Model Business Corporation Act (hereinafter MBCA) § 7.28 (a), (2005).
[196] Id.
[197] Id. § 10.03(b).
[198] Del. Code Ann. tit. 8, § 216 (2006).
[199] Id. § 242(b)(1).
[200] Id. § 109(a).

a bylaw provision repealing the one adopted by the shareholders, even if the shareholder bylaw prohibited them to do so[201]

In view of these problems, some of the provisions of the MBCA and the Delaware Code were amended in 2006, with the aim of facilitating majority voting.[202] The MBCA now provides an opt-in provision in a new section,[203] where the voting standard remains plurality, but, if chosen through a bylaw, a director who fails to receive a majority of votes cast would finish his term at the latest, ninety days after the vote on his election.[204] The opt-in is done through a bylaw adopted either by shareholders or by the board, however if originally adopted by shareholders, it cannot be further on changed by directors.[205] In the adverse case, shareholders (or the board) have a power to repeal such by-laws.[206]

Interestingly however, the ultimate substantive result of the new rule as to the limitation of the term of a director, is weakened by the fact that the board can subsequently choose someone to fill the vacancy and, although such a choice would be limited till the next annual meeting,[207] the board can still choose the same director who failed to get a majority.[208]

In terms of the main Delaware change with regards to bylaw amendments, a new 2006 amendment provided that "*[a] bylaw amendment adopted by stockholders which specifies the*

---

[201] Sjostrom W.K. Jr., & Kim Y.S., *Majority Voting for the Election of Directors* 40 Connecticut Law Rev., 2, December 2007, *available at* SSRN: http://ssrn.com/abstract=962784 (last visited January 15th 2011), at 476.
[202] Id. at 474.
[203] MBCA § 10.22 (Approved amendment 2007) in: Memorandum from the Committee on Corporate Laws, Committee on Corporate Laws Adopts Amendments to the Model Business Corporation Act Relating to Voting By Shareholders for the Election of Directors, June 20, 2006, (hereinafter Committee Voting Amendments), *available at:* http://www.abanet.org/buslaw/committees/CL270000pub/nosearch/mbca/amendments/release.pdf, (last visited January 12th 2011).
[204] *Id.* § 10.22(a)(2).
[205] Id. § 10.22(c)(1).
[206] Id. § 10.22(c)(2).
[207] MBCA § 8.05(d) (2005).
[208] MBCA § 10.22 (Approved amendment 2007) official comment.

votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors."[209]

Following these changes, there was a rise in the adoption of the majority voting rule by many large publicly held corporations.[210] States started to react by enacting legislation which enabled boards and stockholders to provide for majority voting, or permit irrevocable director resignations.[211] Two main forms were followed by corporations: providing for a policy addressing the consequences of a plurality vote election of a director, failing to garner a majority vote, or introducing a binding bylaw/charter amendment requiring a majority voting rule for director elections.[212]

At present however, companies often "*[w]ater down significantly the intended effects of majority voting in terms of shareholders' empowerment*",[213] meaning that a considerable number of them, yet opt for the first option by not providing for a *strict* rule of majority voting.[214] Instead the candidates usually must prepare their resignations before the election, giving up their position, if they are elected but don`t obtain an absolute majority of the votes cast.[215] Again, such resignation remains subject to approval by the existing board. As a result, boards still have the power to override shareholders by rejecting the resignation.[216]

[209] Del. Code Ann. tit. 8, § 216(4) (as amended 2006); 75 Del. Laws 306 (2006).
[210] See Allen Claudia, *Study of Majority Voting in Directors Elections,* Neal Gerber & Eisenberg LL.P. Publication, November 2007, electronic article *available at*: http://www.ngelaw.com/files/upload/majoritystudy111207.pdf (last visited on January 17th 2011).
[211] *Id.* Most notably, among the states that have addressed majority voting are California, Delaware, North Dakota, Ohio, Virginia, Washington, while examples of states permitting irrevocable directors resignations are Delaware, Texas, Utah, Maine, Virginia, etc. Id. at i-iii.
[212] Id. at 2.
[213] Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010, *available* at SSRN: http://ssrn.com/abstract=1558467 (last visited January 18th 2011), at 6.
[214] Id.
[215] Id.
[216] Id.

The above amendments and changes remain a permissible rule left to the discretion of companies and issues of hostility created with the board, continue to pose a setback to the process.[217] Additionally, outside the *hostile* takeover scenario, electoral challenges to directors in the past have been negligible,[218] given that challengers would have to cover the campaign costs, especially so when a proposal to recover some of these costs, *risked* to be ultimately considered as asking the Board of Directors to violate their fiduciary duties.[219] The issue of reimbursement of expenses related to election of directors prompted a case in 2008, in which Delaware confirmed once again where it wanted to draw the line on shareholder powers.[220]

1.3.1.1 Board 'Supremacy' in courts? The CA v. AFSCME case[221]

In an attempt to devise a plan through which changes could be forced by shareholders upon an opposing incumbent board, the American Federation of State, County and Municipal Employees pension fund (AFSCME), tried to advocate in favor of the technique of mandatory bylaw amendment, when it proposed that the board of directors of CA Inc. shall cause the corporation to reimburse a stockholder for reasonable expenses incurred in connection with nominating one or more candidates in a contested election.[222]

CA Inc. decided to exclude the proposal from its proxy statement on the basis that the proposal was not a proper ground for shareholder action under state law and if it was to be enacted, it would be in clear violation of such state law.[223] In April 2008, the counsel of CA Inc.

[217] Id.
[218] Id. at 6-8.
[219] See CA v. AFSCME, 953 A. 2d. 227, (Del Sup. Ct 2008).
[220] Id.; See also Bruner Christopher M., *Shareholder Bylaws and the Delaware Corporation*, 11 Tennessee J. of Bus. Law 1, [66, 75], 2009, at 70-75.
[221] Supra note 219.
[222] Id. at 229.
[223] Id. at 230.

addressed the SEC Division of Corporation Finance stating that the bylaw was proposed for exclusion from the 2008 proxy materials, on the ground that it conflicted with Delaware law.[224] The request was basically for a *no-action letter* by the SEC division assuring that no enforcement action would be recommended in the event of exclusion of the bylaw proposal from the proxy statement.[225] The SEC took the matter to Delaware for resolution of state law questions.[226]

Two questions were critical: first whether the proposed bylaw was a proper subject for shareholder action under Delaware Law and second, whether if adopted, the proposal would cause CA Inc. to violate any Delaware Law provision.[227] Delaware Law provides that shareholders have the power to adopt, repeal or amend bylaws[228] but the main issue was whether the proposed bylaw was a mere proposal on the process and procedures for making decisions, or whether it dictated how the board should decide on specific business choices.[229]

The Court stated that the bylaw proposal was a proper subject for shareholder action, since it relates to the process of electing directors and, the fact that it touches upon reimbursement of expenses, does not, per se, divest it from its process-related nature.[230] However, the proposal would violate common law by requiring reimbursement of proxy expenses under circumstances contrary to fiduciary duties of directors, given that such fiduciary duties would require them not to reimburse to a "*dissident slate.*"[231] In the view of the Delaware Supreme court, *"[t]he Bylaw contains no language or provision that would reserve to CA's*

[224] *See* CA, Inc. v. AFSCME, No. 329, 2008, Del. Sup. Ct., Certified Question from the SEC, June 27, 2008.
[225] Id.
[226] Id.
[227] CA v. AFSCME, 953 A. 2d. 227, (Del Sup. Ct 2008), at 231.
[228] Del. Code Ann. tit. 8, § 109(a) states that : *"[T]he original or other bylaws of a corporation may be adopted, amended or repealed by the incorporators, by the initial directors if they were named in the certificate of incorporation, or, before a corporation has received any payment for any of its stock, by its board of directors[…] The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws."*
[229] CA v. AFSCME, 953 A. 2d. 227, (Del Sup. Ct 2008), at 232-234.
[230] Id. at 236-237.
[231] Id. at 239.

directors their full power to exercise their fiduciary duty to decide whether or not it would be appropriate, in a specific case, to award reimbursement at all."[232] Therefore, with regards to the second question, the Court decided that the bylaw would violate Delaware Law.[233] Although the Court stressed that this decision was case specific, and it was not trying to put a "*bright line*"[234] between shareholder bylaw powers and director powers, the decision, despite its first impression, was in fact a step back to attempts to use bylaws as a means of empowering shareholders.[235]

1.3.1.2 Changes in Proxy Voting

Shareholder votes on the election of directors and other fundamental matters are important enough to warn proper guard against directors' abuse. Proxy voting is essential in this regard and that is why changes aimed at regulating the conduct of proxy-holders, or giving a direct say to shareholders, need to be analyzed.

This subsection will first analyze the New York Stock Exchange (hereinafter NYSE) prohibition of the broker discretionary rule[236] and then the most recent 2010 changes to proxy voting regulations.[237]

---

232 Id. at 240.
233 Id.
234 Id. at 234.
235 Bruner Christopher M., *Shareholder Bylaws and the Delaware Corporation*, 11 Tennessee J. of Bus. Law 1, [66, 75], 2009, at 67.
236 SEC Release No. 34-60215, Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, July 1 2009, *available* at: http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf (last visited on January 17th 2011), (hereinafter SEC Approval of Rule 452); For a discussion on the broker discretionary rule s*ee* infra subsection 1.3.1.2.1.; Also, on a technical note, that many SEC releases are used as sources in this work and for the purpose of referencing and bibliographical categorizations, they are divided functionally based on their purpose. SEC press releases are categorized as commentaries, SEC litigation releases are grouped with case reports and SEC Proposed or Final Rules (hereinafter FR) are grouped with laws, regulations, legislative proposals and voluntary standards. This is also the classification found in the bibliography of this work.

1.3.1.2.1 The Broker Discretionary Rule

On July 1st 2009, the SEC approved the NYSE amendment to Rule 452 eliminating the brokers` ability to vote on their own discretion with regard to elections of directors.[238] This rule allowed brokers to vote on certain *routine* proposals, in case the beneficial owner of the stock had not provided concrete voting instructions at least ten days prior to the meeting.[239] Under the current amendment, director elections, even those that are uncontested, as the majority of cases has proven, will not be considered routine.[240] The importance of the rule rests mainly on the fact that normally, around 75% of the outstanding shares in publicly held corporations, are usually held in street name through financial institutions or brokerage, and were previously voted in a manner dictated by the incumbent management.[241] The introduction of the rule means that incumbent directors will no longer go into annual meetings feeling certain that this group of votes is already in their favor, rather, if uninstructed, these percentages of holdings will not be voted at all in *non-routine matters*, such as directors' elections.[242]

The elimination of the broker discretionary voting indicates that directors standing for reelection, have lost a part of their comfort zone and they might need to step up and gain the

---

[237] SEC Release Nos. 33-9136; 34-62764, Proposed Rule on Facilitating Shareholder Director Nominations, August 25 2010, *available* at: http://www.sec.gov/rules/final/2010/33-9136.pdf, (last visited January 12th 2011); *See infra* subsection 1.3.1.2.2.

[238] SEC Approval of Rule 452 in *supra* note 236.

[239] Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010, *available* at SSRN: http://ssrn.com/abstract=1558467 (last visited January 18th 2011), at 5-8.

[240] SEC Approval of Rule 452, in supra note 236, at 3-5. This amendment is applicable to proxy voting held on or after January 1st 2010, without applying to those meetings scheduled for 2009 but properly adjourned to a date on or after the above mentioned one.

[241] *See* Letter of National Investor Relations Institute to the Securities and Exchange Commission, 16th of March 2009, *available at* http://www.governanceprofessionals.org/images/society/doc/NIRI_comment-letter_Rule452.pdf (last visited January 14th 2011).

[242] See SEC approval of Rule 452 in *supra* note 236.

support of a majority of institutional investors.[243] Institutional investor campaigns against board nominees will be more likely to succeed, yet again, given that plurality vote remains a default rule, and given the weaknesses of some of the forms used to adopt the standard of majority voting, the result of the new NYSE rule remains uncertain.[244]

1.3.1.2.2 Proxy Voting and Shareholder Nominees

Proxy voting is regulated under Rule 14 (a) of the Securities Exchange Act known also as the *proxy regulation*.[245] This rule stipulates when a company should include a shareholder proposal in its proxy statement during an annual or special meeting of shareholders.[246] However, of importance here, are the exceptions under which a company could exclude proposals,[247] with some of the major grounds being: the proposal is not a proper subject for action by shareholders under state law;[248] if it were to be implemented it would violate state law;[249] it deals with a matter relating to the company's ordinary business operations;[250] or the proposal relates to a nomination or an election for membership on the company's board of directors, or a procedure

[243] Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010, available at SSRN: http://ssrn.com/abstract=1558467 (last visited January 18th 2011), at 7.
[244] Id.
[245] Securities Exchange Act of 1934, (Pub. L. No. 291, 48 U.S. Stat. 881), 15 U.S. Code §§ 78a–78nn (2006) (as provided at Code of Federal Regulations (hereinafter C.F.R.) 17 C.F.R.§ 240.14a-8) Rule 14a-8 provides in relevant parts *"…it shall be unlawful for any person . . . in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit . . . any proxy or consent or authorization in respect of any security . . . registered pursuant to . . . this title*". Id.
[246] 17 C.F.R. § 240.14a-8.
[247] The above mentioned case in supra subsection 1.3.1.1 was brought under the exceptions of Rule 14a -8. See CA v. AFSCME, 953 A. 2d. 227, (Del Sup. Ct 2008).
[248] 17 C.F.R. § 240.14a-8(i)(1).
[249] 17 C.F.R. § 240.14a-8(i)(2).
[250] 17 C.F.R. § 240.14a-8(i)(7).

for such nomination or election.[251] This last part was obviously problematic with regard to shareholders' interest in having their director nominees included in their proxy statements.

Realizing this, the SEC adopted a new proposed amendment to Rule 14a-11 in August 2010, with the aim of facilitating shareholder nominations of directors.[252] According to the new proposed rule, provided certain conditions are met, companies would be required to include shareholder nominees for directors in their proxy statements for general or special stockholder meetings when directors are to be elected.[253]

The new amended rule therefore requires companies to include in their proxy materials the nominees of shareholders that, depending on market capitalization and reporting requirements, have owned at least three percent of the company's shares in a continuous way, for at least three years.[254]

One noteworthy aspect of the proposed rule is the restriction put on the number of nominees, namely that a shareholder will be able to include no more than one nominee, or a number corresponding to up to 25 percent of the company's board of directors, whichever is greater.[255] The underlying rationale is to basically prevent shareholders who seek control of the board via company's proxy solicitation. Those who aim to gain such control would have to launch an independent proxy contest, and bear its expenses.[256]

[251] 17 C.F.R. § 240.14a-8(i)(8); *See also* Ahdieh, Robert B., *The Dialectical Regulation of Rule 14a-8: Intersystemic Governance in Corporate Law*, Emory Law and Economics Research Paper No. 08-28;2007.
[252] SEC Release Nos. 33-9136; 34-62764, Proposed Rule on Facilitating Shareholder Director Nominations, August 25 2010, *available* at: http://www.sec.gov/rules/final/2010/33-9136.pdf, (last visited January 12th 2011).
[253] *See* SEC Press Release, SEC Adopts New Measures to Facilitate Director Nominations by Shareholders, 155-2010, August 25 2010.
available at: http://www.sec.gov/news/press/2010/2010-155.htm, (last visited on January 12th 2011).
[254] Id.
[255] Id.
[256] Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010, *available* at SSRN: http://ssrn.com/abstract=1558467 (last visited January 18th 2011), at 14.

A further problem of the new rule refers to the scenario, under which there are more shareholder nominated candidates than available seats. It might happen that the maximum quota of shareholder-nominated directors is already filled at the time of election.[257] This can happen, for instance, in cases of staggered boards and if this is the case, then proxy access would not be available to shareholders.[258]

Soon after the proposal of this rule by the SEC, (but before its final approval), the Delaware legislature did not stay idle on the issue. In 2009, it amended sections 112 and 113 of its General Corporation Law (hereinafter DGCL).[259] The first section provides that the bylaws might now grant shareholders access to the proxy statement in directors' elections, conditional upon specific procedures and criteria, such as a minimum threshold and duration of ownership, and the disclosure of specific relevant information, regarding the nominating stockholder and the nominated candidate.[260] The second section stipulates that the bylaws may provide for reimbursement of the expenses incurred by a stockholder with regards to soliciting proxies for the election of directors.[261]

The amendments analyzed in this section witness a current trend of recognizing the concern regarding shareholders` right on the election of directors. Despite the positive attitude, some problems still remain. As mentioned before, the fact that plurality voting is still a default rule, the weaker forms of majority voting adopted by companies and the potential scenario of

[257] Id.
[258] Id.
[259] Del. Code Ann. Tit. 8, §§112, 113 (2009).
[260] Del. Code Ann. Tit. 8, § 112 (2009).
[261] Del. Code Ann. Tit. 8, § 113 (2009). Bylaws can however limit the reimbursement amount proportionally to the success of concrete proxy solicitation.

filled quotas of shareholder-nominated directors, continue to impose restrictions on the role of shareholders in the nomination and election of directors.[262]

1.3.2 Shareholder Fundamental Transactions in the U.S.

Having discussed the issue of directors` election as an important shareholder right, this section will in turn deal with another significant shareholder prerogative, namely that of voting on fundamental transactions. Although it is accepted that this is a basic shareholder right, there is a real limitation to it, given that directors have significant control over the voting agenda.[263] The fact that shareholders mainly vote on matters that are submitted to them by directors, with the latter most often making initial proposals on fundamental transactions, is an indicator of the type of control resting in directors` hands, control which can be abused. Shareholders may be able to get their own proposals in front of other shareholders, but they mostly remain in the form of non-binding recommendations.[264]

From the directors' perspective, two major points can be emphasized: First, they do not have to ensure that a proposal is satisfactory and optimal for shareholders, it just needs to be so only for achieving a majority approval.[265] Second, although shareholders have the right to vote on fundamental matters, directors retain the power to reshape certain fundamental proposals requiring shareholder approval, into ones that do not require it.[266] That was the case in

---

[262] Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010, available at SSRN: http://ssrn.com/abstract=1558467 (last visited January 18th 2011), at 7-15.
[263] *See, for e.g.*, MBCA § 10.03 (2005) (referring to charter amendments) and § 11.04 (2005) (referring to mergers).
[264] Allen Claudia, *Study of Majority Voting in Directors Elections*, Neal Gerber & Eisenberg LL.P. Publication, November 2007, electronic article *available at*: http://www.ngelaw.com/files/upload/majoritystudy111207.pdf (last visited on January 17th 2010), at 9.
[265] Velasco Julian, *Taking Shareholder Rights Seriously*, 41 UC Davis Law Rev. 2, [605, 682], 2007, available at SSRN: http://ssrn.com/abstract=886340 ,(last visited January 20th 2011), at 613.
[266] Id.

Paramount Communications, Inc. v. Time Inc., where in order to avoid a shareholder vote, a merger of equals was restructured into an asset purchase.[267]

Earlier, courts would analyze such reshape looking beyond the form of a transaction into its substance, such as in the case of ***Farris v. Glen Alden Corp.***, where the court decided to disregard the naming of a transaction and apply the *de facto* merger doctrine.[268]However, subsequent cases demonstrated a turn in the other direction. That was the case in ***Hariton v. Arco Elecs. Inc.,***[269] where the court stated that: "*[T]he sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end*".[270]

This outcome meant that directors had room to maneuver with cases that required shareholder approval, by restructuring them into ones that did not. Furthermore, although shareholders have the right to amend the bylaws of the corporation without the necessity of director approval,[271]such bylaws by their very nature, are a set of self-imposed rules that are expedient for the corporation`s proper functioning[272] and they can not contradict the law or the corporation`s charter.[273] This has given an argument to those who favor directors' wide discretionary powers, claiming that shareholder bylaws cannot interfere in any way with the *competence* of directors to manage the business and activities of the corporation, although this would at times contravene with their right to have a say on fundamental transactions.[274] With the

[267] Paramount Communications Inc. v. Time Inc., 571 A.2d 1140, (Del.1989), at 1145-1148.
[268] Farris v. Glen Alden Corp., 143 A.2d 25, 28-31 (Pa. 1958).
[269] Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963).
[270] Id. at para. 124.
[271] *See* for instance Del. Code Ann,. tit. 8, § 109(a) (2001); *See* also MBCA § 10.20(a) (2005).
[272] *See* the case of Gow v. Consol. Coppermine Corporation, 165 A. 136, 140 (Del. Ch. 1933).
[273] *See* Del. Code Ann. tit. 8, § 109(b); MBCA § 2.06(b) (2005).
[274] *See* Hamermesh Lawrence A., *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 Tulane Law Rev., 409, 1998.

exception of the prohibition regarding bylaw amendments adopted by shareholders on voting standards for the election of directors, on other matters, directors mostly retain the right to amend the bylaws as well.[275]

1.3.2.1 Fundamental Transactions Including Takeovers

In addition to the power to vote on directors' elections and bylaw amendments, shareholders in the U.S. have the power to vote on mergers and charter amendments.[276] However, supermajority requirements for charter amendments and mergers make it difficult for shareholders to have their say on these matters.[277] The requirements give the insider holders of a block, the power to impede charter amendments and mergers, even if they no longer are in control of the board. Reacting in this way would certainly impede the plans of a buyer of a control block to acquire it.[278]

Furthermore, bylaw amendments can often be used by the board as a defense against takeovers.[279] In the famous case of ***Chesapeake Corp. v. Marc P. Shore,***[280] the Delaware court ruled that a supermajority requirement of two-thirds of all outstanding shares for amending a bylaw, had severe antitakeover consequences, making it almost impossible for non-management

[275] *See* Del. Code Ann. tit. 8, § 109(a) providing that charter may confer power to amend bylaws on directors; *See* also MBCA § 10.20(b) providing that charter may deny directors power to amend bylaws, although this is up to shareholders whether they provide for it in the charter.

[276] *See, for e.g.*, MBCA § 10.03 (referring to charter amendments) and § 11.04 (2005) (referring to mergers).Also *See* for example for mergers DEL. CODE ANN. tit. 8, sub. IX.

[277] Bebchuk L, Coates, J. C. IV & Subramanian G., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, .54 Stanford Law Rev. 5, [887, 951], 2002, available at SSRN: http://ssrn.com/abstract=304388 , (last visited January 29th 2011), at 894.

[278] Velasco Julian, *Taking Shareholder Rights Seriously*, 41 UC Davis Law Rev. 2, [605, 682], 2007, available at SSRN: http://ssrn.com/abstract=886340 ,(last visited January 20th 2011), at 616.

[279] Id. at 616-618.

[280] Chesapeake Corp. and Sheffield, Inc., v. Marc P. Shore and co-joined defendants, Civ. A. No. 17626., (Del. Ct. of Chancery, 2000).

shareholders to be able to remove defensive provisions that management earlier put in the bylaws.[281]

Additionally, courts have allowed directors to provide resistance to *hostile* takeovers under defined circumstances. The landmark case on the issue is ***Unocal Corp. v. Mesa Petroleum Co***,[282] where the Delaware Supreme Court ruled that directors may defend the company against the takeover, if their conduct is consistent with their fiduciary duty to act in the best interests of the corporation's stockholders.[283] The Court went on to develop the *enhanced scrutiny test*, according to which, the benefit of the business judgment rule will be given to directors, if they show that they had reasonable grounds to believe there existed a danger to corporate policy, and the defensive measure taken was reasonable in relation to the threat.[284] However, the test is not as efficient as one would first think, indeed anything, if not already a threat to the corporation, can be structured and justified as such.[285] This in turn simply demonstrates the power of directors to prevent shareholders from selling their shares in the takeover market.

Moreover, several antitakeover defenses[286] and constituency statutes[287] serve the purpose of limiting shareholders from exercising their right to sell shares in cases of takeovers.[288] Antitakeover state statutes may provide limitations on acquirers to engage in transactions with the target company for some time after the acquisition, or prevent them from exercising voting

---

[281] Id. at 45.
[282] Unocal Corp. v. Mesa Petroleum Co. 493 A.2d 946 (Del. 1985).
[283] Id.
[284] Id. at 955.
[285] *See* for instance another case, Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995).
[286] Velasco Julian, *Taking Shareholder Rights Serio*usly, 41 UC Davis Law Rev. 2, [605, 682], 2007, available at SSRN: http://ssrn.com/abstract=886340 ,(last visited January 20th 2011), at 617-620.
[287] *See* for constituency statutes, Patterson Jeanne, *Corporate Law and Economic Development: The Impact of State Constituency Statutes on State Economic Development*, Institute for Development Strategies, Indiana University, US, 1995.
[288] Supra note 286, at 617-620.

rights if they acquire certain specified vote percentages, restricting in this way the power to have control over the target company and its assets.[289]

In terms of constituency statutes, although their language is permissive rather than mandatory, they authorize directors to take into account not only the interests of shareholders, but the interests of all stakeholders, including sometimes even the national economy interests.[290] Although understandable from a stakeholder perspective, this approach, at least as a matter of principle, would not be very popular in the eyes of the shareholders.[291] This effect does not necessarily come due to provisions on higher protection of stakeholders, since the interpretation and effectiveness of these statutes is yet problematic, but more so due to the fact that their ultimate result might be the expansion of the power of boards.[292] Without proper guidance as to the *weight* of any constituency interests, directors would have a *carte blanche* to justify every decision as serving the interests of at least one group of stakeholders.[293]

To sum up, the above subsections have given an overview of shareholder rights in the U.S., focusing on election of directors and shareholders` vote on fundamental transactions. The picture given by the U.S. approach is not un-problematic. Indeed, for many years the plurality requirement for the election of directors has weakened the potential for shareholder involvement in this regard. Bylaw amendments and charter amendments have been quite difficult to provide

[289] *See, for example* Del. Code Ann. tit. 8, § 203 (Supp. 2006) known as Delaware's Business Combination Statute. A well-known case regarding anti-takeover statutes was CTS Corp. v. Dynamics Corp. of Am., 481U.S.69 (1987), where the U.S. Supreme Court upheld the Indiana control share acquisition statute regulating internal affairs of the corporation as valid.

[290] Velasco Julian, *The Fundamental Rights of the Shareholder*, 40 UC Davis Law Rev. 2, [407, 467], 2006, available at: http://ssrn.com/abstract=761904, (last visited January 20th 2011), at 463.

[291] Keay Andrew R., *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?*, University of Leeds Working Paper No. 4, January 2010, *available* at SSRN: http://ssrn.com/abstract=1530990, (last visited February 22nd 2011), at 10-12.

[292] See infra section 4.2.5.1; See also Campbell Rutheford B. Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era*, 23 Florida State University Law Rev., [561, 624], 1996, *available* at: http://www.law.fsu.edu/journals/lawreview/downloads/233/campbell.pdf , (last visited February 22nd 2011) at 622.

[293] *See* Bebchuk Lucian, *The Case for Increasing Shareholder Power*, 118 Harvard Law Rev, [833, 917], January 2005, at 853-856.

any significant means for such elections, although the new amendments of Delaware Law and MBCA were aimed at facilitating the role of shareholders. Proxy rules and case law have until recently shown that in the battle between shareholders and the Board on the election of directors, the latter has held victory grounds for quite some time.

The proposed changes on proxy voting, majority requirements and the new NYSE broker discretionary prohibition, are positive steps, but their effects will be properly seen in future cases. Furthermore, the regulation of takeovers in the U.S. is characterized by case law favoring directors under the review restrictions deriving from the business judgment rule. Lastly, the existence of several state antitakeover statutes and constituency statutes, tend to limit shareholders` real profit from the takeover market at the risk of expanding

1.4 Shareholder Rights in the Chosen EU Jurisdictions

In Europe, the debate on shareholder right takes a different European-specific character. That is so especially since the discussions on election of directors and bylaw amendments do not appear as heated as in the U.S. context.[294] From a European perspective, what matters most to the shareholder question might at times differ from the issues we analyzed in the above section.[295] Some European-specific concerns have consisted of reducing uncertainties in the stock lending and depositary receipt, through improved information about voting rights, improved communication prior to the general meeting, not having the voting process being contingent to

[294] See for an earlier comparative analysis, Baums T. & Wymeersch E. (eds.), Shareholder Voting Rights and Practices in Europe and the United States, Kluwer Law International, The Hague, Boston, 1999.
[295] See Masouros Pavlos E., *Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe*, 7 European Company Law, [195, 203], 2010, *available* at SSRN: http://ssrn.com/abstract=1686725 (last visited January 17th 2011).

blocking the shares for a few days prior to the election meeting, the right to add proposals in the agenda and the like.[296]

Some of the specific traits of the European approach to shareholder rights derive also from the EU role in harmonizing company law, although Member States' differences remain non-negligible.[297] Having said this, the following section will deal with the European equivalent to some of the aspects treated in the section pertaining to U.S., but also with the European-specific problems of shareholder protection.

1.4.1 Election of Board Members in the Chosen EU Jurisdictions

When it comes to exercising shareholder rights on the appointment of Board members (Supervisory Board and Management Board, in cases of two tier board structures),[298] there is no similar discussion on plurality voting as in the U.S.

First, majority rule is the default mechanism for corporate elections, with the absolute majority being predominant and with abstention equaling negative voting, although in countries including, amongst others, Germany, the UK, Belgium and Austria, a simple majority rule is employed.[299]

---

[296] Id.; see also Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2011), at 50-69.

[297] *See* Communication from the Commission to the Council and the European Parliament - *Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM (2003) 284, 21. 05.2003, *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN:EN:PDF (last visited on January 17th 2011).

[298] *See* Hopt, K. J. & Leyens, P. C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy.* ECGI, Law Working Paper No. 18, 2004, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=487944, (last visited January 18th 2011).

[299] *See*, Baums Theodor, *General Meetings in Listed Companies – New Challenges and Opportunities,* paper presented at the Conference "Company Law Reform in OECD Countries", Stockholm, 7 - 8 December 2000, downloadable at: http://www.oecd.org (last visited on January 17th 2010), at 9-10.

Second, voting on election of directors depends on whether the particular company has a one tier or two tier board structure and this is especially so, in light of the fact that, providing for the option of choosing between these two models, is now an EU-mandated requirement.[300]

So, in Germany as the typical two tier model, the members of the management board are appointed by the Supervisory Board for a term of five years, with a right to re-election,[301] while members of the Supervisory Board are appointed by the General Shareholders Meeting with a simple majority of the votes cast and by the employees, when the conditions for applying the Co-determination Act are fulfilled.[302] The company articles are also allowed to provide that a third of the representatives of the shareholders may be appointed by a single shareholder or a class of shareholders.[303] Supervisory board members of a German AG, are also appointed for a term of no longer than five years, having the right to re-appointment. In terms of dismissals, if appointed by the general shareholders meeting, members of the supervisory board may be dismissed by shareholders before the end of their term, without cause by special majority of 75% of the votes cast, or even lower thresholds, as may be provided in the Articles, the thresholds being at least more than 50% of the votes cast.[304] Regarding members of the Supervisory Board elected by

---

[300] *See* Communication from the Commission to the Council and the European Parliament - *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward,* COM (2003) 284, 21. 05.2003, *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN:EN:PDF (last visited on January 17th 2011).

[301] Stock Corporation Act *[Aktiengesetz (AktG)]*, of 06.09.1965, published in Federal Law Gazette [*Bundesgesetzblatt BGBT]* I 1089, (hereinafter AktG). The AktG entered in force on the 1st January 1966. For a translation of the Act in English, *See* Peltzer M. & Hickinbotham, A.G. *German Stock Corporation Act and Co-Determination Act,* Otto Schmidt, Köln, 1999. (Stock corporations in German: *Aktiengesellschaft AG);* § 86 AktG.

[302] See § 101(1) AktG; Co-Determination Act [*Gesetz uber die Mitbestimmung der Arbeitnehmer*] of 4 May 1976, published in Federal Law Gazette BGB1 I 1153, (hereinafter MitbestG). For the English translation, *See* Peltzer M. & Hickinbotham, A.G. *German Stock Corporation Act and Co-Determination Act*, Otto Schmidt, Köln, 1999, § 1.7 MitbestG. In the case of Codetermination for companies with more than 2000 employees, half of the Supervisory Board members have to be elected from employee representatives. As for companies employing from 500 to 2000 employees, one third of the Supervisory Board has to be composed of employee representatives, as provided now by the One Third Participation Act. See One Third Participation Act [Drittelbeteiligungsgesetzes (DrittelbG)] of 18 May 2004, published in the Federal Law Gazette BGBI IS. 974; See infra section 4.3.1 and related discussion.

[303] § 101 (2) AktG.

[304] § 103 (1) AktG.

employees, they may be removed by three quarters of the votes cast by the electoral delegates representing the employees.[305]The Supervisory Board itself has the possibility to ask the court for removal of a member for cause.[306]

The Czech model is also similar to the German two tier model and practices of using a majority requirement to appoint directors.[307] While members of the Supervisory Board are appointed for a term of five years[308] and in a very similar way to the German method, (with representation of employees up to one third of the Board, in cases when a company has more than 50 employees),[309] it is interesting to observe that the default rule is to appoint members of the Board of Directors directly from the General Shareholders Meeting, giving the latter power to act through directors in the actual management of the corporation, without the intermediary of the Supervisory Board.[310] The statute of a corporation may nevertheless provide for the power of the Supervisory Board to appoint members of the Board of Directors.[311]

In Romania, the structure for those companies choosing the dual system (the two tier system) includes a *Directorate*, which represents the executive body of the company, and the *Supervision Council*, a body elected by company shareholders to appoint members of the

[305] § 103 (2) AktG.
[306] 103 (2) AktG.
[307] *See* for an overview of the development of corporate governance in Czech Republic, Claessens S., Djankov S. & Pohl G., *Ownership and Corporate Governance: Evidence from the Czech Republic,* Policy Research Working Paper 1737, World Bank, March 1997, *available* at: http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1700series/wps1737/wps1737.pdf (last visited January 19th 2010).
[308] Commercial Code *[Obchodní zákoník]*, published in Law Collection (hereinafter Coll.) 63 of 01.01.2001, (hereinafter Czech Commercial Code); (Note that referral of acts or laws in Czech Republic is done first through the number of the act, then the year of promulgation, accompanied by Coll. For the Commercial Code the referral is Act No. 63/2001 Coll.) The full text of the 2001 Code is *available* in English at: http://www.sec.cz/export/EN/Legal_Regulations/get_dms_file.do?FileId=1223 (last visited January 18th 2010). (Stock corporations in Czech: *Akciova Spolecnost AS*), Art. 194.
[309] Czech Commercial Code art. 200.
[310] Id. art. 200.
[311] Czech Commercial Code art. 194.

Directorate and to supervise its activity.[312] Election of the Supervisory Council members is done for a period of four years (apart from initial members, in which case, the period is up to two years) through majority voting.[313]

In Europe in general, the predominant voting rule on the election of directors in the two tier companies, is the majority voting standard and shareholders appoint the members of Supervisory Boards, while the latter in turn appoints the members of the Management Board.[314] In the one tier system, shareholders reserve the right to elect directors, but with boards often dominated by insider management, combined with a claimed apathy of shareholders, there has always been a prevalence of factual co-optation by the incumbent management.[315]

One specific example of a one tier system, worth mentioning here due to a stronger approach to *empowering* shareholders in terms of removing directors, is the UK.[316] While articles of association would normally provide for retirement by rotation of usually one third of the board, shareholders always maintain the power to replace *all* the directors by calling a special meeting in order to achieve the result, or they may position a candidate on the corporate ballot.[317] Some might think that this model runs the risk of discouraging skilled directors from serving, it

---

[312] Romanian Company Law, Law No. 441, of 31.10.2006, On Amending and Supplementing the Provisions of Law No. 31/1990 On Commercial Companies and of Law No. 26/1990 On the Register of Commerce Registration Procedures *[Lege pentru Modificarea Legii nr. 31/1990 Privind Societãtile Comerciale, Republicata, si a Legii nr. 26/1990 Privind Registrul comertului, Republicata, Nr. 441, 31.10. 2006]*, published in OG No. 955, 31.10.2006, (hereinafter Romanian Company Law). English translation of the latest 2006 amendments of the Law are *available* at: http://www.sova.ro/documente/Draft%20Law%20%20-%20Company%20Law%20-%20December%202006.pdf (last visited on March 12th, 2008). Articles 83 to 102 of the new Company Law, deal with the unitary system, while articles 103-106 deal with the dualist system. Articles 106-184 have provisions regarding both, the unitary and dualist system.

[313] Romanian Company Law, art. 138/2.

[314] Baums Theodor, *General Meetings in Listed Companies – New Challenges and Opportunities*, paper presented at the Conference "Company Law Reform in OECD Countries", Stockholm, 2001, available at http://www.oecd.org/dataoecd/61/15/1931816.pdf (last visited January 20th 2011), at 11-12.

[315] Id.

[316] *See* Davies Paul L., Gower's Principles of Modern Company Law (6th ed.), London, 1997, at 188-193.

[317] UK Companies Act 2006 (The full title of the Act is "An Act to Reform Company Law and Restate the Greater Part of the Enactments Relating to Companies; to Make Other Provision Relating to Companies and Other Forms of Business Organization; to Make Provision about Directors' Disqualification, Business Names, Auditors and Actuaries; to Amend Part 9 of the Enterprise Act 2002; and for Connected Purposes", passed on 8th November 2006, printed by Queen's Printer of Acts of Parliament, No. 352246, hereinafter UK Companies Act 2006), s. 154.

enhances the creation and pursuit of special interests, or it doesn`t inspire boards to pursue long term value-creation strategies, although there is no convincing evidence so far that this is the case.[318]

Recently, a proposal to annually re-evaluate and put the chairmen and directors to stand for re-election caused a heated debate in UK.[319] As part of the UK response to the corporate governance *deficiencies* that might have played a part in the deepening of the credit crisis, there was a review of the corporate governance standards in the UK, with a special focus on banks and other financial institutions.[320] In November 2009, the Walker Recommendations were followed by the Financial Reporting Council Final Report on the Code (renamed as the UK Corporate Governance Code),[321]and a final version was issued in 2010.[322] What is of value to the present analyses, is the recommendation that directors of the Financial Times Stock Exchange (hereinafter FTSE) 350 companies be subject to annual re-election,[323] while directors of other listed companies can do so, not less than every three years.[324] Whether the UK approach will become a trend for other European countries remains to be seen, although its 2009 version,

[318] *See* Becht Marco et al., *Returns to Shareholder Activism*, Evidence from a Clinical Study of the Hermes U.K. Focus Fund, ECGI - Finance Working Paper No. 138/2006, available at SSRN: http://ssrn.com/abstract=934712 (last visited January 20th 2011). It is suggested here that large UK shareholders have used their power over the board to make changes that produce significant value-enhancing outcomes. Id. at 5 et.seq.

[319] The debate was stirred by the publication of David Walker`s report, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities, Final Recommendations*, 26 November 2009, available at: http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf (last visited on January 19th 2011). The Report suggested annual reelection for chairmen and board members of banks and other financial institutions.

[320] Id. at 5. In the meantime, the Financial Reporting Council (FRC) initiated its own review of the Combined Code. For the previous version of the City Code, *See* Financial Reporting Council, *The UK Approach to Corporate Governance*, November 2006, available at: http://www.frc.org.uk/documents/pagemanager/frc/FRC%20The%20UK%20Approach%20to%20Corporate%20Governance%20final.pdf (last visited on January 19th 2011).

[321] For the new revised Code, *See* Financial Reporting Council 2009 Review of the Combined Code*:* Final Report, December 2009, available at http://www.frc.org.uk/images/uploaded/documents/2009%20Review%20of%20the%20Combined%20Code%20Final%20Report1.pd (last visited on January 19th 2011).

[322] Financial Reporting Council, The UK Corporate Governance Code, June 2010, available at: http://www.frc.org.uk/documents/pagemanager/Corporate_Governance/UK%20Corp%20Gov%20Code%20June%2002010.pdf, (last visited January 19th 2011).

[323] Id. Rec. B 7.1

[324] Id.

which remained unchanged in crucial points, was received with some polarized reactions by listed companies.[325]

The chosen EU jurisdictions` *counterpart* of directors` election presents a different approach from the U.S. one, that being so due to two main reasons: first, the enhanced attention posed on issues such as employee representation in boards, especially in the cases of Germany and Czech Republic and second, the *undisturbed* established practice of using majority voting for the election of directors in most EU countries. One variation to the debate is the example of the UK approach, which, although not part of the chosen jurisdictions, was included due to its peculiarity with regards to the *intensified* shareholder power on re-election of directors.

1.4.2 The EU Shareholder Rights Directive

Bearing in mind the special EU level focus placed on shareholder rights, the following part will deal with the novelties brought through, and upon full implementation of the EU Shareholder Rights Directive.[326]

The period from 1989 until 2001, has been often characterized as a time of major controversies on EU company law issues, due to supranational level discussions on voting rights and takeover regulations.[327]In 2003, the EU issued its Communication on *Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*

[325] For a review of the perceptions of the 2009 Code which remained unchanged in crucial propositions, s*ee* Sarkar T., Jay S., & Manley G., *An Analysis of the Walker Review of Corporate Governance in U.K. Banks and Other Financial Institutions,* 127 The Banking Law Journal 3, [242, 251], March 2010.

[326] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies, OJL 184/17, 14.07.2007, *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF (last visited on January 18th 2011), (hereinafter EU Shareholder Rights Directive).

[327] *See* Masouros Pavlos E., *Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe,* 7 European Company Law, [195, 203], 2010, available at SSRN: http://ssrn.com/abstract=1686725 (last visited January 17th 2011), See also for discussions regarding a Takeover Directive during this period, Mosca Chiara, *The Takeover Bids Directive: An Opportunity for Europe or Simply a Compromise?,* Paolo Baffi Centre Research Paper No. 64, December 2009.

(hereinafter Action Plan).[328] The key policy objectives of the Action Plan, involved strengthening shareholder rights,[329] increasing the number of independent directors in listed companies,[330] increasing their responsibility for key financial and non-financial actions,[331] establishing the proper criteria for directors' remuneration[332] and properly addressing the principle of proportionality between capital and control.[333] The 2006 review of the Action Plan continued to prioritize the need for strengthening shareholder rights, although it acknowledged a growing sense of regulatory fatigue and the need to pause and allow more time for digestion of the recent legislation by Member States.[334]

Within the Action Plan, the EU Shareholder Rights Directive of 2007[335] identified that there was an immediate need for minimum investor protection standards related to the free and facilitated exercise of voting.[336] The complexity of cross-border proxy voting, the barriers imposed by requirements that blocked shares before meetings, and problems of information access, were the main concerns to be solved by the Directive.[337] The core provisions of the Directive dealt with notice of general meetings at least 21 days prior,[338] removing blocking

[328] Communication from the Commission to the Council and the European Parliament - *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM (2003) 284, 21. 05.2003, *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN:EN:PDF (last visited on March 10th 2010).
[329] Id. at 7.
[330] Id.
[331] Id. at 8.
[332] Id. at 8-9.
[333] Id.
[334] *See The EU Approach to Corporate Governance: Essentials and Recent Developments*, International Finance Corporation Publication, February 2008, *available* at: http://www.ifc.org/ifcext/media.nsf/AttachmentsByTitle/IFC_EUApproach_Final/$FILE/IFC_EUApproach_Final.pdf (last visited January 18th 2011).
[335] EU Shareholder Rights Directive.
[336] Id. preamble at 10.
[337] Id. preamble at 4 – 14; See also Pinto Arthur R., *The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and Observations*, 32 Fordham Int. Law J. 2, [489, 524], September 2008.
[338] Art. 5(1) EU Shareholder Rights Directive.

mechanisms, such as share deposits, aimed at restricting participation in the general meetings,[339] facilitating proxy voting individually or through securities accounts,[340] and making electronic participation in general meetings a viable option.[341]

Despite the fact that the Directive set August 2009 as an implementation deadline,[342] in January 2010, for instance, twelve Member States, amongst which France, Italy, Hungary and Spain, had not yet notified the Commission on any measures transposing the Directive, although all the specific jurisdictions included in this discussion have done so.[343] This prompted an action by the EU Commission in order to ensure that these countries implement the directive.[344]

Very recently, the EU has launched a public consultation on a Green Paper on the EU Corporate Governance Framework, with a particular focus on boards, shareholders and the comply-or-explain principle.[345] In terms of board composition, the Commission is concerned with problems pertaining to gender and national diversity, risk management and executive compensation.[346] Regarding shareholder rights, the focus is on how to increase shareholder involvement and encourage their interest on sustainable long-term returns.[347] As for the comply-or-explain principle, the main objective is to improve monitoring and enforcement of voluntary

---

[339] Id. art.10.
[340] Id. art.(s) 10, 11.
[341] Id. art.(s) 8, 14. The Directive required availability and disclosure of the information pertaining to meeting times, shares` voting rights, content of proposals and other documents to be posted on the internet, while providing also for the possibility of proxy appointment via internet, and voting possibilities through electronic means (except when barriers are imposed for shareholder identification purposes). Id. Exception at art.14.
[342] Id. art. 15.
[343] For a report on implementation of the Directive in January 2010, *See Countries drag their feet over Shareholder Rights Directive Transposition,* January 14th 2010, electronic article *available* at http://blog.manifest.co.uk/2010/01/2787.html (last visited on January 19th 2010).
[344] *See* European Commission Press Release 10/ 815, Internal Market: Commission Acts to Ensure that 12 Member States Implement EU Rules on Shareholders' Rights in Listed Companies and Public Procurement Redress, 24 June 2010, available at: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/815&type=HTML (last visited January 22nd 2011).
[345] EU Commission Green Paper COM (2011) 164 on the EU Corporate Governance Framework, 5 April 2011, available at: http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf (last visited on April 12th 2011).
[346] Id.at 3.
[347] Id.

codes in the Member States.[348] This initiative is still under creation and its results are yet to be seen. However, given the past experience with the implementation of the EU Shareholder Rights' Directive, the chances of a positive receipt by Member States of this initiative and its effectiveness, are at best questionable.[349]

1.4.3 Shareholders' Vote on Fundamental Transactions in the Chosen EU Jurisdictions

In most EU countries, shareholders enjoy similar rights when it comes to voting on fundamental matters, such as for instance, amendment of articles of association, voting on mergers and on decisions that would otherwise *substantially alter* the activity of a company.[350] The following subsections will first analyze the rights of shareholders on fundamental transactions in Germany, the chosen CEE jurisdictions and then, due to the special EU attention devoted to takeovers, it will focus on the role of the EU Takeover Directive.[351] Lastly, the section will provide a separate comparison between the takeover regimes in the U.S. and the EU.

1.4.3.1 Shareholder Fundamental Transactions in Germany

In Germany, as a rule, the power to block some fundamental decisions to be taken by the company, is granted only to shareholders who hold a certain percentage of the shares in the

[348] Id.
[349] *See* for an analyses of some of the problems pertaining to shareholder voting rights in the EU, Zetzsche Dirk A., *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, Center for Business and Corporate Law Research Paper Series No. 0031, July 2008, *available* at: http://ssrn.com/abstract=1120915 (last visited January 22nd 2011).
[350] *See*, Vossestein Gert-Jan, Modernization of European Company Law and Corporate Governance: Some Considerations on Its Legal Limits, Kluwer Law International, UK, January 2010.
[351] Directive 2004/25/EC of the European Parliament and of the Council of 21 January 2004 on Takeover Bids, OJL 142/12, 30/04/2004 *available at:* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:HTML (last visited, April 18th, 2011), (hereinafter EU Takeover Directive).

company.[352] For instance, statutory law requires the consent of at least 75% of the registered share capital represented at the General Meeting, for amending the Articles of Association, as well as for other major decisions such as restructuring the company.[353] A General Meeting shall be convened if shareholders, whose aggregate holding is not less than 5%, demand it.[354] As far as the relation between shares and voting rights is concerned, the general principle is *"one share-one vote."*[355] The KonTraG law required banks to provide information to their share depositors of alternative ways of exercising their votes and it aimed to strengthen the banks` fiduciary duties[356] to *"[v]ote proxies in the best interests of the average shareholder*."[357] Although the law tried to put restrictions on banks and offer possibilities for alternative mechanisms of proxy voting, such as for instance shareholder associations, in the end, it did not curb critical bank interests.[358] This was so, especially given the fact that, although requiring lower participation of banks in equity holdings, banks had already started the process of liquidating such holdings as

[352] See for e.g. § 179(2) AktG.
[353] Id.
[354] §122(2) and (1) No. 2 AktG. Shareholders, holding 5% of the capital or representing a proportional amount of not less than € 500,000 may ask for items to be included on the published agenda of the meeting. § 122(1) No. 1 AktG.
[355] § 12(1) and 138-140 AktG.
[356] Law On Control and Transparency *[Gesetz zur Kontrolle und Transparenz im Unternehmensbereich]*, of 27 July 1998, published in Federal Law Gazette BGBl. I S.786. KonTraG required banks to disclose all board mandates held, their ownership holdings, and alternative ways for their share depositors to exercise their votes. *See* Ulrich Seibert, *Control and Transparency in Business* (KonTraG): *Corporate Governance Reform in Germany*, 10 European Business Law Rev., [70, 75], March 1999. Minority shareholders may also contest shareholder resolutions, which violate these duties and bring an action for damages, for omission, for information access denial or for certain other actions against the majority shareholder This has been claimed by analogy to § 243(2) AktG, *See* Van Aaken Anne, *Shareholder Suits as a Technique of Internalization and Control of Management: A Functional and Comparative Analysis,* in: Uniform Terminology for European Private Law, [120, 157], European Commission Improving Human Potential Program Publication, Heidelberg, 2004, *available* at http://www.uniformterminology.unito.it/downloads/papers/AakenShareholder.pdf (last visited January 18th 2011), at 134-135; Additionally the amendments in 2005 liberalized the initiation of proceedings by shareholders holding at least 1% of the capital or shares with par value of at least € 100,000 against directors when there is a reasonable doubt that they engaged in conduct amounting to dishonesty. § 148 AktG ; For background, *See* Baums T. & Scott K.E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, ECGI Law Working Paper No. 17/2003, available at: http://ssrn.com/abstract=473185 , (last visited January 12th 2010), at 23-25.
[357] Cioffi John W., *Restructuring "Germany Inc." The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002, available at SSRN: http://ssrn.com/abstract=513743, (last visited January 18th 2011), at 20.
[358] Id. at 20-21.

part of their modernizing strategies, in view of becoming globally competitive.[359]

Another important issue worth discussing is the role of the German jurisprudence on clarifying shareholder rights on fundamental transactions. The ***Holzmüller*** *case*[360] and the subsequent ***Gelatine*** cases[361] provided some guidance with regard to transactions involving a substantial alteration of the organization or activity of a company, although their results remain highly debatable even nowadays.[362]

The ***Holzmüller*** case involved a decision of the management board of the defendant company to transfer approximately 80% of its total assets to a subsidiary and the court held that the management board did not have the right to make such transfer, without the consent of the shareholders' meeting.[363] The German Supreme Court held that the Management Board is limited by an unwritten competence of the Shareholders' Meeting to decide on matters of significant importance.[364] The ***Holzmüller*** doctrine triggered a lively debate among German legal scholars, leading to a high degree of uncertainty in which for almost two decades, it was totally ambiguous which management decisions needed shareholder approval.[365]

In 2004, the same court in the ***Gelatine*** decision[366] stressed that the unwritten right to demand shareholder approval, is a mere exception from the rule that the Management Board independently runs the company.[367] Yet, it remained unclear what would be the criteria to decide

[359] Id.
[360] Holzmüller Case, BGH 25.2.1982, II ZR 174/80, BGHZ 83, 122.
[361] Gelatine Case, BGH 26.4.2004, II ZR 155/02, BGHZ 159, 30.
[362] *See* Löbbe Marc, *Corporate Groups: Competences of the Shareholders' Meeting and Minority Protection – the BGH's Recent Gelatine and Macrotron Cases Redefine the Holzmüller Doctrine,* 5 German Law Journal 9, [1057,1079], September 2004.
[363] Id. at 1059-1064.
[364] *See* Hopt Klaus J., *Modern Company and Capital Market Problems: Improving European Corporate Governance after Enron*, 3 Journal of Corporate Law Studies, [221,268] 2003.
[365] Supra note 362 at 1064.
[366] Gelatine Case, BGH 26.4.2004, II ZR 155/02, BGHZ 159, 30.
[367] Id. at 43-44.

which management action constitutes a substantial alteration of a company`s structure and activity.[368]

1.4.3.2 Shareholder Fundamental Transactions in the Chosen CEE Jurisdictions

In Czech Republic the debate on shareholder rights to vote on fundamental matters, is similar to the German approach, at least from a law-on-the-books perspective.[369] For instance, decisions on the change in capital structure, or rights attached to shares require supermajority votes of 2/3rd and 3/4th, as opposed to other decisions taken by simple majority.[370] The right to convene a General Meeting of Shareholders depends on the relation between shareholdings and the amount of the registered capital of a corporation.[371] If the amount of registered capital is more than 100,000 Czech Koruna (CZK), then shareholders holding 3% of the capital, have the right to convene a meeting, while lower capital requires higher percentages of holdings.[372]

As already stated, due to the special agency problem in most CEE countries between majority and minority shareholders,[373] a note on the rights of minority shareholders with regards to fundamental transactions is due here. Several scandals erupted in the late 1990s in Czech Republic, involving especially financial companies engaged in fraudulent transactions in complete disregard of the rights of minority shareholders, or duties of disclosure and

[368] See Böttcher L. & Blasche S., *The Limitations of the Management Board's Directive Powers in German Stock Corporations*, 11 German Law Journal 5, [493, 512], 2010, at 501-509.
[369] See Claessens S., Djankov S. & Pohl G., *Ownership and Corporate Governance: Evidence from the Czech Republic*, Policy Research Working Paper 1737, World Bank, March 1997, *available* at: http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1700series/wps1737/wps1737.pdf (last visited January 19th 2011).
[370] *A*rt.(s) 185/1, 186 of Czech Commercial Code.
[371] Id. art. 181/1.
[372] Id. If the amount is below the aforementioned sum, a requirement of holding at least 5% of the capital is necessary to convene a General Meeting and make proposals to be included in the agenda.
[373] See Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in*: Cornelius, P.K. &Kogut, B. (eds.), *Corporate Governance and Capital Flows in a Global Economy*, [267, 304], Oxford University Press, UK, 2003.

transparency.[374] The transactions involved the sale of company assets at prices that were disadvantageous to their shareholders, by using off- shore centers in the Cayman Islands and other banks with lenient regulations.[375] A 1997 scandal concerned the *CS Fondy* investment group, which was believed to have allocated away almost CZK 1.22 billion to foreign bank accounts.[376] Another scandal in 2000, involved the previous third largest Czech Bank, *IPB*, where assets were fraudulently transferred to Cayman Island banks, via undisclosed corporate transactions.[377]Additionally, an early survey of the 2000 largest Czech companies in 1996, concluded that most insiders did not know their responsibilities towards minority shareholders and there was a prevailing perception that members of the Boards acted only in the interest of major shareholders, disregarding minority shareholders.[378]

In Romania, the basic legal framework regarding shareholder rights is set in the Company Law.[379]The law provides that shareholders, directly or indirectly representing at least 5% of the share capital, have the right to submit proposals to the Shareholder Assembly and may also request the Directorate or the Supervision Council to convene the General Assembly.[380]In terms of shareholders` role in significant transactions, whenever the value of a transaction exceeds 20% of the company's net assets, there is a requirement for approval by the Extraordinary General Assembly.[381]

As it has become evident this far in the chapter, the problem however is not simply one of

[374] *See* Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002, *available* at: http://www.worldbank.org/ifa/Czechrosc_cg0702.pdf (last visited January 22nd 2011), at 4.
[375] Id.
[376] Id.
[377] Id.
[378] *See* Czech Republic: A Capital Market Review, World Bank Country Study, Washington, D.C., 1999, at 55.
[379] Romanian Company Law in *supra* note 312.
[380] Id. art. 1151
[381] Id. art.1152; *See also* Law No. 297 On Capital Markets *[Legea Privind Piata de Capital, nr. 297, 28.06.2004]* published in OG 571, 29.06.2004, *available* at: http://www.cdep.ro/pls/legis/legis_pck.htp_act?ida=50285 (last visited January 18th, 2011), art. 241.

whether laws and Codes of Corporate Governance[382] contain rules and recommendations designated to protect the role of shareholders on fundamental transactions, but more so, whether there is effective enforcement of such rules.[383] Previous reports on assessment of the protection of shareholder rights[384] have shown that the right of minority shareholders, especially the right to require the convocation of a General Meeting when holding 5% of the capital or to file an action against an illegal decision of the latter, has been only partially observed.[385] The length and costs of legal proceedings in an environment where a shareholder culture is yet immature, combined with problems of law enforcement, have in most cases stopped minority shareholders from resorting to litigation.[386]

The above analyses has provided a view on what the basic legal rules of the chosen CEE jurisdictions stipulate, with regards to shareholder voting rights on fundamental transactions and protection of minority shareholders. The chosen CEE jurisdictions provide similar rules on the rights of shareholders on fundamental transactions, mostly by referring to cases when the approval by the General Meeting of Shareholders is required. Lastly, protection of minority shareholders has suffered from prevailing board attitudes to follow mostly the interests of majority shareholders and enforcement problems.

[382] An early version of the Romanian Corporate Governance Code, was the Strategic Alliance of Business Associations, Code of Corporate Governance, 24 March 2000, *available* at: http://www.ecgi.org/codes/documents/romania.pdf, (last visited January 18th 2011).
[383] *See f*or an assessment of the effectiveness and extensiveness of corporate governance in Romania as compared to other South-Eastern European countries, Bobirca A. & Miclaus P. G., *Extensiveness and Effectiveness of Corporate Governance Regulations in South-Eastern Europe,* 1 International Journal of Humanity and Social Sciences, [7, 12], July 2007.
[384] Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Romania, World Bank-IMF, January 2004, *available* at: http://www.worldbank.org/ifa/rosc_cg_rom.pdf (last visited January 18th 2011), at 4-8.
[385] Romanian Company Law, art.1171.
[386] *See* Bobirca A. & Miclaus P. G., *Extensiveness and Effectiveness of Corporate Governance Regulations in South-Eastern Europe,* 1 International Journal of Humanity and Social Sciences, [7, 12], July 2007, at 9.

1.4.3.3 The Directive on Takeover Bids: Giant Step or False Compromise of Harmonization?

Due to the special EU attention given to the regulation of takeovers, this section will analyze the framework set by the EU Directive on Takeover Bids[387] and some of the dilemmas pertaining to its enforcement. Although there were earlier discussions on a harmonized approach to takeover regulations,[388] 1988 was the year, in which the EU faced a strong pressure to regulate takeovers at the supranational level.[389] In the same year, the Italian entrepreneur *De Benedetti* launched a *hostile* takeover of the Belgian company *Société Generale de Belgique*.[390] The attempt was overridden through an acquisition by a French company, so called *white knight* in takeover terminology, referring to the friendly acquirer of a company in a *hostile* takeover attempt by another company.[391]Nevertheless, the case gave rise to increased concerns in Europe about such an important under-regulated territory. One year later, European authorities started to elaborate on the possibility of proposing a directive on takeovers, but it was in the end considered a premature move, due to the fact that most European states, were at the time

[387] Directive 2004/25/EC of the European Parliament and of the Council of 21 January 2004 on Takeover Bids, OJL 142/12, 30/04/2004 available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:HTML (last visited, April 18th, 2011). (hereinafter EU Directive on Takeover Bids).

[388] See High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels, 10 January 2002, available at: http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf, (last visited January 20th 2011), (hereinafter Takeover Report), at 13 et.seq.; See also Hopt K.J. & Wymeersch E., (eds), European Takeovers - Law and Practice, Butterworths, London, 1992.

[389] Hopt Klaus J., *Takeover Regulation in Europe - The Battle for the 13th Directive on Takeovers*,15 Australian Journal of Corporate Law 1, [1, 18], 2002, at 9.; *See also* Hernández-López Ernesto, *Bag Wars And Bank Wars, The Gucci And Banque National De Paris Hostile Bids: European Corporate Culture Responds To Active Shareholders*, 9 Fordham Journal of Corporate and Financial Law 1, [127, 190], 2003, at 129 et. seq.

[390] Id. at 9.

[391] White Barbara, *Conflicts in the Regulation of Hostile Business Takeovers in the United States and the European Union*, 9 Ius Gentium, [161, 195], 2003, at 178; Note here also that the use of the adjective *hostile* to describe some takeovers is of a more practical than legal character and it usually connotes 'hostility' towards the management of the target corporation, since it is used to refer to the takeover of a target corporation, whose management opposes it. Management has a conflict of interest regarding bids, given that if a takeover was to be finalized, it could risk their position. Nevertheless, shareholders benefit from the offers, not only due to the fact that they get the bid premium, but because the threat of a takeover can keep the management under alert. Romano Roberta, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 Cincinnati Law Rev., [457, 506], 1988-1989, at 457.

unfamiliar with takeovers and mandatory bids, as well as rules relating to the conduct of the *offeror* and *offeree*.[392] Another proposal in 1996 following the UK City Code style, faced strong opposition,[393] and it was once again the rise of a major takeover case involving the takeover of Mannesmann AG by Vodafone plc. in 1999, that dictated the necessity of having such regulation in place.[394]

A proposal was submitted in 2001 but it reached a deadlock with Germany strongly opposing it.[395] As one commentator put it, it was not that Germany was opposed to economic liberalization, but it kept its position due to the fact that *"[d]omestic reforms had already liberalized the legal structure of corporate governance to a significant degree and other member states had not undertaken similar steps."*[396] Around that time, several states had already passed legislation that would have given competitive restrictions to their corporations if faced with bidders from other Member States, hence, not leveling up the play field, was no longer a viable option.[397]

Finally, the Directive was passed in April 2004.[398] Despite the long-awaited result, its final text was however a compromise that left considerable regulatory freedoms to national

[392] For the 1989 proposal s*ee*, Initial Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover Bids, OJ C 64, (8) 14 March 1989, with explanatory memorandum Supp. 3/89 - Bull. EC.
[393] *See* Second Proposal for a Thirteenth Directive on Company Law Concerning Takeover Bids, OJ C 162, COM(95)655 final (5), 8 February 1996 (6 June 1996, with explanatory memorandum COM(95)655 final).
[394] The case refers to the takeover of Mannesmann AG. by Vodafone plc., See Jackson G. & Höpner M., *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance*, Max Planck Institute for the Study of Societies, Discussion Paper No. 01/4, September 2001.
[395] Hansen Jesper Lau, *When Less Would Be More: The EU Takeover Directive in its Latest Apparition*, 9 Columbia J. Eur. Law, [275, 290], 2003, at 276.
[396] Cioffi John W., *Restructuring "Germany Inc." The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002, available at SSRN: http://ssrn.com/abstract=513743, (last visited January 19th 2011), at 46.
[397] Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, Available at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2011), at 54.
[398] EU Directive on Takeover Bids.

legislatures and cast certain doubts over the effects of its implementation.[399]

The basics of the Takeover Directive rest in the three main features that it introduced: the mandatory bids,[400] the board neutrality[401] and the breakthrough rule.[402]

First, the mandatory bids requirement stipulates that whenever a natural or legal person, alone or acting in concert with others, acquires securities *"which added to any existing holdings of those securities […], directly or indirectly give him a specified percentage of voting rights in that company, giving […] control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders[…] Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price."*[403]

Basically, a public offering will be made in the event that the control level, (and voting rights associated with it), dictates such event, although what constitutes control level is intentionally left to Member States, taking into consideration the variations that might exist between companies operating in environments with different levels of ownership concentration.[404]

The price of the bid is also of importance, and the Directive provides that this price shall be *"the highest price paid for the same securities by the offeror…over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid."*[405] As

[399] *See* Gatti Matteo, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 Eur. Bus. Org. Law Rev., [553, 579], 2005, *available* at SSRN: http://ssrn.com/abstract=879819 (last visited on January 18th 2011).
[400] Art. 5(1) EU Directive on Takeover Bids.
[401] Id. art. 1(2); *See* also art.(s) 9(5), 6(3) (i).
[402] Id. art. 11.
[403] Id. art. 5(1).
[404] For a comprehensive study dealing with the theoretical economic models explaining takeovers and a critical survey of the empirical data, *See* McCahery J.A., Renneboog L., Ritter P.& Haller S., *The Economics of the Proposed European Takeover Directive*, 32 Research Report in Finance and Banking, January 2003, at 52 et. seq.
[405] Art. 5(4) EU Directive on Takeover Bids.

*obvious from this statement, t*he price is determined by reference to the highest price, which most likely will include entire control premiums. Although the provision creates the possibility for a price paid to controlling shareholders that is lower than the one at which the bid must be launched, it is protective of minority shareholder interests.[406] This would be consistent with the central agency conflict in cases of concentrated ownership, nevertheless, it risks a deterrence of value-maximizing takeovers.[407] That is why some states have provided for rules that allow minority shareholders to participate in only part of the control premiums, negotiating the highest price paid via references to market prices or other relevant criteria.[408]

The Directive also aimed to increase the protection of minority shareholders especially so via the introduction of the sell-out right.[409] The sell-out right allows minority shareholders to require bidders who acquire not less than 90% of the capital carrying voting rights, or the same percentage of voting rights,[410] to buy their shares at a fair price.[411] It is basically a reversal of the *squeeze-out* right which provides for a bidder that has acquired the above percentages, to be able to require the remaining holders to sell their shares at a fair price.[412] *Sell-out* provisions were to be introduced for the first time in several Member States and were expected to have some positive impact on the protection of minority shareholders[413]

[406] Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?*, Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2011), at 58.; See also Papadopoulos Thomas, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 Law and Financial Markets Rev. 6, [525, 533], 2007, available at SSRN: http://ssrn.com/abstract=1088894 (last visited January 18th 2011).
[407] Id. at 58-59.
[408] Id. at 59.
[409] Id. art. 16.
[410] Note here that as per art. 15(2) (which applies also by reference to art. 16), Member States may opt for higher thresholds but not more than 95%.
[411] Id. art 16(2) et.seq.
[412] Id. art 15 (2) et.seq.
[413] Commission Report on the Implementation of the Takeover Bid Directive, SEC (2007) 268, Brussels, 21 February 2007, available at: http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf (last visited on January 20th 2010), at 9-10.

Secondly, following the British approach,[414] the *board neutrality rule* means that when a bid is launched, be it mandatory or voluntary, the directors of the target corporation cannot engage in any action that might *frustrate* the bid or cannot issue *"any shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company*."[415]While the criteria necessary for defining lasting impediments and their evaluation as such, is left to Member States, some interpretative guidance in this regard might have facilitated matters.[416]

Furthermore, post-bid actions by the directors can be undertaken only by authorization of the Shareholder Meeting. Indeed, anything that during this period lies outside ordinary business and the implementation of which might *frustrate* the bid, has to be approved by shareholders.[417] Here, similarly as in the U.S., there might be room for directors to shape certain transactions that would otherwise require shareholder approval into ones which do not, and looking into the substance of a transaction might bring long, complex litigation procedures.[418]

One permissive course of action is to allow Member States to provide for company action before the bid is issued but when it is certain that its issuance is imminent.[419] That is for instance the case in Germany, where the Shareholder Meeting can release a preliminary general authorization (*Vorratsbeschlüsse*) to the directors to amend the bylaws.[420] Although this is

414 Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?*, Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2011), at 60-61.
415 Art. 1(2) EU Directive on Takeover Bids.
416 Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2011), at 62.
417 Id. at 60.
418 Id. at 62 (referring to the ambiguities in distinguishing between ordinary course of business and extraordinary).
419 Art. 9 (2) (2) EU Directive on Takeover Bids.
420 See § 33 (2) 3 of Securities Acquisition and Takeover Act [Wertpapiererwerbs und Übernahmegesetz (WpÜG)] of 20 December 2001, published in Federal Law Gazette BGBI IS. 3822, (hereinafter WpÜG).

usually a competence for the Shareholders` Meeting, it can help provide defensive measures.[421] However, in order not to make this a *carte blanche* for directors, the procedure is quite complicated and draws upon the strong power of shareholders in takeover scenarios.[422] The law requires that the shareholders approve a specific defensive measure by a supermajority of three fourth of the votes; the *Vorratsbeschlüsse* is valid only for eighteen months and lastly, defensive measures adopted by the Management Board, will have to be approved by the Supervisory Board.[423]

Thirdly, the *breakthrough rule* is aimed at making inoperative some anti-takeover devices in case of a *hostile* offer.[424] Some of the previously used methods, have consisted of the issuance of dual-class share structures with multiple voting rights owned by a block holder, agreements that restrict the free transferability of shares, or golden parachutes for directors becoming active when an undesirable change in control occurs.[425] One of the main objectives of the breakthrough rule is to eliminate the above defenses during the takeover period, and to allow for a successful bidder to easily remove the incumbent board, as well as to change its articles of association.[426] The rule was therefore an attempt to limit the ability of a controlling group to root its position and get rid of efficient offers,[427] while certainly creating, at least some level of harmonization

[421] Steinhauer Carsten, *La Nuova Legge Tedesca Sulle Offerte Pubbliche di Acquisto*, [The New German Law on Acquisitions], 29 Giurisprudenza Commerciale I, [391, 443], 2002, at 412.
[422] Id. at 412 et.seq.
[423] Id.; *See* § 33 (2) WpÜG.
[424] Art. 11 EU Directive on Takeover Bids.
[425] Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2010), at 62.
[426] Id. at 61-62.
[427] Id.; See also Mülbert Peter O., *Make it or Break It: The Break/Through Rule as a Break-Through for the European Takeovers Directive?*, ECGI Law Working Paper No. 13, 2003, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=441120, (last visited January 20th 2011).

amongst Member States.[428] The issue of whether the EU harmonization for this and other provisions of the Directive was effectively achieved will be analyzed in the following subsection dedicated to its implementation.

1.4.3.3.1 Harmonization of the EU Directive on Takeover Bids?

The EU Directive on Takeover Bids makes room for variance in the character of arrangements that implement some of its provisions.[429] Thus, Member States have the option to choose between imposing the board neutrality and the breakthrough rules or not, but if they choose the latter, they are forbidden from preventing companies to apply the rules on a voluntary basis.[430] If the companies so decide, this decision has to be adopted or overturned by the General Meeting of Shareholders.[431]

The Directive also introduced the reciprocity requirement, which permits Member States to allow companies applying one or both of the above rules, to reverse such application against a bidder who is not subject to the same rules.[432]

Regarding implementation of the Directive, the 2007 Commission Report lining out the measures taken for the main three pillars,[433] with respect to the board neutrality rule, provides that, a majority of states chose to impose the obligation of board neutrality.[434] Some of the countries that opted for the mandatory imposition of the board neutrality rule include Czech

[428] *See* Hertig G. & McCahery J. A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?*, ECGI Law Working Paper No. 12, 2003, available at SSRN: http://ssrn.com/abstract=438421 ,(last visited January 20th 2011).
[429] Art. 12 of the EU Directive on Takeover Bids states that: *"Member States reserve the right not to require companies which have their registered offices within their territories to apply Article 9(2) and/or Article 11."* Art. 9(2) refers to board neutrality, while art. 11 refers to the breakthrough rule.
[430] Id. art. 12(2).
[431] Id.
[432] Id. art. 12(3); *See also* for a critical analysis on the reciprocity option, Becht Marco, *Reciprocity in Takeovers*, ECGI Working Paper Series in Law No. 14, 2003.
[433] Commission Report on the Implementation of the Takeover Bid Directive, SEC (2007) 268, Brussels, 21 February 2007, available at: http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf (last visited on January 20th 2011).(Hereinafter Commission Report of 2007)
[434] Id. at 4-5.

Republic, Romania, France and the UK.[435] However, the states that did not do so, most notably, Germany, Belgium and Denmark, already had provisions to restrict the use of post-bid defenses.[436]

In terms of the breakthrough rule,[437] the *status quo* of a majority of Member States was not expected to change significantly, given the fact that a majority of them did not impose it, except for the Baltic States making it optional for their companies.[438] It was estimated that a negligible part of a mere 1% of listed companies in the EU would apply the rule on a mandatory ground.[439] However, some Member States, including Germany, had already taken steps to eliminate multiple voting securities and other pre-bid defenses, and make the structure of their companies more open towards takeovers.[440]

In terms of the reciprocity exception, Germany has opted for it, while other countries, amongst which several CEE jurisdictions, such as Czech Republic, Romania and the Baltic States, decided not to do so.[441] For the states adopting it, the endorsement of the reciprocity rule was justified by reasons of creating a level - playing field with those countries which do not apply the rule and thus, give management greater room for maneuvering against foreign raiders.[442]

---

[435] Id.; Romania was not included in the Commission Report of 2007, however it has implemented the board neutrality rule, via the Romanian Capital Markets Law, art. 180 et.seq. (Law No. 297 of 28.06.2004, On Capital Markets [Legea Privind Piata de Capital] OG No. 571, 29.06.2004); See also Regulation No.31/2006 Amending CNVM (Romanian National Securities Commission) Regulations by Implementing Certain Provisions of European Directives, approved by Order No. 106/14.12.2006, (effective as of January 2007 after the accession of Romania in the EU), available at : http://www.cnvmr.ro/pdf/regulamente/en/Regulation-31-2006.pdf (last visited on January 20th 2010).

[436] Id.

[437] Art. 11 of the EU Directive on Takeover Bids.

[438] Commission Report 2007 at 4-6.

[439] Id. at 7.

[440] Id. at note 17.

[441] Commission Report 2007 at 9.

[442] *See* Gatti Matteo, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 Eur. Bus. Org. Law Rev. [553, 579], 2005, *available* at SSRN: http://ssrn.com/abstract=879819 (last visited on January 18th 2010).

Apart from the permitted deviations from the above two rules, Member States` control levels regarding the mandatory bid rule vary to some degree.[443] The levels which *trigger* the mandatory bid rule vary amongst countries, most of which set it at a 30% level of acquisition of voting rights. This is the case in Germany and the UK, while in some CEE countries the threshold appears higher.[444] In Czech Republic the threshold is at 40%,[445] while in Romania it is set at 1/3 of the voting shares, counting for direct, as well as indirect holdings.[446] Some of the exceptions from the mandatory bid rule are considered necessary to ensure that this obligation applies only where the holding actually confers control, while others are more far-reaching and have protectionist features.[447] Also, in some Member States, supervisory authorities appear to have extensive powers to grant exceptions from the rule and undermine the effectiveness of its protection.[448]

In sum, the Commission Report realized that the creation of a European market for corporate control was uncertain, especially so given the reluctance of Member States to lift takeover obstacles[449] and neutralize protectionist policies.[450] The soft implementation procedures regarding the board neutrality and breakthrough rules, and the existence of broad authority to

443 EU Directive on Takeover Bids, Commission Report 2007, Annex 3, at 15-17.
444 Id. Annex 4 at 18.
445 Id. In Latvia the control level is surprisingly set at 50%.
446 Art. 66(5) of Law No. 297 On Capital Markets, OG No. 571, 29.06.2004 (as amended by Regulation No.31/2006).
447 Commission Report 2007 at 9; For an analyses on implementation of the Directive, reasons for deviation and the differences pre and post implementation, s*ee* Davies, P. Schuster, E. & Van de Walle de Ghelcke, E., *The Takeover Directive as a Protectionist Tool?* ECGI Law Working Paper No. 141, 2010, available at http://ssrn.com/abstract=1554616 (last visited on January 19th 2011).
448 Id.
449 Id. at 10-11.
450 *See* Davies P. L., Schuster, E-P. & Van de Walle de Ghelcke E., *The Takeover Directive as a Protectionist Tool?*, ECGI Law Working Paper No. 141, 2010, *available* at SSRN: http://ssrn.com/abstract=1554616 (last visited January 21st 2011); *See* also for factors influencing the choice of implementation forms or its lack for some of the provisions of the Directive, Sjåfjell Beate, *Political Path Dependency in Practice: The Takeover Directive*, 27 Yearbook of European Law, [387, 404], March 2008.

grant exceptions from the mandatory bid rule, question the existence of a truly harmonized European ground for takeovers.

1.5 A final Note on the Two Takeover Regimes

The analyses of the two takeover regimes offered above, show that at a regulatory level, the EU and U.S. approaches, differ somewhat in terms of substantive *rules* and protection focus.[451] At this level, the European regime, despite the soft implementation versions of the EU Directive on Takeover Bids,[452] is characterized by mandatory bids, board neutrality and breakthrough rules, aimed at ensuring a central role of shareholders in the case of a *hostile* acquisition.[453] Their power to approve or disapprove defensive measures and the requirement for offering all outstanding securities, are factors that enhance their role.[454]

On the other hand, the U.S. system does not provide for a strict counterpart of the mandatory bid and it is characterized by broader freedom for directors regarding adoption of defensive measures.[455] Anti-takeover and constituency statutes can also ultimately contribute in expanding the power of directors in cases of takeovers.[456]

Despite these differences however, the jurisdiction-specific features in terms of ownership structures and agency conflicts might somehow come to level up parts of the divergences from a justification perspective. It is claimed that if European-style rules were to be implemented in the U.S., they would produce a strong empowerment of minority shareholders,

[451] See supra subsections 1.3.2.1 and 1.4.3.3
[452] See supra subsection 1.4.3.3.1
[453] Art.(s) 5, 9, 11 EU Directive on Takeover Bids.
[454] Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2010), at 77.
[455] Id.; See also supra section 1.3.2.1.
[456] Velasco Julian, *Taking Shareholder Rights Seriously*, 41 UC Davis Law Rev. 2, [605, 682], 2007, available at SSRN: http://ssrn.com/abstract=886340 ,(last visited January 20th 2011), at 617-620.

yet, they do not have quite the same effect in jurisdictions where the main agency conflict is between majority and minority shareholders.[457]

Furthermore, while the EU seems to grant the decision-making powers in cases of takeovers, to controlling shareholders, the U.S. regime provides stronger powers for directors. Albeit this would sound somewhat surprising, the argument goes that in the end, both regimes appear to favor constituencies claimed to be "*facing the deepest conflict when confronting a proposed takeover*."[458]

At the practical level however, EU leaves room for maneuvering due to its soft implementation forms, especially with regards to the board neutrality and the breakthrough rule.[459] In the end, there might be scenarios in which defensive tactics are employed similarly as in the U.S. case, especially if the Member State has opted for reciprocity. So, while in the US, the lack of compulsory tender offers makes takeovers more attractive and less expensive,[460] the existence of defensive measures somewhat mitigates these effects. In the EU in the meantime, the mandatory bid makes takeovers more expensive and, theoretically, the board neutrality and breakthrough rules make defenses less potent.[461] However, deviations from the latter in the form of reciprocity requirements might result in strong defenses.[462] In sum, it appears that EU takeovers are more expensive and, as a matter of practice, it will be difficult to oppose defensive measures when there are deviations from the board neutrality and breakthrough rules.

---

[457] Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005, *available* at SSRN: http://ssrn.com/abstract=819764 (last visited on January 18th 2010), at 77-78.
[458] Id. at 78
[459] Art. 12(3) EU Directive on Takeover Bids.
[460] Id. at 78.
[461] Id.
[462] See Gatti Matteo, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 Eur. Bus. Org. Law Rev. [553, 579], 2005, available at SSRN: http://ssrn.com/abstract=879819 (last visited on January 18th 2011).

However, one is not to underestimate the role that the market for takeovers has to offer.[463] Just like major takeover cases indicated the necessity to deal with the regulation of takeovers and put some order in the midst of an undisciplined takeover market in Europe,[464] the same way, cases of cross-Atlantic takeovers might have some influence to the Member States` approaches taken with regards to takeovers. [465]

1.6 Conclusions

This chapter has analyzed shareholder rights on directors' elections and fundamental transactions, with a final special focus on the two takeover regimes in the U.S. and chosen EU jurisdictions. It started with a historical overview on shareholder rights in the U.S. and in the chosen EU jurisdictions. In the U.S., the increase in the role of shareholder activism from the early 1920s till the present, has contributed in the intensity of shareholder debates and at times, in enhancing shareholder rights. Germany`s history was characterized by early forms of protecting minority shareholders, later reforms to extend such protection to stakeholders and also laws aimed at limiting the role of banks. In CEE, the *modern* history of immediate post-privatization showed some problems with regards to the scope and orientation of the reforms, with its pre-communist legal heritage being not, in and of itself, decisive of the paths chosen.

In terms of shareholder rights on election of directors, while the move from plurality to majority voting has captured the attention of many academics in the U.S., the focus on the other side of the Atlantic, appears to be less concentrated on this specific issue, and more on enhancing

[463] Id. at 78-79.
[464] See Hopt Klaus J., *Takeover Regulation in Europe - The Battle for the 13th Directive on Takeovers*,15 Australian Journal of Corporate Law 1, [1, 18], 2002, at 9 et. seq.; See also Jackson G. & Höpner M., *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance*, Max Planck Institute for the Study of Societies, Discussion Paper No. 01/4, September 2001.
[465] Id.

the information on voting and the accessibility to General Meetings. In the U.S., the majority voting rule for directors' elections, albeit an increasing trend, has nevertheless been adopted in weaker forms. Other changes have consisted of eliminating the NYSE broker discretionary voting rule with regards to non-routine matters, such as election of directors, changing bylaw amendment rules to provide more power for shareholders, and providing for shareholder nominees to be included in proxies under defined circumstances.

In the chosen EU jurisdictions, the election of directors is dependent on the structure of the boards and is characterized by two main features, namely the participation of employee representatives in Supervisory Boards (when applicable) and the prevailing majority voting rule for elections of directors. At the EU level, the focus on increasing shareholder rights has been directed towards creating better information access for shareholders, providing new and improved means of communication between them prior to voting, and facilitating the process of proxy voting.

In terms of shareholder rights on fundamental transactions, case law in the U.S. has shown that shareholder rights remain restricted in view of the boards' discretion to shape transactions that require shareholder approval, into ones that do not. Furthermore, supermajority requirements for charter amendments in an environment of dispersed ownership might impede these rights.

In Germany, courts have raised the issue of transactions that need approval by shareholders, when they significantly alter the structure and activity of a company, however, the most recent cases have considered a shareholder approval as an exception from the rule that management independently runs the company. In the chosen CEE jurisdictions, the main persisting problems in this regard have been the lack of a mature shareholder culture and weak enforcement procedures.

The chapter has finally dealt with the takeover regimes respectively in the U.S. and the EU. The approaches on both sides differ at the *regulation* level and in terms of protection focus and the differences might reflect the respective diverging central agency conflicts based on ownership structures. U.S. represents a less regulated regime with no strict mandatory bid rules and broader board discretions on adopting defensive measures, as seen through the analyses of relevant case law and the claimed effects of antitakeover and constituency statutes. The EU model with its mandatory bids, the board neutrality and the breakthrough rules, in principle is aimed at increasing the protection for all shareholders during a *hostile* takeover, with a real power of approving or disapproving defense measures, resting with controlling shareholders. The deviations in the implementation of the board neutrality and breakthrough rules, allow for defensive mechanisms to be employed and question the effectiveness of takeover harmonization in the EU.

On a final note, while some of the discussed issues on shareholder rights in the chosen EU jurisdictions have been of a pan-European interest, others have been at a Member State level of attention. The issues considered important from the chosen EU jurisdictions' perspectives and the relative attention devoted to them at both levels of the discussion, have also varied from the U.S. debate. Nevertheless, these cannot be reasons to claim a quantitatively or qualitatively richer debate on shareholder rights in the EU. After all, some of the problems considered important from a European perspective, will not necessarily mirror those that have been more worthy of attention from the U.S. point of view.

CHAPTER II

DIRECTORS` FIDUCIARY DUTIES

2.1 Introduction

In any discussion related to the *main* corporate governance agency problem,[466] an analysis of directors' fiduciary duties is necessary. That is so for the simple reason that if one is to *remedy* such an agency conflict and wishes to provide protection of the company and its shareholders, concepts such as the *duty of loyalty* and *care*, come to play an important role.[467]

This chapter will focus exactly on fiduciary duties in the U.S. and in the chosen EU jurisdictions, demonstrating that the discussion on both sides differs significantly in this regard, with additional differences to be viewed within the EU jurisdictions themselves. The differences stem from various reasons, starting from philosophical rationales behind the imposition of fiduciary duties, to procedural differences, to litigation cultures or in some cases due to the lack of a proper understanding of these duties.[468]

[466] *See*, Zingales Luigi, Corporate Governance, in: P. Newman, ed., The New Palgrave Dictionary of Economics and the Law, (497, 503), Macmillan, New York, 1998.

[467] *See* Ball C., Sonnie M., & Triponel, A. F., *Advice for Corporate Directors* in: Mergers and Acquisitions 2010: Trends and Developments, [137, 230], Practicing Law Institute Publication, New York, 2010, available at SSRN: http://ssrn.com/abstract=1558020141 (last visited January 20th 2011).

[468] Id. for the U.S.; *See* for Germany, Baums Teodor, *Personal Liabilities of Company Directors in German Law*, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article *available* at http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited January 8th 2011); *See* for CEE jurisdictions, Pistor K. & Xu C., *Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the*

We will see also differences in the categorization of these duties. While the U.S. provides a clearer division between the duty of care and the duty of loyalty, although categorization problems are not foreign to the U.S. debate either,[469] the chosen EU jurisdictions do not put a strict emphasis on this differentiation.[470]

Lastly one limitation needs to be mentioned here. Due to the fact that fiduciary duties touch upon some corporate governance debates covered in this work, such as stakeholder protection and executive compensation, those discussions related to whether fiduciary duties are *owed* in such a way as to include stakeholder groups, (for instance creditors and employees), as well as cases dealing with executive compensation brought under a claim for breach of fiduciary duties, will be dealt in detail in the relevant chapters on executive compensation and stakeholder protection.[471] This classification is necessary in order to maintain a topic related structure of the thesis. Although this chapter will also touch upon some of the above issues, its main focus is the comparison between the fiduciary duties of care and loyalty in the U.S. and their *counterparts* in the chosen EU jurisdictions, as owed to the corporation and its shareholders, with the necessary jurisdiction-specific interpretations and reservations regarding the latter.[472]

Incomplete Law Theory, ECGI - Law Working Paper No. 01/2002, *available* at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480 (last visited January 12th 2011).

[469] See for claims to categorize the concept of *good faith* as a separate '*duty'* Sale Hillary A., *Delaware's Good Faith*, 89 Cornell Law Rev., [100, 137], 2004, available at SSRN: http://ssrn.com/abstract=456060, (last visited January 23rd 2011); See however Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) at 370 (providing that the '*duty*' of good faith is to be considered as a subset of the duty of loyalty); For the '*duty*' of disclosure, ***see*** Pfeffer v. Redstone, 965 A.2d 676 (Del. 2009) at 684 (where the court stated that the duty of disclosure was not an free standing duty but it stemmed from the other two main fiduciary duties).

[470] *See* Cheffins Brian R. & Black Bernard S., *Outside Director Liability Across Countries*, ECGI Law Working Paper No. 71, 2006, *available* at: http://www.cgscenter.org/library/Board/OutsideDirectorLiability.pdf ,(last visited February 24th 2011).

[471] For fiduciary duties employed in cases dealing with problems of executive compensation *see infra* sections 3.3.2, 3.4.2, and 3.4.4 and related discussion; For an analysis on whether fiduciary duties are owed to stakeholders, see sections 4.2, 4.3.1 and 4.3.2 and related discussions.

[472] See for a discussion on fiduciary duties owned to the corporation and its stockholders in the U.S., as opposed to stakeholders, Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February

2.2 The Duty of Care and Loyalty in the U.S.

The concept of fiduciary duties in the U.S. derives its origin from the law of trusts and agency.[473] A trustee holding title but not ownership of a property, should act faithfully to the beneficiary, who in equity can assert ownership benefits.[474] While at first, directors were treated as trustees under an obligation to act in the best interest of the beneficiaries of a corporation, namely the shareholders,[475] later on courts started to differentiate the fiduciary duty concepts from the law of trusts.[476] In achieving such differentiation, courts stated that fiduciary duty standards should not be considered equal to those of a trustee, since *"[t]he classic trusteeship is not essentially a risk taking enterprise, but a caretaking one.*"[477] Given the fact that directors of a corporation need to take risks in order to fulfill their obligations, the issue therefore is one of putting the process that leads to a decision undertaking such risks under a prudence standard.[478]

In the U.S., "*[t]he business and affairs of every corporation …shall be managed by or under the direction of a board of directors.]*"[479] As a matter of fact however, the boards of

---

22nd 2011); *See* for Germany, Cioffi John W., *Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002, *available* at SSRN: http://ssrn.com/abstract=513743, (last visited February 24th 2011), where the author states that: "*Codetermination legitimate[d] at least two sets of interests - those of the shareholders and those of employees - that must be reflected in the law's conception of directors' fiduciary obligations.*" at 8. For a discussion on the German codetermination influence with regards also to the issue of fiduciary obligations to stakeholders such as employees via the interpretation of the concept of 'company interest', *see* Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, *German Corporate Governance in International and European Context*, [111, 144], Springer, Berlin, Heidelberg, 2007; For the chosen CEE jurisdictions, see infra section 4.4 and related discussion.

[473] Brudney Victor, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 Columbia Law Rev. 7, [1403, 1444], 1985, at 1403 – 1420.

[474] Id.

[475] Millstein, Gregory, Altschuler & Di Guglielmo, *Fiduciary Duties Under U.S. Law*, ABA Section of Business Law, International Developments in Corporate Governance Subcommittee, March 2011, electronic article available at: http://www2.americanbar.org/calendar/section-of-international-law-2011-spring-meeting/Documents (last visited March 23rd 2011), at 18.

[476] *See* Stegemeier v. Magness, 728 A.2d 557 (Del. 1999).

[477] Id. at 562; See also Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, (Del. Ch. 1994), at 1148.

[478] Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, (Del. Ch. 1994), at 1148.

[479] Del. Code Ann. tit. 8, § 141 (a), (2009); See also RMBCA § 8.01(b), (2005).

directors of modern publicly held corporations, have almost nothing to do with the daily business of the corporation.[480] The internal organization of these corporations usually involves very "*complex hierarchical structures*"[481] where management is given broad discretion.[482] In a very basic sense, the duties of day-to-day management are conferred upon various executive officers selected by the board and being accountable to the latter.[483] The officers` fiduciary duties "*are the same as those of the directors*."[484] This clarification is made in order to justify the idea that, when proceeding with the discussion on fiduciary duties, the second component of *supervision* will make more sense than the first component of a board actually managing the daily affairs of a corporation.

Having in mind the agency problem lineated in the first chapter of the thesis, the question of how can directors *be disciplined*, remains crucial. Statutory corporation law and a corporation`s main documents, such as articles of incorporation and the bylaws, are imperfect in this regard, since they cannot cover all circumstances of various factual cases.[485] It is here that courts step in to fill the gaps of corporate law, including the law on fiduciary duties.[486] Therefore, common law has traditionally taken an active role in shaping and interpreting issues pertaining to fiduciary duties.[487]

---

480 Hamilton Robert W., *Reliance and Liability Standards for Outside Directors*, 24 Wake Forest Law Rev. 5, [9, 12], 1989, at 9.
481 Id.
482 Id. et.seq.
483 See Del. Code Ann. tit. 8, § 141 (e), (2009).
484 Gantler v. Stephens, 965 A.2d 695, (Del. 2009) at 709; See also Guth v. Loft, 5 A.2d 503, (Del. 1939) at 510.
485 Millstein, Gregory, Altschuler & Di Guglielmo, *Fiduciary Duties Under U.S. Law*, ABA Section of Business Law, International Developments in Corporate Governance Subcommittee, March 2011, electronic article available at: http://www2.americanbar.org/calendar/section-of-international-law-2011-spring-meeting/Documents (last visited March 23rd 2011), at 2-3.
486 Id. at 3-4
487 Id.; See for instance Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) where the court found liability for breach of the duty of care and raised controversy regarding the business judgment rule. In its immediate aftermath Delaware enacted DGCL § 102(b)(7) (1986) in order to protect directors from monetary liability resulting from violations of a duty of care. See infra sections 2.2.1 and 2.2.2.

Basically, directors "*stand in a fiduciary relation to the corporation and its shareholders.*"[488]Directors in the U.S. have primarily two main fiduciary duties, the duty of care[489] and the duty of loyalty,[490] with other '*duties'*, such as the '*duty'* of good faith and the '*duty'* of candor, being considered as parts of the former two duties.[491] The following subsections will give an analysis on the content of these duties, with the purpose of seeing how they establish safeguards from *imprudent* directorial behavior.

2.2.1 The Duty of Care

The duty of care requires first that, in managing the affairs of a corporation, directors should act "*in good faith…in a manner the director reasonably believes to be in the best interests of the corporation.*"[492] However, this is not all that is required. Previous section 8.30 (a) of the MBCA provided that the standard of prudence was that of an *"ordinarily prudent person in a like position"*[493] while section 8.30 (b) of the Revised Model Business Corporation Act (hereinafter RMBCA), provides that the standard of care is the one which *"a person in a like position would reasonably believe appropriate under similar circumstances*."[494] The court in ***Caremark*** provided that it will not refer to an ordinary prudence standard, but to a business one.[495] It is also important to note that the above provision of the RMBCA, is conditioned by the fact that this standard should be applied to cases when directors become informed with regards to

[488] Guth v. Loft, 5 A.2d 503, (Del. 1939) at 510.
[489] RMBCA § 8.30 (b) (4th ed. 2008, Supp. 2009) (hereinafter RMBCA); See also MBCA Ann. § 8.30 (a) (1984).
[490] RMBCA § 8.60.
[491] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) at 370 (providing that the duty of good faith is to be considered as a subset of the duty of loyalty); Pfeffer v. Redstone, 965 A.2d 676 (Del. 2009) at 684 (where the court stated that the duty of disclosure was not independent but it stems from the other two main fiduciary duties); See also O'Reilly v. Transworld Healthcare Inc., 745 A.2d 902 (Del. Ch.1999) (where the court differentiates between a duty of candor (disclosure) pertaining to the fiduciary duty of care or the fiduciary duty of loyalty).
[492] RMBCA, § 8.30(a).
[493] MBCA Ann. § 8.30 (a) (1984).
[494] RMBCA, § 8.30(b).
[495] In Re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996), at 969, note 16.

decision-making and pay attention to their *oversight duties*.[496] Therefore, this standard of care is to be applied to the process of being informed, rather than to the decision itself.[497] However, as of 2010, a majority of the states that have codified the duty of care[498] follow the previous version of the MBCA, instead of the new provision providing for a *higher* standard of prudence.[499]

The difference with regards to the *process* as opposed to *results*, relates also to the divergence of applying the standard in tort law and how courts apply it under corporate law.[500] In tort law the standard is result-oriented, while in corporate law it is process-oriented.[501] There might be possible exceptions to the latter as well, such as the case of egregious conduct involving "*a gross abuse of discretion*"[502] or decisions which would have been taken by "*no person of sound ordinary business judgment*."[503] Despite the above however, the duty of care focuses on the way the duties are performed, rather than on the "*correctness of the decisions made.*"[504] It requires directors to gather information in a way that is reasonably diligent, to deliberate the issues that are of relevance and act on an informed basis and in good faith.[505] The

[496] RMBCA, § 8.30(b).
[497] Hamilton Robert W., Corporations Including Partnerships and Limited Liability Companies, Cases and Materials, (7th ed.), West Group, St. Paul, Minn., 2001, at 763-764, quoting Hansen Charles, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule,* (ABA) 41 Bus. Law, (1237, 1247), 1986, at 1238-1242.
[498] RMBCA § 8.30 comment at 8-208-09.
[499] Knepper William E & Bailey Dan A., Liability of Corporate Officers and Directors, (8th ed.), New Jersey, 2010, § 3.02, at 3-3.
[500] Hamilton Robert W., Corporations Including Partnerships and Limited Liability Companies, Cases and Materials, (7th ed.), West Group, St. Paul, Minn., 2001, at 763-764, quoting Hansen Charles, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule,* (ABA) 41 Bus. Law, (1237, 1247), 1986, at 1238-1242.
[501] Id.
[502] Id.
[503] Id.
[504] 2 RMBCA § 8.30, comment at 8-189.
[505] American Law Institute, (hereinafter ALI), Principles of Corporate Governance: Analysis & Recommendations, West Thompson, (1994 & supp. 2008), (hereinafter ALI Principles), § 4.01.

culpability standard employed in finding liability for a breach of the duty of care is gross negligence.[506]

Importantly, the concept of the business judgment rule is inextricably linked to the issue of finding liability in cases of claims for a breach of the duty of care and the rule has traditionally been considered as a safe liability shield.[507] The business judgment rule is basically a judicial presumption that when making decisions, *"disinterested directors"*[508] of a corporation acted with *"informed due care [and] with a good faith belief that the decision will serve the corporation's best interests.*"[509]Therefore, while the duty of care is a measuring standard guiding the directors` conduct *ex-ante*, the business judgment rule is a presumption that serves as a safe harbor protecting business decisions from *ex-post* judicial review.[510] The burden of proof to rebut the presumption offered under the business judgment rule, rests with the party challenging the decision of a director.[511]

The main idea behind the business judgment rule is the reluctance of courts to second guess business decisions given the fact that they are not equipped to interfere with mechanisms of "*corporate wealth production*."[512] Another justification rests also on the reluctance of courts to discourage directors from risk-taking, meaning that although business is inherently risky, the

[506] *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984), at 812; See also Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) at 873 (citing Aronson).
[507] Hansen Charles, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule*, (ABA) 41 Bus. Law, (1237, 1247), 1986, at 1238-1242; See also Barton N., Block D. & Radin S., *Business Judgment Rule: Fiduciary Duties Of Corporate Directors*, 5th Ed., Aspen Publishers, 1998.
[508] In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, (Del. 2006), at 52.
[509] Id., Aronson v. Lewis, 473 A.2d 805 (Del. 1984), at 812; Beam v. Stewart, 845 A.2d 1040, (Del. 2004), 1048 at note 16.
[510] Ironically U.S. courts have at times confused the duty of care to the business judgment rule. Triem Fred, *Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule*, 24 Alaska Law Rev., [23, 44], 2007, at 29-30.
[511] ALI Principles § 4.01 (d).
[512] Hansen Charles, The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule, ABA 41 Bus. Law, (1237, 1247), 1986, at 1238.

latter might be necessary for entrepreneurial success.[513] Having this in mind, it has been claimed that policy choices behind the business judgment rule have, after all, favored shareholders` interests, based on the belief that in the absence of such a rule, people would not be willing to take directorship positions and they wouldn`t be afforded proper space and power to take appropriate risks, for the benefit of the corporation and its shareholders.[514]

Yet again, more often than not, the business judgment rule serves as a liability shield, under which directors will not be held liable for their judgment mistakes when they basically act in the absence of *"bad faith or some other corrupt motive."*[515]

This is not to say that American courts have not occasionally played with the very foundations of the business judgment rule.[516] One such occasion was the landmark ***Smith v. Van Gorkom*** case,[517] a case which not only raised a lot of controversy regarding the application of the business judgment rule, but which also developed at a time when debates around the gross negligence level of culpability were flowing in uncertain waters.[518] The case clarified many components of the duty of care mentioned above,[519] and yet, it caused much controversy when it came to the application of the business judgment rule.[520]

---

[513] In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009), at 115 note 6. Here the court noted that the protections of "*the business judgment rule (are) designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly*."

[514] *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February 22nd 2011), at 342-343.

[515] Cramer v. General Telephone & Electronics Corp., 582 F.2d. 259 (3d Cir. 1978), at 274; *See* also ALI Principles § 4.01(c).

[516] *See* Fischel Daniel, *The Business Judgment Rule and the Trans Union Case*, 40 Bus. Law, [1437, 1455], 1985; *See also* Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 Bus. Law 1, [1, 14], 1985.

[517] Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

[518] Radin Stephen A., *Smith v. Van Gorkom on its 15th Anniversary*, 24 Directors & Boards 3, [24, 44], 2000.

[519] Id. at 26 et. seq.

[520] See Herzel L. & Katz L, *Smith v. Van Gorkom: The Business of Judging Business Judgments*, 41 Bus. Law., [1187, 1192] 1986.

Smith v. Van Gorkom involved the approval by the board of the Trans Union company of a cash-out merger proposed by the Chairman and the CEO of the company, *Van Gorkom*. The latter had himself proposed a price per share and had informed the senior management of the company on the proposed transactions one hour before the board meeting.[521] The board, without prior notice and without knowledge as to the role of the CEO in setting the price of the shares, approved the transaction after two hours of deliberation.[522]

The Delaware Supreme Court stated that the board of directors of Trans Union had not adequately informed themselves as to the role the chairman and then CEO of the company (*Van Gorkom*), played in forcing the *sale* of the company and in setting share purchase price.[523] They were also uninformed as to the intrinsic value of the company[524] and "*given these circumstances, at a minimum, were grossly negligent in approving the 'sale' of the company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.*"[525] The court found the directors grossly negligent, and stated that they forfeited the protection offered under the business judgment rule, despite of the fact that the transaction provided shareholders with a substantial premium above the share market price.[526]

The decision raised reasonable fears as to how exposed had directors become and it was considered by *Fischer* as "*surely one of the worst decisions in the history of corporate law*."[527] Other criticism derived partly from the fact that the court "*pierced the Business Judgment Rule*

[521] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) at 860 et. seq.
[522] Id.
[523] Id. at 872-873.
[524] Id. at 873
[525] Id.
[526] Id. at 874.
[527] Fischel Daniel, *The Business Judgment Rule and the Trans Union Case*, 40 Bus. Law., [1437, 1455], 1985, at 1455.

and imposed liability on independent (even eminent) outside directors."[528] This in turn would simply provide a disincentive for attracting the best directors. Further considerations referred to concerns about greater formalities on the side of the board, since now it would have to create an overly cautious environment of care and diligence.[529]

It is understandable that a decision running on the face of the business judgment rule would raise concerns about uprooting concepts of such a fundamental character. Nevertheless, many years after *Van Gorkom*, the number of cases in which a lack of due care has been found, has been small and has usually involved changes in control cases, similarly egregious behaviors of directors and mostly, contexts of preliminary injunctive relief.[530] What is of importance however, is the fact that although *Van Gorkom*`s message warned limits to the business judgment rule, the decision itself inspired what would make its future applicability less frequent.[531] The case prompted states to enact legislation on director protection and alerted shareholders to enact provisions in their certificates of incorporations following such legislation, in order to either eliminate or limit the personal liability of directors to the corporation or the stockholders in cases of a breach of the duty of care.[532]

---

[528] Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 Bus. Law 1, [1, 14], 1985, at 1.

[529] Herzel L. & Katz L, *Smith v. Van Gorkom: The Business of Judging Business Judgments*, 41 Bus. Law., (1187, 1192) 1986, at 1188-1189.

[530] Radin Stephen A., *Smith v. Van Gorkom on its 15th Anniversary*, 24 Directors & Boards 3, [24, 44], 2000, at 26-27.

[531] Id. at 26.

[532] DGCL 102(b) 7 (1986) states: *"…(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:…(7) a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit."* Section 174 mentioned in the provision refers to directors` liability for unlawful dividends and stock repurchases or redemptions. Also note that the provision refers to the liability of directors, not officers; See also MBCA 2.02(b)(4) (as amend. 1990), official comment 2-16, that states: "*Developments in the mid- and late 1980s highlighted the need to permit reasonable protection from exposure to personal liability…so that directors would not be discouraged from fully and freely carrying out their duties…*".

2.2.2 The Duty of Loyalty

The other fiduciary duty, namely the duty of loyalty, requires those who are under a fiduciary relationship, to act in good faith and in the best interests of the corporation.[533] The duty of loyalty runs to the corporation and its shareholders.[534] Under this duty, basically directors should refrain from self-dealing, meaning they should not take actions that benefit them at the expense of the corporation.[535] Breaches of a duty of loyalty might range, amongst others, from acts of self-dealing,[536] to misappropriation of the corporate assets or opportunities,[537] to cases of conflicts of interest that have not been appropriately disclosed.[538] Due to the importance of this duty, statutory exculpation clauses cannot be used to limit the liability for its breach[539] and the *entire fairness* review will be employed in most cases.[540] The burden of proof in cases of a

[533] Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993) at 361 (referring to the interest of the interest of the corporation and its shareholders); Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007) at 357, (stating that a breach can be found when directors act in "*bad faith*" or for their own gain); Ball C., Sonnie M., & Triponel, A. F., *Advice for Corporate Directors* in: Mergers and Acquisitions 2010: Trends and Developments, [137, 230], Practicing Law Institute Publication, New York, 2010, available at SSRN: http://ssrn.com/abstract=1558020141 (last visited January 20th 2011), at 141.

[534] Hollinger Int'l Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004); See also Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995).
Ch. 1995).

[535] *See* 2 RMBC § 8.60.

[536] Millstein, Gregory, Altschuler & Di Guglielmo, *Fiduciary Duties Under U.S. Law,* ABA Section of Business Law, International Developments in Corporate Governance Subcommittee, March 2011, electronic article available at: http://www2.americanbar.org/calendar/section-of-international-law-2011-spring-meeting/Documents (last visited March 23rd 2011), at 9-10.

[537] Id; Northeast Harbor Golf Club, Inc. v. Harris, 661 A2d 1146 (Maine Sup. J. C. 1995).

[538] Id.

[539] DGCL 102(b) 7 (2009).

[540] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), at 711, where the court stated: "*The concept of fairness has two basic aspects: fair dealing and fair price.*"; Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, (Del. 1995), at 1172-1176, where the court considered fair dealing as referring to a fair and reasonable process followed, while fair price referred to whether the price was within a fair value range. Supra note 536 at 33.; Note however that the enhanced scrutiny test will apply in Revlon scenarios (involving changes of control via initiating active bidding for the sale or making the break-up of the corporation inevitable) as opposed to viewing merely the rationality of directors decision. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) at 182; In re Toys "R" Us, Inc., Shareholder Litig., 877 A.2d 975 (Del. Ch. 2005) at 1000.; The reason for this is based on the shift of the duty of directors to basically get the best price for stockholders. Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009) at 235 (providing that this is the only Revlon duty).

breach of the duty of loyalty will stand on the board to provide that the transaction was entirely fair to the company and the shareholders.[541]

Nevertheless, there are ways out of the *strictness* presented by the duty of loyalty as well. In cases of interested directors, there are several ways of restricting their influence, amongst which, recusal at board meetings,[542] abstention from voting on a decision in which the director is interested,[543] or via statutes that set guidelines for approving interested transactions.[544]

One crucial point of focus that has often been used in Delaware case law with regards to fiduciary duties is the concept of good faith, which has been at times referred to as the *duty of good faith*,[545] despite recent confirmations that it is a subset of the fiduciary duty of loyalty.[546]

Of interest is the fact that failure to act in good faith is used to distinguish the normal standard of culpability in cases of breach of a duty of care and a duty of loyalty.[547] Basically "*failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence).*"[548] Due to this nature, good faith (and its lack thereof), is central to the fiduciary duties of loyalty and care. The concept helps to understand and compare the standard employed

---

[541] Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) at 182, stating that:."*Rather, the burden is on the board in such cases to prove that the challenged transaction meets the requirement of "entire fairness" to the company and its stockholders."*

[542] ABA Committee on Corporate Laws, Corporate Director`s Guidebook, (5th ed.) 2007, at 23. .

[543] Id.

[544] Del. Code Ann. tit. 8, § 144 (2009); Millstein, Gregory, Altschuler & Di Guglielmo, *Fiduciary Duties Under U.S. Law*, ABA Section of Business Law, International Developments in Corporate Governance Subcommittee, March 2011, electronic article available at: http://www2.americanbar.org/calendar/section-of-international-law-2011-spring-meeting/Documents (last visited March 23rd 2011), at notes 48-49. In cases of shareholder approval that is done on a fully informed basis, this serves as a full defense to duty of care claims. In cases of the duty of loyalty, this approval changes "*the standard of review to the business judgment rule [with the same burden of proof on the plaintiff] or leave[s] 'entire fairness' as the review standard, but shift the burden of proof to the plaintiff."* Wheelabrator Techs. Inc. Shareholder Litig., 663 A.2d 1194 (Del. Ch. 1995) at 1203. Id.

[545] *See* Sale Hillary A., *Delaware's Good Faith,* 89 Cornell Law Rev., [100, 137], 2004, available at SSRN: http://ssrn.com/abstract=456060, (last visited January 23rd 2011).

[546] Stone v. Ritter, 911 A.2d 362 (Del. 2006) at 370.

[547] Id.; See also In re the Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) at 64-67.

[548] Stone v. Ritter *911 A.2d* 362 *(*Del. 2006), at 369.

under a claim for a breach of the above two fiduciary duties.[549] This and other related concepts that touch upon both duties, either directly, or via providing comparison means, will be treated separately in the following subsections.

2.2.3 The Disney and Lyondell Cases: Defining 'Bad Faith' and Gross Negligence?

The discussion on what constitutes lack of good faith and when does it differ from gross negligence, was elaborated in the famous ***Walt Disney*** case.[550] Although the court decided to proceed with analyzing the lack of good faith, it did not state whether this was to be considered a separate duty.[551] The case focused around the hiring of *Michael Ovitz*, the president of Disney, the termination of his employment and the *golden* severance pay of around $ 140 million, triggered upon his no-fault termination. The plaintiffs basically argued a claim for breach of fiduciary duties on the basis of the approval of the employment agreement (done without advice from expert consultants, without reference to the entertainment industry, and the meeting in which these issues were decided, lasted for a very short time)[552] and on the basis of the allowance for dismissal of *Ovitz*, by the CEO of the company, under a no-fault provision.[553]

The Delaware Supreme Court, upheld the previous decision of the Chancery Court, and found that the directors of Disney did not act in bad faith and at most, they were to be found

[549] Ball C., Sonnie M., & Triponel, A. F., *Advice for Corporate Directors* in: Mergers and Acquisitions 2010: Trends and Developments, [137, 230], Practicing Law Institute Publication, New York, 2010, available at SSRN: http://ssrn.com/abstract=1558020141 (last visited January 20th 2011), at 154.
[550] In re the Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) (hereinafter Disney II); In re the Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005) (hereinafter Disney I); See also In re The Walt Disney Company Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003); See also In re the Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del. Ch. 1998); See also Brehm v. Eisner, 746 A.2d 244 (Del. 2000).
[551] Disney II 906 A.2d 27 at 64-67 defining lack of good faith.
[552] Disney I 907 A.2d 693, at 712 et seq.; See also Veasey N.E. & Di Guglielmo C.T., *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 Univ. of Pen. Law Rev. 5, [1399, 1512], 2005, at 1441 et.seq.
[553] Id.

ordinarily negligent, a standard which is insufficient to find a breach of the duty of care, the criteria for the latter being gross negligence.[554]

What is of importance, however, is that the Supreme Court continued to give some guidance as to what constitutes "*candidates for the 'bad faith' pejorative label*"[555] and categorized the latter into three classes. First, bad faith can be found in cases where there is a conduct motivated by "*an actual intent to do harm*."[556] Secondly, the court recognized the other category of bad faith as "*lack of due care – that is, fiduciary action taken solely by reason of gross negligence and without any malevolent intent*."[557] Lastly, a category that rests in between the previous two, refers to *"intentional dereliction of duty [or] a conscio*us *disregard for one's responsibilities."*[558] This latter type of conduct was considered as lack of good faith constituting a breach of the duty of loyalty, which would not be subject to the business judgment rule presumptions and will not be capable of becoming exculpable.[559]

Another important aspect of the Disney case was the fact that, as per the decision of the Chancery Court, while best practices of corporate governance may provide a contextual framework in which to evaluate the fulfillment of fiduciary duties, they do not however provide a standard for a determination on whether these duties have been violated.[560] Disney is often referred to as facilitating the content of best practices to be followed with regards to the minutes

[554] Disney II 906 A.2d 27 at 66.
[555] Id. at 64
[556] Id.
[557] Id. at 65.
[558] Id.at 66-67.
[559] Id.; *See also* for comments on the issue of breach of fiduciary duties but also on the issue of executive compensation, Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007, electronic article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011).
[560] Disney I, 907 A.2d 693, at 697 et. seq. (Note however that the opinion started with a careful remark that "*the actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and applying 21st century notions of best practices in analyzing whether those decisions were .actionable would be misplaced*."Id.

of meetings and deliberating processes.[561] The case is seen as making a plea for better governance practices, also via the indirect understanding that the actual practices followed by Disney constitute the '*not to do*' lists for directors and officers.[562] Despite these modest contributions of a case that lasted almost a decade and was presented with an opportunity to break new legal grounds in the realm of fiduciary duties, Disney reconfirmed the prevalent stance of Delaware courts that the actions of the board members and senior managers, would have withstood scrutiny, as they did, be it a case of duty of care, duty of loyalty or of a yet uncategorized, *duty* of good faith.

Apart from the above definitional attempts in the Disney case, Delaware courts have tried to clarify again that gross negligence alone cannot be a basis for claiming breach of the duty of loyalty.[563]One such case clarifying the dividing line between gross negligence and bad faith was the case of ***Ryan v. Lyondell***.[564] The Delaware Supreme Court stated that *"even gross negligence on the part of corporate directors is insufficient to state a breach of duty of loyalty claim.*"[565] The court went on to clarify that if the directors failed to do everything they should have done, they breached their duty of care.[566] The duty of loyalty would be considered breached, only if directors knowingly and completely failed to undertake their responsibilities.[567]

---

[561] Grossnickle Faith, *A Disney Tale*, Electronic Journal of Corporate Counsel, January 2006, available at http://www.corporatecounsel.com/01006.pdf (last visited January 23rd 2010).

[562] Id; *See also* Godfrey Cullen M., *In re The Walt Disney Company Derivative Litigation: A New Standard for Corporate Minutes,* 17 ABA Bus. Law. 6, 2008, electronic article available at: http://apps.americanbar.org/buslaw/blt/2008-07-08/godfrey.shtml, (last visited January 23rd 2010).

[563] In McPadden v. Sidhu, 964 A.2d 1262 (Del. Ch. 2008), the court found that the plaintiff failed to plead a violation of the *duty of good faith* where a board of directors accepted a price at the lowest end of the valuation range received by its investment banker and was not actively engaged in negotiations on the sale of one of its subsidiaries. Specifically, the court found the directors' conduct constituted gross negligence, rather than bad faith, and therefore fell outside the realm of a duty of loyalty claim. Id. at 1274.

[564] Ryan v. Lyondell Chem. Co., 907 A.2d 235 (Del. 2009).

[565] Id. at 241.

[566] Id.

[567] Id. at 243-246. The Court stated: *"Instead of questioning whether disinterested, independent directors did everything that they (arguably) should have done…, the inquiry should have been whether those directors utterly failed to attempt to obtain the best sale price". Id.*

From the above analyses, one can observe a certain undisturbed *standard* established by Delaware courts with regards to their own activity: the standard of being judicially extra-cautious with fiduciary duty decisions. For cases involving the duty of loyalty, courts have set and maintained a high culpability standard, perhaps, counterbalancing somehow the fact that exculpation clauses do not provide a shield from liability. In the meantime, for cases involving the duty of care, the business judgment rule, even though occasionally tested, continues to provide a safe harbor.

2.2.4 Directors` Liability for Failure to Act

A detailed test of finding directors` liability for inaction amounting to breach of fiduciary duties was set in ***Caremark.***[568] Caremark was charged in 1994 in an indictment involving mail fraud linked to payment of doctors for patient referrals and defraud of government medical programs.[569]It subsequently entered into settlements with federal and state governmental entities and in no settlement were any of the directors, or senior officers, charged with wrongdoing.[570] A derivative suit followed in 1994 against individual members of the Board of Directors, seeking recovery of damages (on behalf of the company) for all the losses suffered by Caremark.[571] A settlement was negotiated and the Delaware Court of Chancery dealt with the motion to approve the settlement as fair and reasonable.[572]

[568] In re *Caremark* International Inc. Derivative Litigation 698 A 2d *959* (Del. Ch. 1996) (hereinafter for the purpose of this section *In re* Caremark 698 A 2d 959)
[569] *See* also Bainbridge Stephen M., *Caremark and Enterprise Risk Management,* 34 Journal of Corporation Law 4, [967, 990], June 2009.
[570] Hamilton Robert W., Corporations Including Partnerships and Limited Liability Companies, Cases and Materials, (7th ed.), West Group, St. Paul, Minn., 2001, [original comment by ed.] at 784.
[571] *In re* Caremark 698 A 2d 959
[572] Hamilton Robert W., Corporations Including Partnerships and Limited Liability Companies, Cases and Materials, (7th ed.), West Group, St. Paul, Minn., 2001, [original comment by ed.] at 785.

The complaint provided that the defendants had breached "*their duty of attention or care*"[573] and had allowed the development of the circumstances that exposed the company to legal liability. Due to this, they had violated "*a duty to be active monitors of corporate performance*."[574] The Court stated that directorial liability for breach of the *duty of attention,* could arise in principle in cases when a board`s decision resulted in a loss because it was "*ill advised or negligent*"[575] or from *"an unconsidered failure of the board to act, [when] due attention would arguably have prevented the loss."*[576]

The Court formulated a test under which, in order to successfully claim that directors breached their fiduciary duty of care by failing to monitor employees, a plaintiff would have to show that "*the directors knew or should have known that violations of law were occurring; […][they] took no steps in a good faith effort to prevent or remedy that situation, and such failure proximately resulted in the losses complained of]*."[577]

With regards to cases of failure to monitor where no knowledge of liability exposure can be established, the Court stated that *"only a sustained or systematic failure of the board to exercise oversight- such as an utter failure to attempt to assure [that] a reasonable information and reporting system exists*"[578] will be capable of establishing the required level of lack of good faith, as a necessary condition for liability.[579]

We can observe an in-between approach of the Court in this case, with a desire to affirm oversight duties for directors on one side, and a fear of lowering liability bars on the other. Albeit

[573] *In re* Caremark 698 A 2d 959 at 961.
[574] Id.
[575] Id. at 967.
[576] Id.*[emph.add.]*.
[577] Id. at 971 *[emph.add.]*.
[578] Id. *[emph.add.]*.
[579] Id.

the decision was presumed to serve the interests of shareholders[580] by providing that corporations need to attempt to ensure the existence of the information and reporting systems,[581] the case set the standard of liability quite high. Apart from this observation however, it is claimed that Caremark created an *affirmative duty* to take good faith efforts to establish compliance procedures.[582] The provision might raise implications for cases when a board might have to follow through with existing mechanisms, by either reviewing or modifying them. This question was also left open by **Stone *v. Ritter***,[583] a case which later confirmed Caremark.[584] In Stone, the court provided for cases when the board "*having implemented such system or controls, consciously fails to monitor or oversee its operations*"[585], however it is not clear whether in order to not fail monitoring, the operations can turn into a positive duty to actually update the appropriate compliance systems.

One related question is also whether patterns of *red flags*, meaning basically signs of heightened exposure to liability, would indeed create a *stronger* duty to *modify* information and reporting programs.[586] This in turn, would make one wonder whether there is a risk that courts will become entangled in cases of evaluating the reasonableness of these programs under the circumstances they are adopted.[587] A simple application of the business judgment rule and the

[580] Id. at 971-972.
[581] *See* Elson C.M. & Gyves C.J., *In re Caremark*: *Good Intentions*, *Unintended Consequences*, 39 Wake Forest Law Rev., [691, 702], 2004.
[582] Id. at 691.
[583] Stone v. Ritter, 911 A.2d 362 (Del. 2006).
[584] This was despite of the fact that Stone shifted the oversight duties from a duty of care domain to that of a duty of loyalty. Bordonaro Peter D., *Comment, Good Faith: Set In* Stone?, 82 Tulane Law Rev. [1119, 1135], 2008, at 1136.
[585] Stone v. Ritter, 911 A.2d 362 (Del. 2006), at 370.
[586] For the reference to "red flags" In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009), at 124.
[587] Demetriou A. & Olmon J.T., *Stone v. Ritter: The Delaware Supreme Court Affirms the Caremark Standard for Corporate Compliance Programs*, 3 ABA Health Law Section 6, 2007, electronic article available at: http://www.americanbar.org/content/newsletter/publications/aba_health_esource_home/Volume3_06_demetriou.html, (last visited January 23rd 2010); See also Brown Lowell H., *The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 Delaware Journal of Corporate Law 1, [1-145], 2001, available at SSRN: http://ssrn.com/abstract=287206 (last visited January 10th 2010).

traditional judicial deference employed by it, would provide a straight answer to the negative.[588] A partial answer to basically the same effect came via decision in ***Citigroup.***[589]

In ***Citigroup***, the court dealt with the issue of director liability related to the participation of the company in the subprime lending market.[590] The plaintiffs basically argued that there was a failure to adequately monitor and manage risks resulting from the market, and a failure to properly disclose the real exposure to it.[591] Specific reference was made to the fact that there were enough "*red flags*"[592] to put directors in alert of persistent problems. The Court however sustained its long standing tradition of careful consideration of whether there was a departure from good faith,[593] the fact that the latter cannot be an independent fiduciary duty[594] and the courts` consistent approach of not interfering with directors` business decisions.[595]

The last element of not second-guessing directors` prudence under the business judgment rule was the key to the court`s approach to directors` monitoring of business risk. As the Court provided, to allow for liability in cases of failure to monitor such risk, would be against *"well settled policy of Delaware law by inviting courts to perform a hindsight evaluation of the reasonableness or prudence of directors' business decisions."*[596] As for the red flags that (in plaintiff`s view), would have given enough notice and alert of existing problems, the court was of the opinion that the existence of these signs was not indeed enough to establish that directors were aware of the fact that the company`s disclosures were false or misleading[597] Although failure to respond to such red flags is a viable claim under *Caremark*, for cases of a systematic

[588] Id.
[589] In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009).
[590] Id.
[591] Id. at 111.
[592] Id. at 124.
[593] Id. at 122. Citing Caremark`s standard of liability for failure to exercise oversight.
[594] Id. at 122-123 Citing Stone v. Ritter.
[595] Id. at 126.
[596] Id.
[597] In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009), at 135.

and sustained failure, these flags will need to be *"numerous, serious, directly in front of the directors, and indicative of a corporate-wide problem."*[598]

As regards the reactions to the case, on one side, it has been claimed that the decision is indeed what it should have been, for "*bad outcomes do not necessarily prove an ex-ante failure to act.*"[599] It has also been argued that the case law stance so far, has considered risk management and assessment as two types of activities not different in kind to the compliance and accounting control cases, but more so different in degree.[600] Given the latter then, the liability bar is believed to have been reasonably set quite high, for absent firm-specific facts, a failure to predict the business future, should not be a ground for personal liability of directors.[601]

Others have claimed that the final outcome of a *duty* of oversight will often translate into *de facto* immunization from liability.[602] According to this view, albeit increased duties of monitoring and risk-assessment were imposed by legislation, Delaware Courts should have expanded the role of the duty to monitor and should have emphasized its importance.[603] Yet, courts are standing between two choices of heightened monitoring obligations and judicial deference. Advancing the first option could easily translate into stepping over well-established standards of review. While the preservation of the latter is important for the U.S. system, it often constitutes a blockade to finding liability for breach of fiduciary duties.

[598] Burch Regina F., *Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron*, 6 Wyoming. Law Rev. 2, [481, 532], 2006, at 498.
[599] Bainbridge Stephen M., *Caremark and Enterprise Risk Management*, 34 Journal of Corporation Law 4, [967, 990], June 2009, at 989.
[600] Id. at 990.
[601] Id.
[602] Pan Eric J., *A Board's Duty to Monitor*, Cardozo School of Law Working Paper No. 281, 2009, at 26.
[603] Id.

2.3 Directors` Fiduciary Duties in the chosen EU jurisdictions

The debate on fiduciary duties of board members in the chosen EU jurisdictions presents a different scenario from the one seen in the U.S.[604] It is important to understand that the analyses provided for the U.S. is typical to that jurisdiction and a similar counterpart in continental Europe cannot be found in identical fashion.[605]

Also as in the case of the previous sections of this chapter, the analyses regarding the fiduciary duties approach towards stakeholders and their application in cases involving executive compensation, is covered specifically and in detail in the third and fourth chapters.[606]

2.3.1 Fiduciary Duties in Germany

The different kind of discussion with regards to fiduciary duties in the German context goes back to the underlying philosophy of the corporations` organization in Germany.[607] As opposed to the common law systems, which base their justification of directors' fiduciary duties on the concepts of agency and trust law,[608] German law considers the boards as bodies or organs

[604] *See* Hopt Klaus J., Directors' Duties to Shareholders, Employees and Other Creditors: A View from the Continent, in: McKendrick E (ed.), Commercial Aspects of Trusts and Fiduciary Obligations, [115, 135], Clarendon Press, Oxford, 1992.
See for Germany Baums Teodor, *Personal Liabilities of Company Directors in German Law***,** Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited January 8th 2010); See for CEE countries, Pistor K. & Xu C., *Fiduciary Duty in Transitional Civil Law Jurisdictions Lessons from the Incomplete Law Theory*, ECGI - Law Working Paper No. 01 2002, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480 (last visited February 12th 2011).

[605] *See* Cheffins Brian R. & Black Bernard S., *Outside Director Liability Across Countries*, ECGI Law Working Paper No. 71, 2006, *available* at: http://www.cgscenter.org/library/Board/OutsideDirectorLiability.pdf ,(last visited February 24th 2011).

[606] For executive compensation cases involving the application of fiduciary duties, *see infra* sections 3.4.2, and 3.4.4 and related discussion; For an analysis on the chosen EU jurisdictions` approach to whether fiduciary duties are owed to stakeholders, *see infra* sections 4.3.1 and 4.3.2 and related discussion.

[607] Baums Teodor, *Personal Liabilities of Company Directors in German Law***,** Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited January 8th 2010),at 7-8.

[608] See for the U.S. Brudney Victor, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 Columbia Law Rev. 7, [1403, 1444], 1985, at 1403 – 1420.

of the company, placing more emphasis on their independence rather than on their *agency serving* functions.[609]

While we have seen how the U.S. differentiates between the duty of care and the duty of loyalty, German law does not differentiate with the same emphasis, although similarities between the content of the respective duties can be drawn.[610] First, it is important to establish that in the German context, as a matter of principle, duties run to the company, not the shareholders.[611]

This was not however exactly the case when the two-tier board system was first introduced, which did not provide as to whom did the duties of board members run.[612] Instead, early presumptions held that the interest of the company basically referred to the interest of the shareholders.[613] The German approach has however evolved from those early days, so as not to equate the interest of the company with those of the shareholders, but to also refer to the inclusion of other stakeholder interests, especially so employees.[614] The German Codetermination Act has also favored such considerations with regards to employees.[615] The prevailing understanding is therefore that the interests to be served are those of the company and this does not translate into exclusive shareholder interests.[616]

---

[609]Supra note 607, at 7-8.
[610] Id. at 5.
[611] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 120.
[612] Id. at 119 note 52 referring to the introduction of the two-tier board system by German General Commercial Code, [Allgemeines Deutsches.Handelsgesetzbuch**,** (ADHGB)] of 31 May 1861, (publication gazette info omitted).
[613] Id. at 120.
[614] Id. at 121, note 63, referring to Schmidt Karsten, Gesellschaftsrecht, (Company Law), 4th ed., Carl Heymanns Publishing House, 2002, at 805.
[615] Co-Determination Act [*Gesetz uber die Mitbestimmung der Arbeitnehmer*] of 4 May 1976, published in Federal Law Gazette BGB1 I 1153; Stakeholder considerations are treated in the fourth chapter, see infra section 4.3.1 and related discussion.
[616] Baums Teodor, *Personal Liabilities of Company Directors in German Law***,** Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at: http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited February 18th 2011),at 6-7.

2.3.1.1 Duty of Care and the Business Judgment Rule

In Germany, members of the Supervisory Board and members of the Management Board are subject to the duty of care contained in the Stock Corporation Act (hereinafter AktG) which states that in the conduct of business, a director has to act with the care "*of a diligent, conscientious manager*."[617] From the wording of the rule, the requirement refers to the diligence of a prudent business person.[618] However, with regards to directors who are members of the Supervisory Board, this reference is interpreted to require that their specific duties, in particular their supervisory duties are performed in a diligent, conscientious way.[619] All members of the Supervisory Board, irrespective of whether they are representatives of employees or shareholders, are subject to the same duty of care.

The standard appears to govern how a director acts as opposed to what he should do,[620] a comparison similar to the process-oriented duty of care standard in the U.S. context.[621]

Nevertheless, although directors' concrete obligations have to be distinguished from the standard governing the conduct, German courts have however reduced them to the same basic question: that of how a prudent diligent manager would have acted in similar circumstances.[622]

---

[617] § 93 (1) AktG Stock Corporation Act *[Aktiengesetz]* 06.09.1965, BGBT I. S.1089, (hereinafter for this section AktG); § 116 Aktg regarding liability of members of the Supervisory Board explicitly refers to § 93 on liability of members of the management board; Baums Teodor, *Personal Liabilities of Company Directors in German Law*, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at: http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited February 18th 2011),at 5.

[618] Baums Teodor, *Personal Liabilities of Company Directors in German Law*, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at: http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited February 18th 2011),at 5.

[619] Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 130.

[620] *Supra* note 618, at 9.

[621] *See supra* section 2.2.1 and related discussion.

[622] *Supra note* 618 at 10.

The general principle that a director should act with the diligence of a prudent business person is one of mandatory law.[623] Liability to the corporation will be triggered by "*culpable action, i.e., negligent or willful action that breaches [the] duty of prudent business management*."[624]

The standard of care would refer to that "*used by an average member of [a board] in a comparable company*."[625] Furthermore, the standard is objective and claims that a director has acted, as he would have acted in his own personal business matters, do not constitute a defense.[626] The law also assumes that directors must have the knowledge and skills necessary for conducting their activities. Here the specific required skill standards will differ depending, amongst others, on the size, activity and importance of the business.[627] Also for members of the Supervisory Board, sitting in committees due to their special skills, the member will be held liable in view of such skills.[628]

The minimum standard of culpability is negligence and the burden of proof will rest on the director accused of a breach, to show that he acted with the diligence of a prudent, conscientious manager.[629] Basically, while the company has to show that it suffered damage as a result of an action or omission of the director, the ultimate burden of proof when a company has so established, will rest on the said director.[630]

---

623 § 23(5) AktG.

624 Baums T. & Scott K.E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany.* ECGI Law Working Paper No. 17/2003, available at: http://ssrn.com/abstract=473185 , (last visited January 12th 2011), at 16 *[emph.add.]*.

625 Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 112 *[emph.add.]*.

626 Supra note 618, at 10.

627 Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 113.

628 Id. at 130.

629 Id. at 112; § AktG 93 (2).

630 Id. ; See also Hopt, Kanda, Roe, Wymeersch & Prigge (eds.), Comparative Corporate Governance: The State of the Art and Emerging Research, Oxford University Press, Oxford-New York, 1998, at 265[ff.].

A form of the business judgment rule was first introduced in Germany through judicial innovation in 1997 and later on embedded in an amendment of the AktG.[631] In the ***Arag/Garmenbeck*** case, the German Federal Supreme Court was faced with an action brought by some members of the Supervisory Board of Arag AG.[632] The members had challenged a majority decision refusing to bring an action against the chairman of the Management Board, although, as the members bringing the claim argued, the chairman had violated his duty of care. This violation was claimed to have occurred due to the chairman`s loss of company funds, via dealings with a pyramid scheme. [633]

The case went through a regional court which found in favor of the dissenting members of the Supervisory Board, and then into the Appellate level which provided for the need of courts to grant *freedom* to business decisions and dismissed the complaint.[634] After the dissenting members appealed, the Federal Supreme Court stated that members of the management board *"possess a wide margin of appreciation for their activities, as [...] any business activity is inconceivable without such discretion."*[635] It further stipulated that liability would be found only in cases when in view of the welfare of the company, directors had passed the limit of responsible directorship and the desire for entrepreneurial risk had become irresponsible.[636] The wide ranging discretionary powers for members of the Management Board, therefore, include the taking of business risks, such as the risk of making miscalculations in their assessments.[637]

[631] Arag/Garmenbeck Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997; § 93 (5) AktG.
[632] Id.
[633] Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007, Electronic Article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 14.
[634] Id. at 14-15.
[635] Translation taken from Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions: England, the US, Germany and China,* Kluwer Publications, Shanghai, 2007, at 222.
[636] Id.
[637] Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 113.

With regards to the directors in the Supervisory Board, if involved in business decisions taken by the Management Board, for instance, by granting consent when it is required, then they have the same wide discretion as the Management Board. If this discretion is properly exercised, the directors will not be found liable.[638] However, there is no discretion regarding the duty to properly supervise and monitor the Management Board and the Supervisory Board is obliged to look at any identifiable concerns in order to avoid damage.[639]

What is more interesting with regards to the business judgment rule however, is that although this formulation might resemble a lot to the typical U.S. version, the Court, via the same decision, appeared to overstep a standard of deference that U.S. courts would usually follow.[640] When it came to deciding whether the company should bring an action against the chairman, the Court did not show deference. Instead, it provided that an evaluation of the merits of the likely claim against the chairman was a matter where directors lacked the necessary expertise.[641] Also, the court showed little deference when it provided that "*only in cases of extraordinary circumstances, the Supervisory Board had the option to refuse pursuing a claim against the members of the Management Board.*"[642] Instead of deferring this as a business decision to the directors, the Court would evaluate the *pros* and *cons* of such claims.

Later on, the new rule was included into German statutory law.[643] According to the legal provision that formally adopted the rule, a member of the Management Board is not liable under the following conditions: he makes a business judgment in good faith, free from conflict of

---

[638] Id. at 131.
[639] Id.
[640] Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007, Electronic Article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 15.
[641] Id.
[642] Id.; See also Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions: England, the* US, *Germany and China,* Kluwer Publications, Shanghai, 2007, at 222-223.
[643] § 93 (1) AktG as amended by Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], of 15.06.2005 published in *Bundestagsdrucksache (BT-Drs.)* 15/5693 (hereinafter AktG as amended 2005).

interests, in the interest of the company, based on sufficient information taking into account the importance of the specific business measure.[644] From the conditions set out in the rule, it is understood that it cannot dispense of the duty of loyalty, meaning for instance, that a member of the board acting in his own interest, or that of a third party, might not invoke the protection of the business judgment rule.[645]

It has been shown above that the German business judgment rule differs from the U.S. version due to the standard of deference afforded to business decisions. Another difference is that, while under U.S. law, a plaintiff shareholder bears the burden of proof to show that the business judgment rule is not applicable, under German law, the director has to prove that he has acted with the care of a diligent and conscientious manager.

2.3.1.2 Duty of Loyalty and Conflicts of Interests

In terms of the duty of loyalty, the German doctrine refers to a duty called *Treuepflicht*[646] owed to the company, the faulty breach of which will incur strict personal liability, although there is no elaboration in a fashion similar to the U.S. one, also due to the above mentioned reason that, in Germany, boards are considered organs of the company, emphasizing their independence rather than their agency role.[647]

[644] Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 114.
[645] Id.
[646] Baums Teodor, *Personal Liabilities of Company Directors in German Law*, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996, electronic article available at: http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/a0696.pdf (last visited February 18th 2011), at 7.
[647] Id. at 7-8.

Nevertheless, rules on self-dealing provide that if a member of the Management Board or Supervisory Board, unjustly depletes corporate assets for his own purpose, then, this member would violate his duty of loyalty and become subject to strict civil liability.[648]

As for conflict of interest and self-dealing transactions, the German approach usually uses procedural rules with regards to interested transactions between members of the Management Board and the company. In the context of conflict of interest transactions, these directors have to provide complete disclosure to the Supervisory Board.[649]

Furthermore, loans and guarantees to directors and certain third party credit transactions require authorization.[650]If the director enters into a transaction that involves self dealing, but not covered by specific provisions, the transaction is considered void, if it is harmful to the company and there is a showing of bad faith.[651]The Supervisory Board will be held liable for damages if it failed to impose adequate rules on the Management Board in cases of related party transactions, from which the company has suffered damage.[652]

The division into the Management Board and the Supervisory Board however sheds light into the difficulties of actually bringing directors to face liability in cases of self-dealing.[653]

Leaving aside for a moment the possibility of shareholder derivative suits that were recently introduced into German law,[654] and the technicalities of which will be addressed further

---

[648] Id. at 13; See § 93 AktG.

[649] Enriques Luca, *The Law on Company Directors' Self-Dealing: A Comparative Analysis,2* International and Comparative Corporate Law Journal 3, [297-333], April 2000, available at http://web.mmc.edu.cn/shekebu/faxue/legal%20english/LinkedDocuments/The%20law%20of%20company%20director.pdf, (last visited January 10th 2011), at 316-317.

[650] Id. See § 89 AktG. In the case of credit transactions, the *Supervisory Board*'s ratification is expressly allowed by § 89 (5) AktG.

[651] Id. at 317.

[652] Baums T. & Scott K. E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, ECGI Law Working Paper No. 17/2003. *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=473185 (last visited January 9th 2010), at 13.

[653] Id.

[654] § 148 AktG as amended by Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], of 15.06.2005 published in

on, the fact that as a rule, the company is represented by the Supervisory Board, would mean that when claiming breach of fiduciary duties against members of the Management Board, the Supervisory Board has to initiate such an action.[655] However, since the Supervisory Board is entrusted with the monitoring and oversight of the Management Board activities, one could logically claim that, members of the former would fear being accused for failing to properly monitor members of the Management Board.[656]

Furthermore, as for dealings between a Supervisory Board member and the company, the Management Board may not represent the company alone, but it must act so in concert with the whole Supervisory Board, thus creating an environment for more "*back scratching*"[657] between members of both boards.[658]

Despite the above rules and the problems they raise, the German system, appears stricter in terms of possible liability, given that apart from strict civil liability, cases of willful breaches may cause the triggering of criminal liability under the concept of *Untreue.*[659] *Untreue*, basically means *breach of trust* or *disloyalty*, and as per section 266 of the German Criminal Code, it criminalizes one who *"violates the duty to safeguard the property interests of another incumbent upon him by reason of statute […]or fiduciary relationship, and thereby causes detriment to the person, whose property interests he was responsible for].*"[660]*Untreue* can result in fines or

Bundestagsdrucksache (BT-Drs.) 15/5693.

[655] Baums T. & Scott K. E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany.* ECGI Law Working Paper No. 17/2003, *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=473185 (last visited January 9th 2010), at 7-8.

[656] Id.

[657] Id. at 12.

[658] Id. at 8-12.

[659] German Criminal Code [*Strafgesetzbuch*] As promulgated on 13 November 1998, [BGBI I, 945, 33220], § 266. The English version of the Code can be found in http://www.iuscomp.org/gla/statutes/StGB.htm (last visited January 10th 2011).

[660] Id.; Conac P. H., Enriques L. & Gelter M., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy,* ECGI - Law Working Paper No. 88/2007, October 2007, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532221, (last visited on January 31st 2011), at 31.

imprisonment[661] and members of the Management and Supervisory Boards are both subject to this provision.[662]

There has been a lot of controversy regarding its lack of clarity particularly as related to the corporate world, and more so to the broad spectrum of cases that can result in a conviction under *Untreue*, given that any case considered as misconduct by courts, might potentially fall within its reach.[663]

One of the biggest cases related to the concept of *Untreue* was the ***Mannesmann*** case[664] which, due to its peculiarities with regards to the issue of executive compensation, has been treated in the third chapter under that specific perspective.[665] The prosecution in this case argued that by paying the amount of almost € 60 million in bonuses, the defendants, (members of the compensation committee) breached their duty to "*the broader interest of the company, which consequently damaged the company*."[666] As for the claims brought under *Untreue*, the first instance court found that a breach of fiduciary duty under criminal law had not occurred, but the award of bonuses was inappropriate and therefore breached § 87 of AktG, requiring members of the Supervisory Board to ensure that compensation of members of the Management Board appropriately reflects their responsibilities and the overall situation of the company.[667] While the Federal Supreme Court was of the opinion that not only *aggravated* cases would warrant convictions under *Untreue*, without indeed defining as to what were the other cases that would

[661] § 266 II StGB (as it refers to §§ 243 II and 263 III StGB).
[662]Conac P. H., Enriques L. & Gelter M., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, ECGI - Law Working Paper No. 88/2007, October 2007, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532221, (last visited on January 31st 2011), at 31.
[663] Id. at 33.
[664] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[665] See infra section 3.4.
[666] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited January 31st 2011) at 834.
[667] Id. at 844; § 87(1) (i) AktG states: "*When determining the total remuneration of individual executive directors, the supervisory board…must ensure that total remuneration is kept in appropriate relation to the tasks of the executive director and the state of the company*." Id. at 831.

risk breaching section 266 of the Criminal Code,[668] the case was settled before retrial.[669] Although cases of *Untreue* might be brought as a reaction to the lack of effectiveness of civil litigation,[670] the decision left room for ambiguity as to which bad faith cases of breach of fiduciary duties would fall under its scope.

2.3.1.3 Failure to Act

As a rule, members of the Management Board are obliged to take care that the company complies with all provisions applicable to it, in order to prevent the company from suffering disadvantages such as damage claims by third parties.[671] The personal liability of a member of the Management Board will apply not only in cases of ordering or acting so as to expose the company in the above way, but also when he tolerated actions or failed to take the necessary steps to prevent such exposure.[672]

As for the members of the Supervisory Board, they would be found liable if they failed to exercise proper oversight of the activity of the Management Board.[673] One special characteristic in this regard is the fact that, as per the *Arag* decision, members of the Supervisory Board are obliged to assert claims for damages against Management Board members, unless there is an overriding company interest.[674] This means that only in exceptional circumstances, could there

---

[668] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[669] Franklin A., *Disney in a Comparative Light*, 26th of February 2007, Electronic Article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 9.
[670] Id. at 14-17.
[671] Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 113.
[672] Id.
[673] Id. at 130-131.
[674] Id. at 114-115; See Arag/Garmenbeck Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997.
.

be a refusal to bring a well founded claim, which in turn implies that failure to do so in normal circumstances, would trigger liability of the members of the Supervisory Board.[675]

Another interesting aspect pertaining to liability of directors was raised recently by German Courts and it referred to a duty to get information and to conduct thorough research prior to decision making, the failure of which will make the business judgment rule inapplicable.[676] While acting on an informed basis is a normal requirement for the protection under the business judgment rule, the German recent approach seems to emphasize increased efforts in terms of thorough research prior to decision-making. One such example involved the near insolvency case of the German bank *IKB AG*.[677]

At the wake of the financial crisis, *IKB AG* had invested in the U.S. securities market, which was, in the view of the Dusseldorf Court trying the civil claims, a complex market structure, that had been neither properly understood, nor sufficiently researched by the directors of IKB.[678] The Court stated that "*the excessive complexity of the securitization sector [made it] close to impossible to make decisions on an adequately informed basis*."[679] Although realizing the low probability of understanding the securitization sector, yet, directors were considered not adequately informed and they could not rely on the protection of the business judgment rule. The court stated specifically further on, that *"no management board acts diligently, if it allows the company to take risks, which, if realized, lead to the collapse of the company*."[680] This formulation represents a strong limitation of the business judgment rule for failure to exercise

[675] Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007, Electronic Article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 15.
[676] LG Düsseldorf, 14.07.2010, 14 KLs 6/09.
[677] Mattusek Karin, *Germany Opens First Criminal Case Linked to Financial Crisis*, NY Times, 17 March 2010, available at: http://query.nytimes.com/gst/fullpage.html?res=9904E5DE113FF934A25750C0A9669D8B63, (last visited January 31st 2011). Although a criminal case was brought under *Untreue*, the article analyzes the civil claims as well.
[678] Id.
[679] Id. at 1. *[emph.add.]*The reference to the quoted part as per the translation offered in this article.
[680] Id.

risk assessment and risk management, very different from the one seen in the U.S. Citigroup case.[681] Although the case was recent and future cases will better demonstrate the approach of the German courts, it nevertheless shows a certain intent to limit the protective reach of safe harbors and '*punish*' excessive risk-taking.

2.3.1.4 A Note on Shareholder Derivative Suits

From a procedural perspective, until recently, there has been a long standing tradition in Germany of not permitting shareholder derivative suits.[682] The situation changed in 2005 when derivative action was facilitated under § 148 AktG.[683] Under this new rule, shareholders holding shares with an aggregate nominal value of at least € 100,000, or at least 1 % of the registered share capital, can now address a court to obtain approval and bring an action for damages on behalf of the company.[684] Nevertheless, the court has to decide on the acceptance of the action claim, which is similar to a preventive trial as to legitimacy of claims by American courts.[685] In so doing, a court will take into account whether shareholders held such position when the breach occurred, whether they had previously addressed the company to put forth the action, whether there is suspicion as to the company suffering from damages caused by the managers, and

[681] In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009)

[682] Baums T. & Scott K. E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany.* ECGI Law Working Paper No. 17/2003, *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=473185 (last visited January 9th 2010), at 24-25.

[683] § 148 AktG as amended by Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], of 15.06.2005 published in *Bundestagsdrucksache (BT-Drs.)* 15/5693.

[684] Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010, at 115.

[685] Latella Dario, *Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive,* 6 Eur. Com. & Fin. Law Rev. 2, [307, 323], 2009, available at: SSRN: http://ssrn.com/abstract=1614931 (last visited January 31st 2011), (numbering of the pages as offered by the author in the electronic version accessed), at 12.

whether putting forward the action interferes with the interest of the company.[686] This procedure was set in order to discourage abusive shareholder derivative litigation.[687]

Provisions regarding the litigation expenses in cases of derivative suits appear to protect the initiative of minority shareholders bringing such claims.[688] Here, there needs to be a differentiation with regards to whether expenses will be covered by the company as per two distinct cases. As per the procedure for acceptance of the claim, in case of a rejection, shareholders bear the costs.[689] In case the claim is accepted, then the company bears the costs.[690] In the second case of the merit judgment, the company will refund costs, unless the claim was accepted under false information.[691]

The introduction of shareholder derivative suits and the facilitation of the litigation expenses in favor of the initiating shareholders, show a tendency to increase shareholder protection and facilitate the options for bringing claims against directors. While this is a positive step, the absence of a mature shareholder litigation culture in Germany and the fact that the procedure for bringing such actions is yet complicated, might reduce the frequency of shareholder derivative suits.[692]

---

[686] Id.
[687] Baums T. & Scott K. E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany.* ECGI Law Working Paper No. 17/2003, *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=473185 (last visited January 9th 2010), at 25. Although the law was not passed at the time of the artice, Baums argues that the provisions proposed with regards to the procedural aspects of the claim were intended to avoid “strike suits”.
[688] Supra note 685 at 12.
[689] Id.
[690] Id.
[691] Id.
[692] Baums Teodor Shareholders at 25.

2.4 Directors` fiduciary duties in CEE

It is obvious by now that when we speak of directors fiduciary duties and divide them into the duty of loyalty and the duty of care, we have in mind the division brought by American case law. The reality is different in Europe and especially so in CEE countries.[693] There is no developed debate on directors' fiduciary duties and less focus in terms of court cases developed in this regard.[694]

Although company laws devote several articles to duties of board members,[695] and despite Codes of Corporate Governance[696] emphasizing the need for enhanced scrutiny of the board members' activities, there is more ambiguity than clarity in the realm of fiduciary duties. On top of it, the lack of a litigation culture, as well as procedural considerations make the pursuit of a claim against board members less attractive than internal company resolutions , or even mere passivity in the face of possible problems.[697]

In Romania for instance, those few academic works touching upon the duty of care and loyalty, have drawn parallels between what is referred to as the *duty of care* in an American

[693] *See* the World Bank Reports on Doing Business Project, where statistics for director fiduciary duties and liability in CEE show that the level of protection of shareholders by means of fiduciary duties is low or at most in average compliant (that is in the law-level).Information available at http://www.doingbusiness.org/ExploreEconomies/, (last visited on January 10 2010).

[694] Pistor, K., Raiser M., and Gelfer S., *Law and Finance in Transition Economies, 8 Economics of Transition,* [325, 368], March 2000.

[695] For Czech Republic, Commercial Code *[Obchodní zákoník]* Act. No. 63/2001 Coll., 1.01. 2001; For Romania Law No. 441/2006 On Amending and Supplementing the Provisions of Law No. 31/1990 On Commercial Companies and of Law No. 26/1990 On the Register of Commerce Registration Procedures. *[Lege pentru Modificarea Legii nr. 31/1990 Privind Societãtile Comerciale, Republicata, si a Legii nr. 26/1990 Privind Registrul comertului]*, OG No. 955, 31.10.2006.

[696] For Czech republic, *See* Corporate Governance Code based on the OECD Principles, Czech Securities Commission, Prague, June 2004; For Romania, *See* Voluntary Code of Corporate Governance, Romania, Strategic Alliance of Business Associations, Bucharest, 2002.

[697] *See* for instance Pistor K.& Xu C., *Fiduciary Duty in Transitional Civil Law Jurisdictions Lessons from the Incomplete Law Theory*, ECGI - Law Working Paper No. 01/2002, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480 (last visited January 12 2010). Here the author focuses more so on the examples of Poland and Russia.

context, as the duty to manage the business and keep the books and records under Romanian law.[698] The 2009 Corporate Governance Code, provides in principle five that a board " *will act to the best interests of the company and [it] will protect the general interests of the shareholders by ensuring the sustainable development of the company.*"[699]

Yet, despite the resemblance that this recommendation might have to a duty of loyalty to the company and the reference to shareholders` interest, the concept has traditionally in the past been limited to a duty to inform shareholders and a duty of non-competition. The latter have often been considered as the core components of fiduciary duties and they have been seen as inextricably linked, since they derive from the same origin: namely the agency relationship between shareholders and the management.[700] Yet, the simplistic translation of fiduciary duties into these two components highlights that there is little guidance as to their proper definition, content and clarification in the Romanian context.

The major provisions of the revised company law, reconsidered the status of directors by providing for the introduction of the business judgment rule.[701] According to the latter, a director is not considered to be in breach of the due diligence standard, if "*upon making a business decision he is reasonably entitled to consider that he is acting in the company's interest and based upon adequate information.*"[702] Therefore, directors will find a liability escape in cases of acts performed under the business judgment rule, although there are some exceptions to this

---

[698] *See* for instance Tripon Catalin Razvan, *Foreign Direct Investment in Romania: Challenging the Romanian Legal Framework* Using *the Delaware Model of Company Law,* Central European University S.J.D. Thesis, Budapest, 2003, at 261-267.
[699] Corporate Governance Code Romania, Bucharest Stock Exchange, Bucharest, January 2009, *available at*: http://www.ecgi.org/codes/documents/bucharest_se_code_jan2009_en.pdf, (last visited February 15th 2011), principle V. *[emph.add.]*.
[700] Id.
[701] Romanian Company Law, art. 144 regarding director liability.
[702] Iancu Monica & Statescu Monica, *Obligations and Civil Liability Incumbent under Romanian Law, Corporate and Commercial Legal Developments*, August 2008, electronic article available at http://www.worldservicesgroup.com/publications.asp?action=article&artid=1909, (last visited January 18th 2011).

protection. The exceptions are formulated in the form of fraud, engaging in activities which constitute conflict of interest, acting *ultra vires*, and not *performing due care* in basic activities such as attending meetings, deliberating in a meaningful way before reaching decisions and looking to inform oneself on corporate matters.[703] Apart from this though, there is little complementary interpretation of the application of the business judgment rule in Romanian companies. Company law deals in several articles with the joint liability of the members of the Directorate and the Supervision Council, providing in a simple enumerating way, cases in which joint liability will incur, mostly for supervision activities and failure to perform managing duties.[704]

Focus is given in the new amended law to avoiding conflicts of interests. Directors are considered to be precluded to decide on matters in which they hold a personal interest, and must disclose such interests to other administrators and the auditors.[705] As a matter of principle, shareholders can file derivative actions against directors or managers.[706] However, there have not been any significant reported cases of suits against directors for breach of fiduciary duties.

Czech Republic presents a rather similar pattern to the Romanian one, with literature and court cases on fiduciary duties being almost non-existent. The basic rules for outlining such concepts can be found in the Commercial Code,[707] which provides for a duty of *due managerial care* and a prohibition of disclosing confidential information, if the latter damages the company.

[703] Id.
[704] Id.
[705] *See* for an overview of the changes of the new Company Law, Glodeanu I. & Cocea R., *Romania: Company Law Now in Line with EU*, International Financial Law Rev., February 2006, electronic article available at http://www.iflr.com/Article/1977998/Company-Law-now-in-line-with-EU.html (last visited January 10 2010).
[706] Article 181 Company Law 441/2006.
[707] Commercial Code *[Obchodní zákoník]* Act. No. 63/2001 Coll., 1.01. 2001, art.(s) 194-200.

The *onus probandi* in cases when there is a dispute over whether a particular member of the board acted with such due managerial care (due diligence), is on the member so accused.[708]

Liability provisions in Czech Republic focus more on providing mechanical sets of rules, such as the one referring to liability for members of the board being jointly and severally liable for causing damage to the company by breaching legal duties while exercising their powers. Any agreement to limit such a type of liability is considered null and void.[709]

Furthermore, directors cannot discharge their liability by claiming that they followed a specific instruction of the General Meeting, if such an instruction was in contravention of statutory provisions.[710] Liability of board members in such cases is limited to the extent of providing compensation for damages caused. Yet, these few provisions on fiduciary duties, in the absence of comprehensive interpretative literature, do little to add any vibrancy to the discussion.

Regarding shareholders' rights to bring suits against board members, the Czech Commercial Code provides for this right depending on the level of share ownership, but there has been a constant lack of court cases involving a suit for breach of fiduciary duties.[711]

Lastly, concerning a definition as to the interest to be served by board members, the Czech Corporate Governance Code and the accompanying comments on recommendations, create an ambiguous view in this regards.[712] While realizing that the interest to be furthered by board members is the company`s best interest, at the same time, the commentary makes notice of

[708] Id. article 194(5).
[709] Id.
[710] Id.
[711] Shareholders holding shares with a total value of more than 3% of the registered shared capital which exceeds CZK 100,000,000 or shareholders having more than 5% of the registered shared capital of the company which amounts to CZK 100,000,000 or less, can file action for damages against the board members as per section 182 of the Commercial Code.
[712] *See* for an example of ambiguous interpretations, the commentaries on the Czech Corporate Governance Code referring to the need to further develop a shareholder value concept in Czech Republic. Czech Corporate Governance Code 2004, *available at*: http://www.ecgi.org/codes/documents/czech_code_2004_en.pdf (last visited on February 15th 2011), (hereinafter for this section Czech Corporate Governance Code), Commentary at 42.

the necessity to further shareholder value, a concept which in itself is yet underdeveloped in Czech Republic. The commentary of the Code hints to the fact that the 'company interest' might, at times, be difficult to define, and it ultimately leaves such interpretation to courts, which have not provided any guidance via published cases.[713] In the meantime the Code also recognizes the need for the protection of stakeholders, albeit very ambiguously as to whether such interest would be included in the definition of the company`s interest.[714]

The stance of the CEE chosen jurisdictions to fiduciary duties represents a static approach of providing for duties of the board via legal provisions, without a clear cut distinction between the features that would distinguish the duty of loyalty from the duty of care, and without much interpretation or case illustrations of these duties. One major focus in this regard has been to merely enlist in codes all the prohibitions regarding conflicts of interest, and provide formally for a requirement of due diligence and care.

2.5 Conclusions

The review of directors' fiduciary duties in the U.S. and the chosen EU jurisdictions, has lineated some of the similarities and major differences in the respective approaches, as well as the variance, in terms of the directions and levels of development of the discussion on fiduciary duties, within continental European jurisdictions as well.

U.S. is characterized by its sharper categorization of fiduciary duties into the duty of care and the duty of loyalty, while such a division, albeit encountered in the continental European jurisdictions, does not come with the same emphasis. Differences in the philosophy behind the

[713] Id. Commentary at 19, 26, 55.
[714] Id. Commentary at 19.

functions of the boards, as agents in the U.S. and as independent organs in Germany, also explain some of the differences in the treatment of fiduciary duties.

The review of the U.S. approach on directors` fiduciary duties, reveals that the debate is centered around topics such as, the standards of liability in cases of the duty of loyalty and care, the liability shields provided by the business judgment rule, (most recently) the debate on the boards` failure to monitor and conduct some form of risk-assessment, and Delaware`s failure to enhance the *duty* to monitor. The dominant feature of the U.S. approach seems to be the strong emphasis on the preservation of the business judgment rule, which in most cases has proven to be an effective safe harbor for the liability of directors. Even at the onset of the first credit crisis cases, Delaware courts have appeared to stand strong in validating their belief of not second-guessing business judgments, simply showing that the principle is deeply rooted in the system and it is there to stay.

On the other side, the discussion in Germany has also focused on the standards of liability for fiduciary duties, with the level of care required for directors being that of a diligent conscientious business man, an objective and strict standard. The culpability standard for breach of the duty of care is negligence, as opposed to gross negligence in the U.S. Germany also puts special emphasis on the skills and knowledge of directors, dependent on the activity of the company. Furthermore, changes in Germany have brought an opening of the (often rigid) German legal system towards the introduction of the business judgment rule, although its application is yet different in terms of the lower standard of deference paid to business judgments by German Courts.

Another related crucial divergence refers also to the recent German approach on denying the escape from liability under the business judgment rule, in cases of failure to conduct proper risk assessment and management. The conclusion that a board can not be said to act diligently if it takes decisions, in view of risks that if materialized, would lead to the collapse of the company, represents a much stronger approach than the U.S. one which has denied finding liability in cases of failure to predict the future.

Furthermore, the CEE view on fiduciary duties presented here is limited, given the fact that there is little available comprehensive literature in this regard. The main focus has been on providing for specific board member duties and the liability resulting from the breach of these duties, the content of which blurs the distinction between the fiduciary duties of care and loyalty. The tendency observed in these jurisdictions has been one of reforming laws and issuing standards, which provide for a quasi-mechanical listing of conflict of interest restrictions, some formal requirements of due diligence and care, and the introduction of yet unfamiliar concepts, such as in the case of the introduction of the business judgment rule in Romania, without proper complementary follow-up. Lastly, procedural difficulties and lack of a proper litigation culture have not favored bringing claims to courts in cases of breach of fiduciary duties.

CHAPTER III

REGULATION OF EXECUTIVE COMPENSATION

3.1 Introduction

Any discussion on corporate governance would be incomplete without an analysis of the problems pertaining to issues of executive compensation, especially in publicly held corporations. The reason behind the necessity of such a discussion stays in the fact that one of the major corporate governance topics, namely the agency problem and the regulation of the relationship between shareholders and managers, as well as between the latter and the corporation, will undoubtedly be reflected in and influenced by compensation.[715] It is also through compensation that companies establish how they incentivize their '*representatives*', how they create an alignment, or in worst case scenarios, a misalignment of their respective interests and how they further the responsiveness of managers to the company`s objectives.

Indeed, top executive pay has gathered attention like almost no other issue in the history of modern corporations,[716] whether this comes as a result of the natural human response to excessive pay amidst furious corporate scandals, or due to other considerations.

This chapter will focus exactly on the '*appropriateness*' of executive compensation, especially so on the pay of top executives in large publicly held companies, the reason being that

[715] *See* Bebchuk L. A. & Fried J., *Executive Compensation as an Agency Problem*, 17 Journal of Economic Perspective 3, [71, 92], September 2003, *available at*: http://www.law.harvard.edu/faculty/bebchuk/pdfs/2003.Bebchuk-Fried.Executive.Compensation.pdf, (last visited February 10th 2011).

[716] Murphy Kevin J., *Executive Compensation, in*: Ashenfelter O. & Card D. (eds.), Handbook of Labor Economics,1st ed., Vol. 3, [2485, 2563], 1999, at 2486.

the case of top executive pay, represents the maximal scenario in which excesses, as well as governance responses, appear to be more intense.[717]

The chapter will start by giving a historical view of the regulation of executive compensation in the U.S. and EU, since the history of the mechanisms used to tackle problems of executive compensation is quite telling of the approaches chosen to deal with the matter. The chapter will then analyze the regulation of executive compensation in the U.S., starting from a conceptualization of the bargaining positions between shareholders and managers,[718] the role and say of the former in the compensation of the latter, and whether there is sufficient managerial power in deciding executive compensation. It will then continue with a discussion on cases of excessiveness in compensation and the problems pertaining to its appropriateness and its alignment to the long-term interests of the company.

The other part of the chapter will then turn its focus on the chosen EU jurisdictions. In Germany, the analysis will evolve around the highly publicized ***Mannesmann*** case [719] which has touched upon many problematical aspects of the regulation of executive compensation and has exemplified the German scenario in this perspective. Certainly, the most recent legal reforms imposing restrictions on executive pay will also be dealt with. Lastly, this chapter will offer a view of the regulation (or lack thereof) of the issues pertaining to executive compensation in the chosen CEE jurisdictions.

[717] *See* for a discussion of two high profile cases involving executive compensation in the US and Germany, Gevurtz Franklin A., *Disney in a Comparative Light*, Selected Works Publication, February 2007, *available* at: http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=franklin_gevurtz&sei-redir=1#search="disney+in+a+comparative+light", (last visited February 10th 2011).

[718] The phrase bargaining positions in this context is used to refer to the power play in the process of setting executive compensation, especially in the US. *See* Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues*, 17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 10th 2011).

[719] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.

3.2 Historical Overview of Executive Compensation

The *modern* history of regulating executive compensation in the U.S. differs from the chosen EU jurisdictions, as a result of concrete reform paths chosen to curb cases of excessive compensation and the level of regulatory restrictiveness considered appropriate by both systems.[720] Given the fact that the history of executive compensation is still quite young and it illustrates some not-so-distant reforms, the elaborations in the following historical subsections, have to be seen as important in shaping the present initiatives of regulating executive compensation.

3.2.1 History of Regulating Executive Compensation in the U.S.: From Berle and Means to the Financial Crisis

Those who believe that the problem of executive compensation first came into the radar of corporate governance in the 1990s[721] might have had in mind the fact that it received more panic-caused attention during this time. While executive compensation underwent a radical paradigm shift during the early 1990s [722], discussions on the topic date back to the beginning of

[720] *See infra* sections 3.2.1 and 3.2.2.

[721] The idea that the 1990s was the period when executive compensation first entered the corporate governance debate might have been influenced by the vast number of international reports and statements of best practices related to executive compensation that emerged during this period. To mention a few, *see* for instance OECD Principles of Corporate Governance, 1999, (changed since then into the 2004 version) *available at*: http://www.oecd.org/dataoecd/32/18/31557724.pdf (last visited February 11th, 2011). *See also* The Study Group on Directors' Compensation, Directors' Compensation: Report of a Study Group Chaired by Sir Richard Greenbury, Gee, London, 1995, *available at*: http://www.ecgi.org/codes/documents/greenbury_less_recommendations.pdf (last visited February 11th, 2011).

[722] *See* Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Rev. 3, [138, 153] 1990. This is the seminal work to which many scholars attribute the starting point of the paradigm shift regarding the conceptualization of executive compensation. This paradigm shift refers to the idea that after Jensen and Murphy`s work on executive compensation, a new wave of academic work started to focus on this newly

the 20th century.[723] Even before World War I, some business leaders believed that providing only fixed salaries for executives, could never be comparable to the benefits stemming from ownership.[724] Many large corporations started to believe that in order to relate the executive`s performance with that of the company, they had to devise special bonus systems. So, in many corporations, amongst which *American Tobacco Co.* and *U.S. Steel Co.*, [725] provided bonus packages consisting of a base salary, plus a share of the corporation`s annual profits. These new packages can be considered as the beginning of a transition from the old business culture of attaching value to property and considering fixed salary work as inferior to ownership, to the new phase of separation of ownership and control in publicly held corporations.[726]

As often the case with tracing the first clear debates on corporate governance problems, more thorough discussions on executive compensation can be dated back to the topics generated

---

"re-defined" concept of executive compensation as a self-executing mechanism of aligning the interests of shareholders and managers rather than simply a corporate governance problem. Therefore executive compensation started to be regarded as a solution rather than a problem. For other works following this trend and focusing on how to optimize compensation contracts, *see* Yablon Charles M., *Bonus Questions – Executive Compensation in the Era of Pay for Performance*, 75 Notre Dame Law Rev., [271, 298], 1999; For some useful surveys on the structures of compensation packages, *see also* Guay, Core & Larcker, *Executive Equity Compensation and Incentives: A Survey*, 9 Economic Policy Rev. 27, 2003.

[723] Traces of concerns for excessive executive compensation can be found even earlier during the second half of the 19th century, such as in the case of the Robber Barons, Andrew Carnegie, John D. Rockefeller or J.P. Morgan, the compensation of some of which passed the 10 million per year threshold, which considering the time and the subsequent inflation effect were truly enormous. However, the entering of the executive compensation problem into the corporate governance legal discussions can be properly found in the 20th century. *See* Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 279-280.

[724] *See* the reference to Houston R.E. Jr., *The American Tobacco Company Case: A Study in Profit Sharing* II, (unpublished thesis, Yale Law School 1933) *in*: Wells Harwell, *"No Man Can be Worth $ 1,000,000 a Year": The Fight Over Executive Compensation in 1930s America,* 44 University of Richmond Law Rev., [689,769], 2010, *available at*: http://lawreview.richmond.edu/wp/wp-content/uploads/2010/01/Wells-442-JB.pdf (last visited on February 13th 2011), at note 43.

[725] *See* Wells Harwell, *"No Man Can be Worth $ 1,000,000 a Year": The Fight Over Executive Compensation in 1930s America*, 44 University of Richmond Law Rev. [689,769], 2010, *available at*: http://lawreview.richmond.edu/wp/wp-content/uploads/2010/01/Wells-442-JB.pdf (last visited on February 13th 2011), at 699-700.

[726] Id. at 701. Wells here argues that some of the reasons why these bonus plans became popular were the promise for alignment of the interests of shareholders and managers, as well as the attraction of talented executives in an environment where ownership was still highly valued and corporations ran the risk of executives wanting to start their own businesses.

from the seminal work of *Berle* and *Means*.[727] Due to the separation of ownership and control, managers vested with such control ran the risk of serving their own interests, as opposed to the interest of shareholders. Due to such control rights, they would also be prone to abusive behavior by effectively deciding on their own compensation in disregard of their performance.[728]

In the late 1920s some U.S. executives were reported to receive compensation from $ 1 million to $ 1.5 million per annum.[729] The initial attempt to address cases of particularly large compensation was to employ the concept of fiduciary duties.[730] In the case of ***Rogers v. Hill***,[731] the Supreme Court held that a compensation plan was to be considered excessive when it provided "*large, unexpected windfall profits to executives*."[732] The case involved the *American Tobacco Company*, where compensation of executives reached almost unprecedented levels, due to the increase in the market consumption of tobacco. This in turn meant that the bonus of executives in the form of 10% of earning increases over a certain benchmark amount, was also considerably higher.[733] The Supreme Court struggled to determine what standard to use in order to decide whether a compensation scheme was excessive or not.[734]

[727] Berle A. & Means G., *The Modern Corporation and Private Property, (rev.ed.)* Transaction Publishers, New Brunswick-London, 1968.
[728] Id. at 293 et. seq.
[729] Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 281.
[730] Id. at 280-287.
[731] Rogers v. Hill, 289 U.S. 582 (1933); text of the case *available at* http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=us&vol=289&invol=582, (last visited on February 11th 2011).
[732] Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 281.
[733] Id. at 281-282.
[734] Id. at 282.

Another early scandal was that of the CEO of National City Bank, Charles Mitchell, who had received $ 1.4 million in bonus.[735] The reputation of Mitchell didn`t add any credibility in his favor either, given that he was facing allegations of income tax evasion.[736] Mitchell and his notoriety were claimed to be the '*reason*' for legal reforms such as the Glass-Steagall Act, which separated commercial and investment banking.[737] Despite all the controversy surrounding Mitchell`s name, the outcome of the case regarding his compensation, was based on the fact that some incentive compensations had been wrongly computed, rather than on the excessiveness of his pay.[738]

The next group of cases in the U.S. history of regulating executive compensation only witnessed the refusal of courts to determine a benchmark for which compensation was to be deemed appropriate.[739] Instead, courts tried to distinguish simply between *wasteful* and excessive compensation without even giving a definition for the latter. In ***McQuillen v. National Cash Register Co***,[740] the court defined waste as "*a failure to relate the amount of compensation to the needs of the particular situation by any recognized business practices, honestly, even though unwisely, adopted, namely, [as] the result of bad faith, or of a total neglect of or indifference to*

---

[735] For an article on Mitchell`s career and scandals, *see* Huertas T. F. & Silverman J. L., *Charles E. Mitchell*: *Scapegoat of the Crash*?, 60 The Business History Rev.1, [81-103], 1986. Called by various nicknames such as "Sunshine Charlie" and "Scapegoat of the Crash", Mitchell symbolized the ill-founded financial practices of the 1920s and allegedly led to the financial reforms of the New Deal. Id. at 81-82.

[736] Mitchell was acquitted for this in the case of Helverling v. Mitchell, 303 U.S. 391, 396 (1938). The first discovery of his tax evasion activities came out during the Pecora hearings, named after the Senate Banking Committee counsel Ferdinand Pecora. *See* for these hearings, Seligman Joel, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance, Aspen Publishing, New York, 3rd ed., 2003.

[737] Banking Act of 1933, Pub. L. 73-66, 48 Stat.162, June 16 1933.This act was also known as the Glass-Steagall Act, after the names of its legislative sponsors, Carter Glass and Henry B. Steagall. It established the Federal Deposit Insurance Corporation (hereinafter FDIC) and separated investment banking from commercial banking.

[738] Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 113 (N.Y. Sup. Ct.1934).

[739] *See* Heller v. Boylan, 29 N.Y.S.2d 653, 680 (N.Y. Sup. Ct. 1941); *See also*, McQuillen v. National Cash Register Co., 112 F.2d 877 (4th Cir. 1940).Basically, the court in both these cases turn its analyses into the distinction between wasteful and excessive compensation, providing that the first was unlawful, while the latter not.

[740] McQuillen v. National Cash Register Co., 112 F.2d 877 (4th Cir. 1940), at 653.

such practices."[741] This basically meant that, if a corporation was being run honestly and fairly by the directors and it was done in accordance with the formal requirements of law, then the decision of directors as to the appropriate amount of compensation, would not be questioned.

The regulatory reaction to these and other cases was to increase the level of mandatory disclosure for public offerings.[742] Domestic companies were required to disclose the compensation of directors and officers for the previous and forthcoming year following the offering, in cases when such compensation was more than $ 25,000.[743] Any other bonuses or profit-sharing arrangements had to be disclosed as well.[744] The Securities Exchange Act of 1934,[745] which also created the SEC, lowered the level of required disclosure for compensation exceeding $ 20,000 per year.[746] More direct disclosure requirements followed in 1938, when the SEC obliged the annual shareholder proxies to disclose compensation received by the three top earners in a corporation.[747] Nevertheless, despite all the above regulatory reforms and the imposition of more stringent disclosure requirements, the levels of executive compensation for top executives saw a rise from 1936 to 1940, to peaks that would remain almost unprecedented until the 1970s.[748]

Between the 1940s till the 1970s, the executive pay regime featured a slower growth rate with certain declines at times. The reasons for such a different pattern were not necessarily related to changes within corporate governance, but rather to more general alterations related to

[741] Id. at 653 *[emph.add.]*
[742] *See* Securities Act of 1933, Pub. L. No. 22, 48 Stat. 74, 15 U.S.C. §§ 77a– 77aa (2006).
[743] Id. § 77aa, schedule A § 14.
[744] Id. § 77aa, schedule A § 24.
[745] See Securities Exchange Act of 1934, Pub. L. No. 291, 48 Stat. 881, 15 U.S.C. §§ 78a–78nn (2006).
[746] Id. § 12(b)(1)(D)–(F) j(current version at 15 U.S.C. § 78l (2006)).
[747] SEC Release No. 34-1823, 1938 WL 33169, August 13 1938. This Release promulgated the so-called Regulation X-14 which covered proxy solicitations and required additionally detailed disclosure if, shareholder ratification was sought for any compensation plan in the proxy statement.
[748] *See* Frydman C. & Saks R., *Executive Compensation: A New View from a Long-Run Perspective, 1936-2005*, 23 Rev. of Financial Studies 5, [2099, 2138], 2010, *available at*: http://web.mit.edu/frydman/www/trends_rfs2010.pdf, (last visited on February 11th 2011).

the income structure of the nation as a whole.[749] Tax policies depending on the approaches favored during different presidential mandates, also touched upon executive compensation in the U.S.,[750] but little did they achieve in curbing excessive compensation.[751] Even for cases of overly stringent income tax regimes, executives found a way to get enriched by exploiting existing loopholes.[752]

The next historical phase of executive compensation belongs to the period between 1970 and early 1990s and is characterized by a wave of stringent disclosure and performance related

---

[749] *See* for other presumably nation-wide reasons influencing the level of executive pay during this period, such as the narrowing of income inequality or potential changes in social norms related to salaries, Levy Frank & Temin Peter, *Inequality and Institutions in 20th Century America*, MIT Department of Economics Working Paper 07-17, 2007, *available at*: http://web.mit.edu/ipc/publications/pdf/07-002.pdf, (last visited on February 12th 2011); *See also*, Piketty Thomas & Saez Emmanuel, *The Evolution of Top Income: A Historical and International Perspective*, 96 American Economic Rev. 2, [200-205], 2006, *available at*: http://elsa.berkeley.edu/~saez/piketty-saezAEAPP06.pdf, (last visited on February 12th 2011). From the tax increases of Roosevelt`s administration, to reductions during Kennedy's short term, to Reagan`s strong belief in lower taxes, to mention a few, executive compensation did not suffer considerably. The reason for this was that even in cases of tax increases up to wealth-suffocating levels, they could still be avoided by executives via various schemes, such as foundations, tax shelters, etc. *See* Lublin Joann S. & Thurm Scott, *Money Rules: Behind Soaring Executive Pay, Decades of Failed Restraints*, The Wall Street Journal Online, October 12th 2006, electronic article *available at*: http://www.fsb.muohio.edu/evenwe/courses/eco361/Private/readings/executive%20pay.pdf, (last visited on February 13th 2011), at 3 (referring to Roosevelt`s direct address at a State of the Union in 1936 against the "entrenched greed" of American corporations); *See also* Saez Emmanuel, Reported Incomes and Marginal Tax Rates, 1960-2000: Evidence and Policy Implications, in: Poterba James, Tax Policy and the Economy 18, [117-173], MIT Press, Cambridge, USA, 2004; Reagan`s special approach to lowering taxes soon started to be called by the term *Reaganomics,* referring to Reagan`s supply-side economics, with reductions of government spending, income tax and capital gain tax, reduction of government regulation and control of the money supply in order to reduce inflation. *See* Bartlett Bruce R., Reaganomics: Supply Side Economics in Action, Arlington House Publishers, New York, 1981.

[750] *See* Markham Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 287-291.

[751] Id. For an analysis of the effects of tax policies on executive pay, *see* Frydman C. & Molloy R. S., *Does Tax Policy Affect Executive Compensation? Evidence from Postwar Tax Reforms*, NBER Working Paper No. 16812, February 2011, *available at*: http://www.nber.org/papers/w16812.pdf?new_window=1, (last visited on February 13th 2011). During George W.H. Bush and Clinton`s presidencies, taxes were raised with little effect on executives. See Markham Jerry W. at supra note 750 at 290; George W. Bush took a different approach of reducing taxes for the wealthy and for others with the main argument that wealthy executives were being "punished' enough under the tax code already as it was, and that even if taxes were raised, as past experience had shown, they could be avoided or evaded via numerous means. *See* The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, 115 Stat. 38, June 7, 2001; *See also,* The Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. 108-27, 117 Stat. 752, May 23 2003.

[752] *Supra* note 750; *See also* Garfinkle Eugene, *Stock Option Plans for Executives*, 41 California Law Rev. 3, [535,545], 1953.

requirements.[753] For instance, the 1978 SEC amendments required disclosure of all forms of compensation, be it direct or indirect, including options.[754] Other requirements introduced were related to justifying compensation through performance standards. Some economists have labeled the executive pay reforms of this period as *"perhaps the best known changes in policy regarding executive pay."*[755] This was however an overstatement, considering that although disclosure regulations might have increased the transparency and consequently the information available with regards to executive compensation by encouraging disclosure, executive compensation packages were not necessarily reduced, neither were they better related to performance, especially when the criteria for linking pay to performance was yet underdeveloped. True, disclosure gives informational advantages and is the first step towards ensuring better corporate governance, but it is simply incomplete without the other step of properly defining a benchmark of appropriate compensation. Furthermore, having in mind that disclosure at the time effectively meant being in compliance with the law, there was simply no legal issue remaining as to the appropriateness of executive compensation.[756]

[753] Some authors consider the modern phase of executive compensation, starting from the late 1970s or early 1980s and continuing till the present. *See for instance* Murphy Kevin J., *Executive Compensation, in*: Ashenfelter O. & Card D. (eds.), Handbook of Labor Economics,1st ed., Vol. 3, [2485, 2563], 1999, at 2485 – 2486.
However, given that two crucial moments in the beginning of this century, namely the collapse of Enron and the recent financial crisis, influenced considerably the corporate governance reforms that continue to date, the period from the beginning of this century till the present will be considered separately.
[754] *See* SEC Release No. 33-6003, Uniform and Integrated Reporting Requirements: Management Compensation, [43 FR 58151], December 4 1978, (hereinafter referred to as the "1978 Release"); The form of disclosure was also changed later in 1992 into tabular disclosure. *See* SEC Release No. 33-6962, Executive Compensation Disclosure, [57 FR 48126], October 16 1992, (hereinafter referred to as the "1992 Release"); For a comprehensive analyses of all the relevant changes in disclosure requirements made by SEC, *see* SEC Release No. 33-8655, Executive Compensation and Related Party Disclosure, [71 FR 6542], January 27 2006, *available at:* http://www.sec.gov/rules/final/2006/33-8732a.pdf, (last visited on February 12th 2011).
[755] *See* Dew-Becker Ian, *How Much Sunlight Does it Take to Disinfect a Boardroom? A Short History of Executive Compensation Regulation*, CESifo Working Paper 2379, August 2008, *available at:* http://www.ifo.de/portal/page/portal/DocBase_Content/WP/WP-CESifo_Working_Papers/wp-cesifo-2008/wp-cesifo-2008-08/cesifo1_wp2379.pdf, (last visited on February 12th 2011), at 1.
[756] Markham Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 287-291. Other reforms introduced in this period dealt with golden parachutes which are payout mechanisms given usually in cases of takeovers to company executives, in order to remedy the concern that these

In 1990, the executive compensation debate in the U.S. changed considerably due to the work of *Jensen* and *Murphy*, who contributed to a fundamental paradigm shift in the conceptualization of executive compensation.[757] Their theory was that executive compensation was not simply a corporate governance problem, but rather a matter of misalignment between the interests of the managers and those of the shareholders. So, executive compensation in the form of *pay for performance* could become a self-executing mechanism aligning the interests of managers and shareholders.[758]

After *Jensen* and *Murphy*`s work, there was an increase in the popularity of options, given their potential for incentivizing managers and their *then* advantage of not being treated as an expense in the books of the company.[759] Soon enough, compensation schemes were devised to cap salaries at $ 1 million and make option grants as the main means of executive pay. The popularity and the quick spread of options did not however remedy the excessiveness of executive compensation. Statistics showed that CEO compensation increased by 2500 percent

---

executives would be too worried about their future prospects, much so as to neglect their managerial duties during such critical circumstances. In 1984 such parachutes were forbidden when they amounted to more than three times the average annual compensation of that particular executive. Nevertheless, golden parachutes restrictions did not stop executives to continue making huge profits from holdings in mergers they negotiated and executed only after adopting defensive measures against other not as profitable negotiators. *See* Cochran P. L., Wood R.A., & Jones T.B., *The Composition of Boards of Directors and Incidence of Golden Parachutes*, 28 Academy of Management Journal 3, [664, 671], 1985.

[757] See Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Rev. 3, [138, 153] 1990.

[758] The basic differentiation is not that executive compensation seized to exist as a corporate governance issue or topic, but instead of a problem it was re-conceptualized as a solution; *See also*, Yablon Charles M., *Bonus Questions – Executive Compensation in the Era of Pay for Performance*, 75 Notre Dame Law Rev., [271, 298] 1999.

[759] Publicly traded corporations in the US are required by law to follow the Generally Accepted Accounting Principles (GAAP). These principles are issued by the Financial Accounting Standards Board (FASB), which in turn is over*see*n by the SEC. Until 2005, GAAP allowed corporations to show a zero expense for a major part of stock options. However, in 2004, FASB issued a new accounting rule, namely Financial Accounting Standard 123R, which required companies to show an expense on their books for the fair value of the stock options on the date when they are granted. *See* FASB Statement of Financial Accounting Standards 123 (Revised 2004), *Share-Based Payment*, December 2004, *available electronically at*: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820928111&blobheader=application%2Fpdf, (last visited February 12th 2011).

during the 1990s.[760] Additionally, several option scandals followed, such as in the cases of *Enron Corp*., *WorldCom Inc*., *AOL Time Warner Inc*., to name a few.[761] Manipulation of accounts and the creation of inflated revenues became the backbones of corporate culture at the time.[762]

Two other historical moments in the U.S. corporate governance modern history are worth mentioning. First, the collapse of *Enron*,[763] coming just a year later after the internet bubble burst[764] and bringing an aftermath of regulatory craziness, and second, the recent financial crisis from 2007 onwards.[765] For the purpose of this section, given that these two developments have shaped some regulatory responses that continue even to date, only a brief overview of the major legislative consequences that succeeded them will be addressed here and the rest will be dealt with in detail in the main part of this chapter.

The collapse of ***Enron*** in 2001, led to the idea that America was facing a considerable system change when it came to corporate governance regulations,[766] although quite surprisingly, the issue of executive compensation was not extensively tackled by the Sarbanes-Oxley Act of 2002 (hereinafter SOX).[767] Indeed, only two provisions dealt directly with executive

---

760 Markham Jerry W., A Financial History of Modern U.S. Corporate Scandals From Enron to Reform, M.E. Sharpe, Portland, Oregon, 2006, at 30.
761 Id. at 311-376.
762 Some of these scandals will be further elaborated in the main part of this chapter. See infra section 3.3 and related discussion.
763 *See* In re Enron Corporation Securities, Derivative & ERISA Litigation, 235 F. Supp.2d. 549, US Dist., 2002; ERISA refers to the Employee Retirement Income Security Act of 1974, Pub.L. 93-406, 88 Stat. 829, enacted September 2, 1974.(hereinafter referred to as ERISA); For an analyses of Enron and other global corporate scandals, *see* Hill Jennifer G., *Regulatory Responses to Global Corporate Scandals,* Sydney Law School Research Paper No. 06/35, 2006, *available at* SSRN: http://ssrn.com/abstract=886104 (last visited on February 12th 2011); *See also* Gordon Jeffrey N., *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections,* 69 University of Chicago Law Rev., [1233, 1241], 2002.
764 *See* Mills Daniel Quinn, *Buy, Lie and Sell High: How Investors Lost Out on Enron and the Internet Bubble,* Pearson Education Inc. publishing as Financial Times Prentice Hall, New Jersey, 2002.
765 *See* Thomsen S., Rose C. & Risager O., (eds.), *Understanding the Financial Crisis: Investment, Risk and Governance,* 1st ed. Palgrave Macmillan, Hampshire, UK, 2010.
766 *See* Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era,* Vanderbilt Law and Economics Research Paper No. 06-15; 2006, *available at* SSRN: http://ssrn.com/abstract=922299 , (last visited February 12th 2011), at 11-12.
767 Id.; An Act To Protect Investors by Improving the Accuracy and Reliability of Corporate Disclosures Made Pursuant to the Securities Laws, and for Other Purposes, of 2002, Pub. L. 107-204, 116 Stat 745, July 30 2002,

compensation, one regarding the return of bonuses and compensations when a company had to restate its earnings due to material non-compliance with financial reporting standards, as a result of the misconduct of the Chief Executive Officer (hereinafter CEO), or the Chief Financial Officer (hereinafter CFO), and the other, regarding the prohibition of personal loans to executives.[768] Another SOX provision provided a freeze mechanism for extraordinary compensations to executives in companies accused of account manipulations.[769] The interpretation and enforcement of these provisions, has been one of the most inconsistent, ambiguous processes in the modern history of regulating executive compensation in the U.S.[770]

In the period between Enron and the financial crisis of 2007, new proposals to tackle the problem of executive pay arose, especially campaigns by institutional investors to adopt "*Say-on-Pay*"[771] advisory shareholder votes, but these, as often the case with executive compensation curbing measures, did not enjoy much popularity till the financial crisis.[772] Another moment before the financial crisis that would have had the potential of causing a wide reform on executive compensation, but which did not, was the options backdating scandal wave of 2006.[773]

(Sarbanes-Oxley Act, hereinafter SOX). Here however, note that only few little changes were brought by SOX with regards to executive compensation, namely through sections 304, 402 and 1103. S*ee* infra section 3.3.1.

[768] Sec. 304, 402 of SOX.

[769] Sec. 1103 of SOX.

[770] Although one prominent scholar went as far as to suggest that indeed, executive compensation was a possible cause of the Enron scandal, regulatory responses to the executive compensation problem were not as strong as one would have expected if this was the case. *See* Coffee John C., *What Caused Enron? : A Capsule Social and Economic History of the 1990's*, Columbia Law and Economics Working Paper No. 214, 2003, *available at* SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=373581 (last visited February 12th 2011); Other important aspects of corporate governance, such as for instance, the structure of boards and the proper role of auditors attracted more attention in the SOX provisions. See Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era*. Vanderbilt Law and Economics Research Paper No. 06-15; 2006, *available at* SSRN: http://ssrn.com/abstract=922299 , (last visited February 12th 2011), at 11-12.

[771] *See* for facts and statistics on the increase of the popularity regarding Say on Pay proposals, AFSCME Office of Corporate Governance and Investment Policy, *Say on Pay Facts and Background*, No. 0325, 2010, online article *available at*: http://www.shareholderforum.com/sop/Library/20100325_AFSCME.pdf, (last visited February 12th 2011).

[772] Id. It can be *see*n that the financial crisis years witnessed a higher request for a say on pay of the executives by shareholders . Id. at 1 et.seq.

[773] Walker David I., *Some Observations on the Stock Option Backdating Scandal of 2006*, Boston University School of Law Working Paper No. 06-31, 2006. Option backdating refers basically to the case when the option grant

The financial crisis of 2007 brought as its aftermath a wave of aggressive regulatory interventions intended to force the hand of the federal government within the affairs of corporate America. This reawakening was understandable, given the enormous public reaction towards highly paid executives, blamed at times for being the short-termed '*visionaries*' who pocketed returns, while companies were in a rapid downturn slide. The changes brought during this time refer to the passing of the Emergency Economic Stabilization Act of 2008[774] (hereinafter EESA), which later on capped the salaries of executives of the companies receiving aid at $ 500,000[775]; the enactment of the American Recovery and Reinvestment Act of 2009 (hereinafter ARRA)[776], and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[777]These bills introduced the necessity to prohibit the use of options in any additional compensation, except for restricted stock, and promote long-term incentives for the companies. They also provide enhanced disclosure requirements, and lastly, a non-binding shareholder say-on-pay on executive compensation, which was confirmed very recently as of January 2011.[778]

---

date is retroactively put to an earlier time so that the price of the stock is lower compared to the actual date when it is granted. This therefore would allow a corporate insider to purchase stock at a better price. Id. at 5; Companies involved in these scandals were usually hi-tech companies, such as Comverse Technologies, Brocade Communications Systems, Microsoft, etc. Although public anger at executives had been worthy of frontal page capture by journals, it did not result in a wide reform of compensation arrangements. Id. at 8-9.

[774] Emergency Economic Stabilization Act of 2008, 1424, Pub. L. 110-343, 122 Stat. 3765 October 3 2008, *available at:* http://www.govtrack.us/congress/billtext.xpd?bill=h110-1424 (last visited on February 12th 2011), (hereinafter EESA).

[775] The executive cap was done by EESA through the Treasury Guidelines, *see* US Department of the Treasury Press Release, Treasury Announces New Restrictions On Executive Compensation, 4th of February 2009, *available online at* http://www.whitehouse.gov/the_press_office/TreasuryAnnouncesNewRestrictionsOnExecutiveCompensation/ , (last visited on February 12th 2011).

[776] American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115, February 17 2009, *available at:* http://www.govtrack.us/congress/billtext.xpd?bill=h111-1 (last visited on February 12th 2011), (hereinafter ARRA).

[777] A Bill to Promote the Financial Stability of the United States by Improving Accountability and Transparency in the Financial System, To End "Too Big to Fail", To Protect the American Taxpayer by Ending Bailouts, to Protect Consumers from Abusive Financial Services Practices, and for Other Purposes of 2010, Pub. L. 111-203, 124 Stat. 1376, July 21 2010, *available electronically at*: http://www.govtrack.us/congress/bill.xpd?bill=h111-4173, (last visited on March 12th 2011). The short title of the Act is Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, (hereinafter referred to as the Dodd-Frank Act of 2010).

[778] Section 951 of Dodd-Frank Act of 2010, amending Section 14A of the Securities Exchange Act of 1934. The SEC approved the rules on a shareholder say-on-pay in January 2011 with effective date 4th of April 2011. SEC Release Nos. 33-9178; 34-63768 Shareholder Approval of Executive Compensation and Golden Parachute

Considering that these reforms are quite recent and they constitute the *present* legal approach to executive compensation, the specific changes brought by them and the challenges yet ahead, will be dealt in detail in the main part of this chapter.

At this point, suffice it to say that the history of regulating executive compensation in the U.S. has undergone an up-and-down trajectory from the beginning of the 20th century, till the present. The most important points in this trajectory have been the increase by the SEC of rules on disclosure of executive compensation, the redefinition in conceptualizing executive compensation in the 1990s, the increase in the popularity of stock options as means of compensation, the *Enron* collapse, and the financial crisis of 2007 onwards. Its history has been colored by scandals, failed attempts at curbing its excessiveness and a final '*promising*', (at least on a first impressions base), attitude towards strengthening shareholders` voice on executive pay.

3.2.2 History of Regulating Executive Compensation in the chosen EU jurisdictions

The history of executive compensation in continental Europe is shorter and different from the vivid history seen in the U.S.[779] There are several reasons for this.

First, the Anglo-American model of corporate governance differs from the traditional continental European model. Ownership concentration, participation of banks, board models and the stakeholder culture, all of these important elements differ one system from the other.[780] It has

Compensation, [FR vol./ issue info om.]January 21 2011, *available at*: http://www.sec.gov/rules/final/2011/33-9178.pdf, (last visited March 12th 2011).

[779] For some studies that touch upon executive compensation in continental European countries, *see* Conyon M., Fernandes N., Fereira M. Matos P. & Murphy K., *The Executive Compensation Controversy: A Transatlantic Analyses*, Paper presented at the Annual Fondazione Rodolfo De Benedetti (Foundation Rodolfo de Benedetti, May 2009, *available at*: http://www.frdb.org/upload/file/Cagliari%202010/First_report.pdf (last visited February 13th 2011) at 54 et. seq.; *See also* Haid, Alfred & Yurtoglu, B.
Burcin, *Ownership Structure and Executive Compensation in Germany*, 2006, electronic article *available at* SSRN: http://ssrn.com/abstract=948926 (last visited February 13th 2011).

[780] For the differences between Germany and the US and UK models, *see* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001. For

been stated above that if the agency conflict between shareholders and management has been the basis for executive compensation problems in publicly held corporations with dispersed ownership, such a conflict is different in the continental European system.[781] It is rather one between the majority and minority shareholders, due to the higher levels of concentration of ownership. The board models of publicly held corporations in the two systems also differ. For instance the two-tier typical German model[782] differs from the one-tier Anglo-American model,[783] and this bears its consequences in determining who decides on executive pay and what are the dynamics of the bargaining positions during this process. Other differences have to do with the participation of banks in the Supervisory Boards via their block-holdings, as in the obvious case of Germany[784] and the strong corporate culture of stakeholder protection, expressed again in the typical German co-determination system.[785]

This is not to say that concerns about excessive compensation have been missing, or have not captured the attention of scholars and legislators. It is more so to say that the nature of the debate and the issues that have garnered more focus, have been of a different system-specific

---

a comparison between US and EU *see* Conyon M., Fernandes N., Fereira M. Matos P. & Muprhy K., *The Executive Compensation Controversy: A Transatlantic Analyses,* Paper presented at the Annual Fondazione Rodolfo De Benedetti (Foundation Rodolfo de Benedetti, Conference May 2009, *available at*: http://www.frdb.org/upload/file/Cagliari%202010/First_report.pdf (last visited February 13th 2011) at 54 et. seq.

[781] *See* for the case of Germany, Franks J. & Mayer C. *Ownership and Control of German Corporations,* 14 Rev. of Financial Studies 4, [943, 977], 2001; For CEE countries *see* Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe,* in: Cornelius, P.K., Kogut, B. (eds.), *Corporate Governance and Capital Flows in a Global Economy*, (267, 304), Oxford University Press, UK, 2003.

[782] *See* Hopt K. J. & Leyeans P. C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy,* ECGI - Law Working Paper No. 18/2004, *available at* SSRN: http://ssrn.com/abstract=487944 or doi:10.2139/ssrn.487944, (last visited February 13th 2011).

[783] For a discussion on the one-tier US and UK board models, *see* chapter 6 and 7 in a comprehensive study by Maassen Gregory F, An international Comparison of Corporate Governance Models. A Study on the Formal Independence and Convergence of One-tier and Two-tier Corporate Boards of Directors in the United States of America, the United Kingdom and the Netherlands, (2nd ed.), Spencer Stuart Publications, The Netherlands, 2001, at 91-143.

[784] *See* Franks J. & Mayer C,, *Ownership and Control of German Corporations,* 14 Rev. of Financial Studies 4, [943, 977], 2001

[785] Co-Determination Act (*Gesetz uber die Mitbestimmung der Arbeitnehmer*] of 4 May 1976, published in Federal Law Gazette BGB1 I 1153, MitbestG. For the English translation, *see* Peltzer M. & Hickinbotham, A.G. *German Stock Corporation Act and Co-Determination Act,* Otto Schmidt, Köln, 1999.

character. Similarly to the U.S. though, when it comes to the excessiveness of executive pay, especially so recently, erupting scandals have reallocated attention on executive compensation.[786] Even here however, there is a difference with the U.S., since *excessiveness* seen from a European point of view is also unique and differs considerably as compared to the American version. For instance, CEO pay levels in some European countries such as Germany, Italy and France, have been considered excessive, even though considerably lower than American CEO pays.[787]

There is also another difference when dealing with the history of executive compensation in Europe and namely that, with the exception of the UK,[788] scholarly work on the *legal history* of executive compensation is scarce. There is some economic literature on comparing the levels of CEO pay and compensation components trends during certain historical phases,[789] as well as some scattered evidence on European scandals,[790] but as of now, there is no comprehensive legal history work on executive compensation in Europe. That is why this subsection will focus more

---

[786] For an overview of some European scandals, such as Vivendi Parmalat and Messier, *see* Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era*. Vanderbilt Law and Economics Research Paper No. 06-15; 2006, *available at* SSRN: http://ssrn.com/abstract=922299 , (last visited February 12th 2011), at 4-7.
[787] For a comparison between Germany, the UK and US, *see* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 506-509. During the 1980s scandals erupted in the UK involving some top executives especially those of utility industries, who were overcompensated through large gains from share options, large leaving pays, as well as pay increases; *See* Minhat Mariza, *Three Essays on CEO Compensation in the UK*, University of Stirling Online Publication, Accounting and Finance Divisions, June 2009, *available at*: https://dspace.stir.ac.uk/bitstream/1893/2300/1/Minhat-Three-Essays-on-CEO-Compensation-in-the-UK.pdf, (last visited February 15th 2011), at 2-3; For Italy and other continental European countries, *see* Croci E., Gonenc, H.& Ozkan, N., *CEO Compensation, Family Control and Institutional Investors in Continental Europe*, Paper presented at Paris December 2010 Finance Meeting EUROFIDAI – AFFI, 21 December 2010, a*vailable at* SSRN: http://ssrn.com/abstract=1695317 (last visited February 14th 2011), at 50 et. seq.
[788] The UK scenario resembling more to the US approach on executive pay has attracted earlier attention regarding issues of executive compensation. *See* Merret Anthony John, Executive Compensation in the UK, Longmans, London, 1968.
[789] *See* Haid A. & Yurtoglu B. B., *Ownership Structure and Executive Compensation in Germany*, 2006, electronic article *available at* SSRN: http://ssrn.com/abstract=948926 (last visited February 13th 2011). For Italy, *see* Volpin, Paolo F., *Governance with Poor Investor Protection: Evidence from Top Executive Turnover in Italy*, 64 Journal of Financial Economics, [61, 90], 2002, *available at*: http://faculty.london.edu/pvolpin/turnover.PDF (last visited February 13th 2011).
[790] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011).

on the post 1990s, but when available and relevant, it will also provide information for earlier periods.

3.2.2.1 History of Regulating Executive Compensation in Germany

In Germany, the economic studies on executive compensation have found that the average executive pay has faced an increase from the late 1980s till 2003.[791] Nevertheless, an important feature of executive compensation in Germany, despite the above growth, has traditionally been the negative influence of ownership concentration and bank block-holdings.[792] Looking at the correlation between ownership concentration and the level of pay for the highest ranked managers and for and Supervisory Board members during the early 1970s till mid 1980s, it has become evident that a negative relation exists between the two: the higher the level of ownership concentration, the lower the level of executive pay.[793] Another factor that influences executive pay is also the role of banks as monitors via their seats in Supervisory Boards. With regards to the latter, studies have shown that bank seats in Supervisory Boards often surpassed the number that their direct holdings would imply.[794] Although considered as monitoring actors, banks have usually been in a debtor position as well, having little incentive to respond to the interests of other shareholders. Furthermore, the size of a company in Germany has influenced the levels of executive pay, at times, more than firm performance.[795]

[791] Haid A. &Yurtoglu,B.B., *Ownership Structure and Executive Compensation in Germany*, 2006, electronic article *available at* SSRN: http://ssrn.com/abstract=948926 (last visited February 13th 2011), at 2.
[792] Id. at 4-6.
[793] Id.
[794] *See* Edwards J. & Fischer K.-H., The German Financial System, Cambridge University Press, Cambridge, 1994.
[795] For instance, increases in the size of the company have been associated with higher levels of executive pay, when voting rights deviated from cash flow rights. Supra note 791 at 3.

The above characteristics of the German system, some of which are shared by other continental European countries have influenced the features of the reform paths chosen.[796] The trends of executive pay in the U.S. and UK, (UK taken as a more market-based model of corporate governance amongst the European jurisdictions), over the past few decades have not been as persistent in the case of Germany, impacting in this way the pattern of executive compensation significantly.[797] These trends consist mainly of the rapid increase of executive compensation levels in the U.S. and UK during the 1990s,[798] and the trend of providing for mechanisms that linked pay with performance.[799]

With regards to the first, Germany has not witnessed such drastic changes in its levels of executive pay. While in the mid-1980s the level of executive pay was comparable to those in the U.S. and UK, this was not the case after the 1990s.[800] Executives are considerably better-paid in the U.S. than in other countries, including Germany. The disparity between levels of executive pay in the U.S. and Germany became evident in the case of the acquisition of *Chrysler* by

---

[796] For the German embrace and at times resistance of "Americanized" reforms regarding executive compensation, *see* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3, [497, 539], 2001.

[797] Id. at 507-509.

[798] UK has been closer to the American model of executive pay, with higher levels of compensation and an intensification of pay for performance packages especially after the Greenbury report in 1995. See Conyon M. & Schwalbach J., *Executive Compensation: Evidence from the U.K. and Germany*, 33 International Journal of Strategic Management 4, [504-526], 2000, at 506; *See also* The Study Group on Directors' Compensation, Directors' Compensation: Report of a Study Group Chaired by Sir Richard Greenbury, Gee, London, 1995, *available at*: http://www.ecgi.org/codes/documents/greenbury.pdf, (last visited February 15th 2011). In the UK, while inflation for the last three decades and a half for instance was reported to have risen by 125%, the average executive pay has risen more than three times the inflation rise, namely by 422% over 25 years. *See* Institute of Directors and Croner Reward, Directors Rewards 2005/2006 (25th Anniversary Ed.), November, 2005, at 3.

[799] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 509.

[800] *See* for European countries, including Germany Lane Christel, Management and Labor in Europe. The Industrial Enterprise in Germany, Britain, and France, Edward Elgar Publishing, London, 1990; For US , *see* Abowd John M. & Kaplan David S., *Executive Compensation: Six Questions That Need Answering,* 13 Journal of Economic Perspectives 4, [145, 168], 1999.

*Daimler Benz AG***,** where *"Chrysler's No. 2 executive made more in 1997 from salary, bonus and share options than the top 10 Daimler-Benz executives combined.*"[801]

The other American trend of providing for mechanisms that link pay with performance and vary accordingly, has also met with some resistance in Germany.[802] Traditionally, Germany has not been a partisan of a constantly changing pay system and restrictive regulations that were in place for a long time did not help in introducing such forms.[803] Bonds and warrant bonds were still common, but issuing new shares to meet requirements under stock option plans were forbidden for German AGs until the passing of the KonTraG Law in 1998,[804] which liberalized this approach. Furthermore, the performance of a company, as mentioned before, did not matter as much in influencing the level of executive pay, as did the size of the company.[805]

Other legal cultural factors have influenced the features of executive pay in Germany. For instance, the strong stakeholder protection approach in German corporate culture has created a comfortable environment for protected constituencies to raise objections in cases of '*over-empowerment'* of managers.[806] Employees and shareholders alike would fear respectively that executives were paid too much compared to employees,[807] or that equity holdings of shareholders would be diluted, if considerable share portions were to be given to executives.[808] Lastly, another cultural factor that might have deterred the earlier introduction of pay for

---

[801] Supra note 799 at 509.
[802] Id. at 509.
[803] Prior to 1998, German AG-s relied on convertible or warrant bonds if they wanted to create share option schemes for executives. *See* AktG, § 221; *See* for an analyses of the change introduced in 1998, Kalisch Ingrid, *Stock Options: Will the Upcoming Amendment of the German Stock Corporation Act Facilitate Their Introduction by German Stock Corporations?,* 9 Int'l. Comp. & Comm. Law Rev., [111, 125], 1998, at 112-114.
[804] Corporate Control and Transparency Act [*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich]* of 27 April 1998 published in Federal Law Gazette BGBI I, S. 786. (hereinafter KonTrag).
[805] Haid A. & Yurtoglu B. B., *Ownership Structure and Executive Compensation in Germany*, 2006, electronic article *available at* SSRN: http://ssrn.com/abstract=948926 (last visited February 13th 2011), at 2-3.
[806] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 513-515.
[807] Id. at 514.
[808] Id. at 513-515.

performance mechanisms is the fact that Germany, like several other countries in continental Europe, tends to emphasize the preservation of equality when it comes to unfair distribution of wealth.[809] In other words, this means that in continental Europe, there has been a constant fear to incentivize executives, so as respond more to the interests of shareholders than those of other protected stakeholders, a factor which, until recently, has been a deterrent of pay for performance reforms.[810]

Another difference in the historical evolution of executive compensation between Germany and the U.S. has also been the tax system.[811] Germany has traditionally had a quite progressive tax rate, meaning that increases in levels of executive pay would translate into substantially higher marginal tax rates.[812] However, the income tax reforms in 2000 introduced income tax deductions from around 51% to 42%, and created in this way more room for increasing the levels of executive compensation.[813] Furthermore, the Code of Best Practice[814] issued in the same year welcomed the introduction of share option schemes and performance-related incentives linked to share prices, as a way to incentivize managers to guarantee the long-term value of the corporation.[815]

---

809 For an international and historical perspective on top income inequality and growth, *see* Piketty Thomas & Saez Emmanuel, *The Evolution of Top Income: A Historical and International Perspective*, 96 American Economic Rev. 2, [200-205], 2006, *available at*: http://elsa.berkeley.edu/~saez/piketty-saezAEAPP06.pdf, (last visited February 15th 2011), at 204. The authors observe that in the last three decades, the correlation between increases in inequality and growth in top income including top executive pay has been positive and has grown faster in the US and UK compared to continental Europe and Japan. Id. at 204.

810 *See* supra note 806 at 515.

811 *See* for Germany, Dell Fabien, *Top Incomes in Germany Throughout the Twentieth Century: 1891-1998*, Chapter 9 *in*: Atkinson Anthony B. & Piketty Thomas (*eds*.), Top Incomes Over the Twentieth Century: A Contrast Between European and English Speaking Countries, [365, 425], Oxford University Press, Oxford, 2007; *See* for US, Saez Emmanuel, *Reported Incomes and Marginal Tax Rates, 1960-2000: Evidence and Policy Implications*, *in*: Poterba James, Tax Policy and the Economy 18, [117-173], MIT Press, Cambridge, USA, 2004.

812 Id. (referring to Dell Fabien`s work) at 413.

813 Keen Michael, *The German Tax Reform of 2000*, 9 International Tax and Public Finance 5, [603, 621], 2002, *available at*: http://www.springerlink.com/content/p870705k73127150/fulltext.pdf, (last visited February 15th 2011), at 605.

814 German Panel of Corporate Governance, Code of Best Practice for German Corporate Governance, Berlin, July 2000, *available* at: http://www.ecgi.org/codes/documents/code0700e.pdf (last visited February 10th 2011).

815 Id. at Sec. II, para.3.

After this reform wave towards liberalizing executive compensation and introducing performance based incentives, it looked as if the German model of executive compensation was resembling more and more to the American approach.[816] However, this new German trend was closer to an earlier, less regulated version of the American approach, given that while these reforms of 'liberalizing' executive pay appeared at the beginning of the last decade, U.S. was in a rather different mood at that time, trying to impose more and more restrictions related to disclosures of executive pay and regulating the use of options as compensation mechanisms.[817] This period of transition to an Americanized version came with its inherent side effects: sky-rocketing pays (by German standards), to some high profile CEOs[818] and the use of so-called "*golden handshakes*."[819] One of these scandals, which will be treated in detail in the main part of this chapter, involved the leaving pay of *Mannesmann*'s CEO in the sum of $ 16 million after *Vodafone Airtouch plc*. acquired *Mannesmann AG* ,[820] despite the fact that he had lost the battle during this acquisition and was claimed to have sacrificed the independence of his company.[821]

The German liberalizing trend of executive compensation was to be short. The financial crisis of 2007 re-brought the issue of executive pay under regulatory lenses and stricter

[816] For convergence tendencies of the German and US approaches to executive compensation in particular and corporate governance in general, *see* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 509-511.
[817] Despite the effectiveness of the reforms undertaken by the US after Enron, it is undisputable that this period witnessed a wave of new restrictive regulations, starting with SOX, continuing with the option regulations in 2006 and other regulations dealing with the post-crisis aftermath. *See* Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era*. Vanderbilt Law and Economics Research Paper No. 06-15; 2006, *available at* SSRN: http://ssrn.com/abstract=922299 , (last visited February 12th 2011), at 10 et.seq.
[818] For instance the compensation of the Josef Ackermann's in the amount of €6.9 million for 2002 raised eyebrows amongst the shareholders of Deutsche Bank and the public, although the company had a 50% rise in share price in 2003. Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 835.
[819] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 523.
[820] Id. at 523-524.
[821] Id. For an analyses of the case, *see* Kolla Peter at *supra* note 818.

requirements started to be imposed.[822] In the past, German courts had refused to deal with the appropriateness of executive compensation (as in the case of ***Mannesmann***),[823] however, as a reaction to the financial crisis, the German parliament recently decided to introduce new requirements addressing exactly this issue.[824] Limitations for director's compensation were introduced for all stock companies through the new law regarding the Appropriateness of Executive Compensation (hereinafter VorstAG).[825] This law, which will be analyzed further in the main part of this chapter, applies new conditions to awarding executive compensation, references new appropriateness criteria and expands liability risks for the Supervisory Board, if compensation is unreasonably high.[826]

3.2.2.2 'History' of Regulating Executive Compensation in the chosen CEE jurisdictions?

Europe is not unified when it comes to the dynamics and evolution of executive compensation. There is a sharp contrast between CEE jurisdictions on one hand, and developed European countries such as Germany on the other,[827]much so to the effect of making the term 'history' of executive compensation in CEE, rather meaningless. Comprehensive legal studies of

---

[822] *See* Benoit Bertrand, *Germany Gets Tough on Executive Pay*, Financial Times Article, May 29th 2009, electronic article *available at*: http://www.ft.com/cms/s/0/2b08297a-4c57-11de-a6c5-00144feabdc0.html#axzz1IalvbAoB, (last visited February 15th 2011).

[823] Supra note 819, at 527.

[824] For an overview of the German reforms aimed at regulating the financial markets and dealing with the appropriateness of executive compensation in financial institutions as well as stock corporations, *see* Köhler Matthias, *Corporate Governance and Current Regulation in the German Banking Sector: An Overview and Assessment*, Center for European Economic Research Discussion Paper No. 10-002, December 2009, *available at*:, ftp://ftp.zew.de/pub/zew-docs/dp/dp10002.pdf (last visited February 15th 2011).

[825] Appropriateness of Executive Compensation Act, [*Gesetz zur Angemessenheit der Vorstandsvergütung]*, of 5 August 2009, published in Federal Law Gazette BGBl. I, 50, S. 2509, (hereinafter VorstAG**).**

[826] Köhler Matthias, *Corporate Governance and Current Regulation in the German Banking Sector: An Overview and Assessment,* Center for European Economic Research Discussion Paper No. 10-002, December 2009, *available at*: ftp://ftp.zew.de/pub/zew-docs/dp/dp10002.pdf, (last visited February 15th 2011), at 2.

[827] Eriksson Tor, *Managerial Pay and Executive Turnover in the Czech and Slovak Republics*, 13 The Economics of Transition, The European Bank for Reconstruction and Development, 4, [659-677], 2005, *available at*: http://www.hha.dk/nat/wper/03-3_te.pdf, (last visited February 15th 2011), at 661. There is very little scholar work regarding executive compensation in CEE and very little evidence on the functioning of managerial labor markets in the region.

executive compensation in CEE in general, and Czech Republic and Romania in particular, are almost non-existent.[828] The reason might be attributed to the fact that the concept of executive compensation, as used in the other jurisdictions covered, is new for CEE countries. Given state ownership of 'companies' during communism, *"[managerial] incentives to pursue policies to improve firm productivity, were largely absent*."[829] The main characteristics of the then management system were *"motivational problems, strong risk aversion and extensive managerial slack*."[830]

At least for the sake of verbal consistency, if we were to talk about a CEE *approach* to regulating executive compensation, such approach would be unique due to several factors. The privatization process that occurred in CEE caused the corporate governance reforms to focus more so on the aftermath of privatization and the need to regulate the introduction of the new privatized companies, rather than on issues of executive compensation.[831] Concentration of ownership in CEE publicly held companies is also a factor that has shaped the features of this approach, given that the typical agency conflict in these companies has been one between majority and minority shareholders, rather than between shareholders and managers.[832] Having this mind, it is obvious that one cannot talk of executive compensation in CEE with the same mindset as in the case of U.S. or Germany.

First, in understanding the role of executives and their pay after the privatization that occurred in CEE, it is important to see that due to this very process, there has been a drastic shift in the role of managers from making the state - owned companies operational and fulfilling the

[828] Id. at 661-662.
[829] Id. at 660. *[emph.add.]*.
[830] Id.
[831] *See* for instance Estrin Saul, *Competition and Corporate Governance in Transition*, 16 Journal of Economic Perspectives 1, [101-124], 2002.
[832] *See* Frydman, R., Hessel, M. & Rapaczynski, A., *Why Ownership Matters? Human capital and Incentives in the Restructuring of Enterprises in Central Europe*, Columbia Law School, Law-Econ Working Paper No. 172, 1998, *available at* SSRN: http://ssrn.com/abstract=194574 (last visited February 15th 2011).

instructions given by the political leaders during central planning, to their new role as managers of privatized companies in capitalistic societies.[833] The role of managers and the regulation of their election, activity and pay, have therefore changed radically.

Second, there is only fragmented information about the trends of executive compensation and the factors that have influenced its levels during the transition period.[834] One such study conducted in Czech Republic, for instance, reveals that there has been a negative link between managerial pay and firm size in the case of private companies, and a positive relation between the two in the case of state – owned companies.[835] In terms of the link between firm-performance and managerial compensation during the transition period, there has been a positive relation between the two, albeit this latter conclusion has been drawn from subjective performance assessments.[836]

Thirdly, the introduction of standards on regulating executive compensation has been quite recent through voluntary Codes of Corporate Governance,[837] the enforcement of which has consistently lacked strength.[838] In Czech Republic for instance, the 2004 Code of Corporate

---

[833] Eriksson T. Gottvald J. & Mrazek P., *Determinants of Managerial Pay in the Czech Republic,* William Davidson Institute Working Papers Series No. 310, 2000, *available at*: http://wdi.umich.edu/files/publications/workingpapers/wp310.pdf, (last visited February 15th 2011), at 2.

[834] Eriksson Tor, *Managerial Pay and Executive Turnover in the Czech and Slovak Republics*, 13 The Economics of Transition, The European Bank for Reconstruction and Development, 4, [659-677], 2005, *available at*: http://www.hha.dk/nat/wper/03-3_te.pdf, (last visited February 15th 2011), at 661-662. While there are studies on general wage trends in CEE transition economies, there is very little evidence on executive compensation trends in the region.

[835] Eriksson T. Gottvald J. & Mrazek P., *Determinants of Managerial Pay in the Czech Republic,* William Davidson Institute Working Papers Series No. 310, 2000, *available at*: http://wdi.umich.edu/files/publications/workingpapers/wp310.pdf, (last visited February 15th 2011), at 7.

[836] Id. at 5.

[837] *See* Corporate Governance Code based on the OECD Principles, Czech Securities Commission, Prague, June 2004, *available at*: http://www.ecgi.org/codes/documents/czech_code_2004_en.pdf (last visited on February 15th 2011); *See also* Corporate Governance Code Romania, Bucharest Stock Exchange, Bucharest, January 2009, *available at*: http://www.ecgi.org/codes/documents/bucharest_se_code_jan2009_en.pdf, (last visited February 15th 2011).

[838] *See* Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002, *available at*: http://www.worldbank.org/ifa/Czechrosc_cg0702.pdf (last visited February 15th 2011); *See also* Report On The Observance of Standards and Codes (ROSC), Corporate

Governance, which is of a voluntary nature, provides that the compensation policy and the details of individual compensation should be disclosed annually.[839] The Code also requires disclosure of shares and share-options schemes in which members of the boards participate, prior to the general meeting of shareholders.[840]

Furthermore, although the updated version of the Romanian Code of Corporate Governance applying the comply-or-explain principle belongs to 2009, it simply requires disclosure of compensation policies, annual disclosure of the total amount of direct and indirect compensation, and a distinction between the fixed and the variable components of such compensation.[841] Enforcement of the principles provided in these Codes and related to executive compensation, has also been traditionally quite weak.[842] If there is one conclusion that this fragmented information can give, is that issues of executive compensation are somehow, a yet unexplored territory in the corporate governance realm of CEE.

The 'historical' part of this chapter has been long compared to other historical elaborations in this thesis. However, this has been necessary due to two main reasons. The first is that the discussion on executive compensation itself is also quite long, given the fact that it touches upon crucial facets of the agency conflict, and it illustrates important dilemmas pertaining also to the other two corporate governance aspects chosen for analysis. The second is that most of the information analyzed in the historical part, is quite recent by history categorization standards, it exemplifies substantially the ever on-going battle in tackling

---

Governance Country Assessment, Romania, World Bank-IMF, April 2004, *available at*: http://www.worldbank.org/ifa/rosc_cg_rom.pdf (last visited February 15th 2011).

[839] Id. Czech Code of Corporate Governance, at 27, Chapter V, sec. A, para. 4.; *See also* McGee Robert W. , *Corporate Governance in Transition and Developing Economies: A Case Study of the Czech Republic,* August 2010, electronic article *available at* SSRN: http://ssrn.com/abstract=1663113, (last visited February 15th 2011).

[840] Id. Czech Code of Corporate Governance, at 27, Chapter V, sec. A, para. 3.

[841] Romanian Corporate Governance Code of 2009, art. 7.

[842] *See supra* note 838 for the Romanian ROSC.

problems of executive compensation, and it therefore sets the necessary framework for the elaborations in the following subsections.

3.3 Executive Compensation in the U.S.

Before talking about the problems pertaining to executive compensation in the U.S. and the attempts to regulate it, it is important to first see the dynamics of the process of setting executive compensation, who decides on it and how is this decision made. Is it made at an arm`s-length position[843] between shareholders and managers, or do the latter themselves have a say, (most importantly a significant say), on the matter? It is indeed crucial to first analyze this process, since only after having discovered the real *bargaining positions*[844] between managers, boards and shareholders, can one then have the right outline in mind, in order to address the deficiencies of the executive pay system.

A very basic question in any corporate governance discussion is "*who decides*"[845] and in the concrete context of this analysis, the question is translated into "*who decides on executive compensation*"?[846] Generally, corporate law in the U.S. assigns decision making to the Board of Directors or to managers in cases when the board has properly delegated such authority to the latter.[847] Executive compensation is no different in this regard. As for director compensation, as a general rule, most state statutes permit the corporate articles or bylaws to authorize compensation

[843] *See* Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues,*17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 15th 2011).
[844] Id.
[845] Bainbridge Stephen M., *Executive Compensation: Who Decides?,* University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005, *available at* SSRN: http://ssrn.com/abstract=653383, (last visited February 15th 2011), at 41.
[846] Id. at 33 et.seq.
[847] Id. at 41.

of directors. This is the same for MBCA following states[848] and Delaware following ones.[849] The most common practice, however, has been to delegate compensation duties to compensation committees[850] composed of independent directors. In 2002 for instance, under the NYSE's new listing standards,[851] listed companies were obliged to create a compensation committee, composed only of independent directors, the duties of which included setting the CEO's compensation.[852]

Despite these changes, the debate on whether the boards act at an arms' length position from the executives, whose compensation they set, is still ongoing.[853] According to the official view, corporate boards act at an arm`s length position from the executives when deciding on matters of their compensation.[854] The basic idea therefore has been that, corporate boards, having in mind the interests of shareholders, design executive compensation packages that incentivize executives to follow shareholders` interest and increase shareholder value.[855]This official view is then used to legitimize compensation mechanisms to shareholders and courts and create a ground for legal rules and policy choices. The partisans of this view maintain that it is exactly this official story that resembles closer to the reality of executive compensation and whenever faced

---

[848]RMBCA 2005, available electronically at: http://www.abanet.org/buslaw/ (last visited February 17th 2011), § 8.11.

[849] Del. Code Ann. tit. 8, § 141 (h), (2009), available at http://delcode.delaware.gov/title8/c001/sc04/index.shtml, (last visited February 13th 2011).

[850] Creation of committees is permitted for instance by Del. Code Ann. tit. 8, § 141 (c) 1 (2006).

[851] See New York Stock Exchange (hereinafter NYSE), NYSE, Listed Company Manual, § 303A, 05 (a) (2004).; See also Report of the NYSE Corporate Accountability and Listing Standards Committee, 2002, *available at:* http://www,nyse,com/pdfs/corp_govreport.pdf, (last visited on February 11th 2011). The new listing standards were subsequently approved by the SEC. *See* SEC Release No. 34-48745, Order Approving Proposed Rule Changes and Amendments on Listed Company Manuals of NASD and NYSE, [68 FR 64154], November 4 2003.

[852] NYSE, Listed Company Manual, § 303A, 05 (a) (2004). NASD refers to the National Association of Securities Dealers.

[853] For the managerial power theory, s*ee* Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues*,17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 15th 2011); For a critique on this view, *see* Bainbridge Stephen M., *Executive Compensation: Who Decides?,* University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005, *available at* SSRN: http://ssrn.com/abstract=653383, (last visited February 15th 2011).

[854] Id. (referring to Bebchuk and Fried`s work) at 11.

[855] Id.

with '*strays*' from such a picture, the justification has been that these cases represent a deviation, rather than the overwhelming scenarios.[856]

However, the reality of the executive pay decision process is much more complex than the official view. Many factors influence such a process and the level at which executive compensation is set.[857] First, given that this view itself recognizes the agency conflict existing between managers and shareholders, it follows that the first do not automatically seek to maximize the interests of the second, but need to be properly incentivized by the board of directors.[858]

Even the members of the Board of Directors are positioned in an agency relationship to shareholders and there are indeed many factors that influence their behavior, so as not to automatically presume that they serve the interests of shareholders in every executive compensation decision.[859] One crucial influence over directors is the fact that, quite often, director nomination proposals come from managers. Being on the good side of a corporation`s CEO has its own advantages, given that such CEO would have influence over the nomination process. But even in the case of the recent requirements of increasing the role of independent directors in the nomination committees,[860] the power game has continued far too long. Considering the friction that results from a battle between a CEO and a director candidate,

---

[856] *See* for some works based on the arms-length contracting basis, Abowd John M. & Kaplan David S., *Executive Compensation: Six Questions That Need Answering,* 13 Journal of Economic Perspectives 4, [145, 168], 1999; *See also* Core J.E., Guay W. & Larcker D.F., *Executive Equity Compensation and Incentives: A Survey,* 9 Economic Policy Rev., [27, 50], 2003.
[857] Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues,*17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 15th 2011), at 13.
[858] Id.
[859] Id.
[860] Apart from the NYSE requirements on compensation committees, very recently in March of 2011, the SEC issued a proposed rule regarding independence of members of compensation committees. *See* Standards for Compensation Committees, Exchange Act Release Nos. 33-9199; 34-64149 (March 30, 2011), available at: http://www.sec.gov/rules/proposed/2011/33-9199.pdf, (last visited on March 31st 2011). The SEC is supposed to finalize this rule by June 2011.

considering also that both would have to work closely, members of the nomination committee themselves, would not be expected to favor such a nomination.[861]

Then, there is the other side of the story, namely the fact that the CEO himself can still have a say on the independent director's pay, although limited by the NYSE listing rules.[862] For example, these rules still allow the company to pay up to $ 120,000 as compensation to an independent director.[863] There is also no strict prohibition of business dealings with an independent directors` firm, although it is limited by the new rules, neither is there any strict prohibition on providing charitable contributions to a charity, in which the independent director is involved.[864] These gaps on assessing the independence of a director are simply the loopholes that make room for alternative ways of influencing the behavior of an independent director.

Some academics have argued to the contrary however, discouraging the idea that managers exert influence over the directors` pay, going therefore against the "*managerial power model*".[865] Emphasizing the limitations brought by the new rules on increasing the independence of directors and limiting the role of the CEO in the nomination, removal or compensation of

---

[861] See Main B.G.M., O'Reilly C. A. III & Wade J., *The CEO, the Board of Directors, and Executive Compensation: Economic and Psychological Perspectives*, 4 Industrial and Corporate Change 2, [292, 332], 1995.

[862] Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues,*17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 15th 2011), at 13.

[863] The limit used to be $ 100,000 but it was changed in 2008 to $ 120,000. Also the prior NYSE listing standard precluded a director from being considered independent if his immediate family member served as an employee in company's outside auditor, was changed. The current version states provides that such immediate family member has to currently be an employee of the internal audit and to personally works there. NYSE, Listed Company Manual, § 303A.02 (b) (as amended November 2009).

[864] Id. § 303A.02 (a). The 2009 amendment, provides that in assessing independence, the board should take into account a broad range of factors and it enumerates some of the possible scenarios, but it does not strictly prohibit a finding of independence in each of these cases. The 2009 version of the provision states: "*Material relationships can include commercial, industrial, banking,… charitable and familial relationships, among others*".

[865] The strongest opposition came from Bainbridge. *See* Bainbridge Stephen M., *Executive Compensation: Who Decides?*, University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005, *available at* SSRN: http://ssrn.com/abstract=653383, (last visited February 15th 2011), at 12 et. seq.

directors, the followers of this line of argument believed, at the time, that such changes would perhaps suffice to restrict the power of managers over their own compensation.[866]

One of the arguments raised against *the managerial power model* was that since the amendments were recent, only time would show whether they were inadequate, and claims against the *then* current regulation of executive compensation, could not be raised before seeing the effects of such new rules.[867] This argument in itself does not in any way tackle the problem of whether there is indeed very little influence of managers in deciding their own compensation, to the contrary, even from a pure common sense perspective, the fact that new rules were passed in assuring higher independence of directors in compensation committees[868] serves as a witness to the fact that, most probably than not, there was a lack of independence that motivated such a change.

Even the other argument of not coming to conclusions about managerial power before the effects of new rules are seen,[869] while it might have deserved merit at the time when the enactments were recent, it cannot completely hold now. At present, scandals related to excessive executive compensation, pre and during the financial crisis, and the wave of regulatory reforms to restrict executive pay,[870] suggest a strong likelihood that the set of mechanisms and governance procedures have not assured proper transparency of the amounts of pay, its relation

[866] Id.
[867] Id. at 27 et. seq.
[868] NYSE, Listed Company Manual, § 303A.02 (b) (as amended November 2009).
[869] Bainbridge Stephen M., *Executive Compensation: Who Decides?*, University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005, *available at* SSRN: http://ssrn.com/abstract=653383, (last visited February 15th 2011), at 27 et seq.
[870] *See* OECD Publication, *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, June 2009, available at: http://www.oecd.org/dataoecd/3/10/43056196.pdf, (last visited February 12th 2011), at 14 et.seq.; *See also* Bebchuk L. A., Cohen A. & Spamann H., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008*, Harvard Law and Economics Discussion Paper No. 657; November 2009, available at SSRN: http://ssrn.com/abstract=1513522, (last visited on February 11th 2011). The article argues against dismissing the role that executive pay arrangement played in encouraging excessive risk-taking.

and sensitiveness to performance, or the total elimination of managerial power over their own compensation.[871]

The opposition raised here to excessive executive pay however, is not one which attacks big payouts *per se* even in cases when they are deserved through performance means. The problem raised refers only to the cases when such excessiveness, rather than deserved, is produced from negotiations and bargaining positions that are not conducted objectively at an arms' length scenario. Certainly, regulatory changes in the form of increased transparency, higher accountability of directors, shareholders non-binding *say on pay* resolutions, and caps on executive compensation, have changed the realm of executive compensation in the last two decades.[872] The next section will address these changes, starting from the early 1990s when stock options became very popular, to the passing of SOX, till the present days.

3.3.1 The Role of Sarbanes-Oxley and Stock Options

As it has been mentioned before, the seminal work of *Jensen* and *Murphy* in the early 1990s provided a paradigm shift with regards to executive compensation.[873] Instead of being considered a problem, executive compensation pay packages that were properly designed to

[871] When talking about restrictions on the managerial power to influence its own compensation, those opposing the model have suggested that the market for capital, corporate control and managerial labor restricts such influence. See Bainbridge Stephen M., *Executive Compensation: Who Decides?,* University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005, *available at* SSRN: http://ssrn.com/abstract=653383, (last visited February 15th 2011), at 48 et. seq. There might certainly some truth to the above claim in as far as an influence of the market forces is suggested. However whether these restrictions produce the same effect as if acting at an arms` length position does not bear the same standing, given that market restrictions also allow for considerable deviations from a proper arms` length contracting position. In the simple case of the market forces that are at play in a takeover threat scenario, incumbent directors opposing a *hostile* bid would have to be offered extra premiums in order to give up opposition. *See*, John M. Bizjak J.M., Lemmon M.L., & Naveen L., *Has the Use of Peer Groups Contributed to Higher Levels of Executive Compensation?*, Working Paper Series Electronic Article, 2007, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=252544, (last visited February 12th 2011).
[872] See infra sections 3.1 and 3.2 and related discussion.
[873] Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Rev. 3, [138, 153] 1990.

incentivize executives, so as to align their interests with those of the shareholders, started to be considered as a solution to the agency conflict. *Jensen* and *Murphy* were of the opinion that shareholders need not worry about amounts spent on executive compensation, but rather on providing sufficiently strong incentives.[874] Stock options therefore became increasingly popular as a variable component of executive compensation packages that could be used to provide such incentives. The increase in the use of options was so rapid that, by 2000, almost 80% of the compensation of executives was being paid in options.[875] CEOs especially were given enormous option grants; compensations that ultimately looked like telephone numbers became common practice.[876]

The rise in the use of stock options resulted in a rush to manipulate quarterly accounts. Stock options prices had to rise if an executive wanted to properly profit from it, and stock prices were dependent on the quarterly financial analysts' evaluations.[877] The need for rapid quarterly increases in earnings made executives focus more on short-term goals, rather than long-term initiatives. Especially in cases when the stock price went down, executives started to engage in account manipulations, and restatements of financial accounts became a common procedure.[878]

At the turn of the millennium, Enron collapsed.[879] The amount of interest devoted to this case has been unprecedented, due to the enormity of the scale of fraud and account manipulation

---

[874] Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 293 et seq.; *See also* Jensen M. C., Murphy K. J. & Wruck, E. G., *Remuneration: Where We've Been, How We Got to Here, What are the Problems, and How to Fix Them,* ECGI - Finance Working Paper No. 44/2004, July 2004, available at SSRN: http://ssrn.com/abstract=561305, (last visited on February 12th 2011).

[875] Markham Jerry W., A Financial History of Modern U.S. Corporate Scandals From Enron to Reform, M.E. Sharpe, Portland, Oregon, 2006, at 561.

[876] Blackledge Cath, *Euroland Bonanza*, European, June 1998, at 20.

[877] *See* Cicero David C.,*The Manipulation of Executive Stock Option Exercise Strategies: Information Timing and Backdating,* 64 Journal of Finance, American Finance Association 6, [2627, 2663], December 2009, at 2630 et seq.

[878] Id.

[879] *See* In re Enron Corporation Securities, Derivative & ERISA Litigation, 235 F. Supp.2d. 549, US Dist., 2002; For an analyses of Enron *see* Gordon Jeffrey N., *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections,* 69 University of Chicago Law Rev., [1233, 1241], 2002.

involved in it. Some of Enron`s executives had received hundreds of millions of dollars in compensation, the major part of it through stock options.[880] The wave of regulatory reform that followed started with the passing of the Sarbanes-Oxley Act in 2002 (SOX).[881] Surprisingly enough however, the SOX, which was considered as the materialization of the heated reaction mainly towards Enron`s collapse, provided only two provisions that dealt with the issue of executive compensation in a direct way, and a third indirect provision regarding the freeze-out of extraordinary payments, in cases of investigation under SEC.[882] Given that these provisions constitute the main SOX basis on executive compensation, they will be dealt with one by one in the next section. Before such analyses however, a short note on the aggressive style of treating executives after the collapse of Enron, is due.

<u>3.3.1.1 Imprisoning executives</u>

After a harsh presidential speech on corporate misconduct right after *Enron*,[883] a Department of Justice task force was created to pursue the scandals.[884] Having indicted and convicted Arthur Andersen, Enron`s accounting firm,[885] the next focus was on *Enron*`s CEO, Andrew Fastow, who was indicted on 78 counts including fraud, conspiracy and money laundering.[886] He pled guilty on two counts and was sentenced to ten years in prison, a sentence reduced after his cooperation as an informant with the federal government, in order to prosecute

---

[880] Markham Jerry W., A Financial History of Modern U.S. Corporate Scandals From Enron to Reform, M.E. Sharpe, Portland, Oregon, 2006, at 119.
[881] An Act To Protect Investors by Improving the Accuracy and Reliability of Corporate Disclosures Made Pursuant to the Securities Laws, and for Other Purposes, of 2002, Pub. L. 107-204, 116 Stat 745, July 30 2002, (Sarbanes-Oxley Act, hereinafter SOX).
[882] Sec. 304, 403 and 1103 of SOX.
[883] Markham Jerry W., A Financial History of Modern U.S. Corporate Scandals From Enron to Reform, M.E. Sharpe, Portland, Oregon, 2006, at 85-86.
[884] Id. at 205.
[885] Id. at 205-212.
[886] United States v. Andrew Fastow, Ben F. Glisan Jr. and Dan Boyle, Cr. No. H-02-0665329, (US Dist. Ct. South. Dist. of Tex. April 30 2003).

other *Enron* executives.[887] Employing procedures that frustrated a proper defense of executives, such as target letters and denying immunity to witnesses that would aid the defendants, became a common practice. That was the case for Arthur Andersen's conviction, as well as for the conviction of the former head of WorldCom, Bernie Ebbers.[888] Ebbers was known as receiving the highest option grant for any executive at the time in a 5 year period, and, albeit recognizing that a 25 years sentence was uncommon for a white-collar crime, the conviction was affirmed by the court.[889]

Another case which has become an example of biased ruling, was the conviction of Quattrone, an investment banker at Credit Suisse First Boston, on accounts of obstruction of justice and tampering with witnesses.[890] The tampering process identified for the purpose of the charge, consisted of an e-mail sent by him to employees requiring the destruction of files, as required by document retention policies of the company. Certainly this did not relate in any way to the reason why he was targeted in the first place, namely his annual pay at Credit Suisse. Fortunately, his conviction was set aside on appeal and all the charges against him were dropped.[891] The very fact that this case was brought to courts, evidences something beyond the mere intent to react strongly towards fraud and account manipulations by executives, it witnesses the *intent to criminalize* excessiveness in compensations.

[887] Markham, Jerry W., Regulating Excessive Executive Compensation - Why Bother?, 2 Journal of Business & Technology Law 2, [277, 348], 2007 available at SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 310. His wife also pleaded guilty to a misdemeanor income tax charge, although these charges were rather dubious. Id. at 310-311.
[888] United States v. Ebbers, 458 F. 3d, 110, 130, (2nd Circ. 2006).
[889] Id.
[890] United States v. Quattrone, 441 F. 3d, 153, 160, (2nd Circ. 2006).
[891] Markham, Jerry W., Regulating Excessive Executive Compensation - Why Bother?, 2 Journal of Business & Technology Law 2, [277, 348], 2007 available at SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 314.

Another highly publicized case that followed was the ***Grasso*** case.[892] *Grasso* was the CEO of NYSE, at the time a non-for-profit corporation, who received around $ 140 million in deferred compensation in 2003.[893] This, considering the *then* non-for-profit status of NYSE, and the fact that competitor entities did not offer such amounts, led to a frenzy of public anger and became a rather personal battle of the New York Attorney General at the time, Sptizer.[894] Because of the subsequent merger of NYSE with Archipelago Holding in 2006, the NYSE ceased to be a non-for-profit corporation and became a publicly held one.[895] This meant that the Attorney General lacked standing to sue on behalf of the public and ultimately, Grasso did not have to return his compensation.[896]

The outcomes of the cases brought under discussion here did not change much in curbing excessive compensation and slowing abuses. Many other similar cases followed without much difference from previous stories of enormous option grants, severance packages and other excessive perks.[897] The SEC approach towards such cases remained passive at best, at least until recently in 2010.[898] The cases brought under the specific SOX provisions dealing with executive compensation, will be analyzed one by one in the next section.

3.3.1.2 The Clawback Provision of Sarbanes-Oxley and the Passivity of the SEC

First, section 304 of SOX states in the relevant parts:

---

[892] Spitzer v. Grasso No. 04-CIV-4565, (N.Y. Sup. Ct. May 24, 2004).
[893] Penski Rachel, *The Case of CEO Richard Grasso and the NYSE: Proposals for Controlling Executive Compensation at Public Nonprofit Corporations*, 58 Vanderbilt Law Rev. 1, [339, 382], 2005, at 340.
[894] Id. at 340-342.
[895] Andersen Jenny, *Stock Exchange's Ex-Chief Wins Battle to Keep Pay*, NY Times Article, July 2nd 2008, *available* at: http://www.nytimes.com/2008/07/02/business/02grasso.html?ref=richardagrasso, (last visited February 12th 2011).
[896] Markham, Jerry W., Regulating Excessive Executive Compensation - Why Bother?, 2 Journal of Business & Technology Law 2, [277, 348], 2007 available at SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 316-319.
[897] Id. at 316-319.
[898] SEC v. McCarthy, No. 1:11-CV-667-CAP (N.D. Ga. March 3, 2011).

"[I]f an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for

> *1. any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing […]; and*
>
> *2. any profits realized from the sale of securities of the issuer during that 12-month perio[d]."*[899]

Such wording has made this section become one of the provisions that has been largely ignored for several years after its enactment, putting in doubt the motivations behind SEC`s lack of willingness to act on it, and becoming problematical with regards to its interpretation and enforcement.[900] Problems of interpretation have persisted with regards to the failure of drafters to define the very threshold triggering liability, namely the definition of misconduct, which was lacking in the SOX text.[901] The second problem concerned the failure to differentiate between the responsibility of the CEO and the CFO, or to provide clearly for the inclusion of both as liable in cases of misconduct.[902]

Lastly, there has been a problem with properly identifying who has a cause of action for bringing claims under section 304 of SOX,[903] albeit this has been clarified by later court decisions, establishing that there is no private cause of action for these claims, and concluding

[899] Sarbanes-Oxley Act (SOX) of 2002 § 304 (a) 15 U.S.C. § 7243 (2006).

[900] *See* Schwartz Rachael E., *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 Business Law 1, 2, 2008, at 13 et seq.; *See also*, Coffee John C., *Law and the Market: The Impact of Enforcement*, Columbia Law and Economics Working Paper No. 304, 2007, *available at* SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=967482 (last visited February 12th 2011).

[901] Wild Robert J., Designing an Effective Securities and Corporate Governance Compliance Program, Thomson West US, 2006, at 1:152; *See also* Dawes P. H. & Johnson M. D., The Disgorgement Mandates of Sarbanes-Oxley Section 304: Do They Reach Innocent CEOs and CFOs?, PLI Corporate Law and Practice Course Handbook Series No. 8805/ 2006, at 113.

[902] Id. (referring to Dawes & Johnson work) at 113 -116. Another problem raised here is the vague language used to define the types of instruments covered by forfeiture, causing confusion in terms of actually calculating the amount of disgorgement.

[903] SOX § 304 (a) 15 U.S.C. § 7243 (2006).

that only the SEC a cause of action.[904] In doing so however, the task with which the courts were confronted was not easy. In the case of ***Whitehall Jewellers***[905] the court narrowed its focus and, based on the legislative history of the section, it concluded that the Congress did not intend to provide for a private cause of action. In another case, the court adopted a holistic interpretation of the section and declared that, since in a neighboring section, the Congress had provided for a private cause of action, but had not done so in section 304, it meant that it was not the intent of the legislator to provide for it.[906]

A quite recent case also came to the same conclusion,[907] albeit its facts were further complicated by the existence of an agreement to discharge executives from liability under section 304 of SOX.[908] Reaffirming again that no such private right exists, the court went further, explaining that agreements indemnifying directors from liability, would basically put a bar to the kind of relief that the SEC is legitimately authorized to seek.[909] The outcome of these cases is an accommodation by courts of the idea of limiting shareholder litigation and providing a form of exclusivity for the SEC. But even with this kind of recognition of exclusivity, little was achieved in terms of enforcement for several years after the enactment of SOX.

Despite a vast number of cases addressing this *clawback* provision, one can count the number those that SEC has decided to pursue.[910] From the passing of SOX till 2006, for instance,

[904] In order to find whether a private cause of action was intended by this section, in the case of Whitehall Jewellers the court stated that: *"[A]n implicit private cause of action is more likely to be found when: (1) a plaintiff is part of the class for whose benefit Congress enacted the statute; (2) there is an indication of the existence of a private right based on the common tools of statutory interpretation including an examination of legislative history and the structure of the statute; (3) a remedy would be consistent with the legislative scheme; and (4) the cause of action is not one traditionally relegated to state law.*" In re Whitehall Jewellers, Inc. Shareholder Derivative Litig., 2006 WL 468012, at 7 & 8, (citing 422 U.S. 66, 78).
[905] Id. at 8.
[906] Neer v. Pelino, 389 F. Supp. 2d (E.D. Pa. 2005) at 655.
[907] Cohen v. Viray, 2010 WL 3785243 (2d Cir. Sept. 30, 2010).
[908] SOX § 304 (a) 15 U.S.C. § 7243 (2006).
[909] Cohen v. Viray, 2010 WL 3785243 (2d Cir. Sept. 30, 2010), at 4.
[910] *See* Schwartz Rachael E., The *Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 Business Law 1, 2, 2008, at 13-15.

although there were around 1786 restatements by 1121 publicly held corporations[911] due to financial reporting fraud or account misstatements, the SEC had pursued only a very limited number of cases, revealing in its statement of May 2007, that it was its first time making use of section 304.[912] This was so even amidst the eruption of the options backdating scandals in 2006.[913] Many scandals involving option backdating and leading to accounts manipulations, involved companies such as Apple Computer, Power Integrations, Mcafee, UnitedHealth, etc.[914] Only in the case of Broadcom, there were around $ 1.5 billion in understated expenses resulting from backdating options.[915]

SEC`s reaction continued to remain passive and even the adoption in 2006 of expanded compensation disclosure requirements, including a so called "*Compensation Disclosure and Analysis*",[916] did not contribute much in regulating executive compensation. The basic prevailing idea at the time remained that, unless an executive was involved in personal misconduct, he would be able to retain his bonus. This is the conclusion purported by those few cases brought by the SEC till 2010.[917] For instance, the claims typically brought involved the CEO or CFO of a corporation taking part in some action that was exceptionally shocking to the principles set by SOX, and, accumulatively, this was considered to have been done knowingly or

---

911 Commission On Banking, Housing, & Urban Affairs, U.S. Senate, Report to the Ranking Minority Member, Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Activities, GAO-06-678, July 24, 2006, at 4.

912 *See* SEC Press Release, SEC Settles with Mercury Interactive and Sues Former Mercury Officers for Stock Option Backdating and Other Fraudulent Conduct, 2007-108, May 31 2007.

913 Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 available at SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 304-308.

914 Id. at 305.

915 Id. at 304.

916 *See* SEC Press Release, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters, 2006-123, July 26 2006, *available at:* http://www.sec.gov/news/press/2006/2006-123.htm, (last visited on February 12th 2011).

917 Dawes P. H. & Johnson M. D., The Disgorgement Mandates of Sarbanes-Oxley Section 304: Do They Reach Innocent CEOs and CFOs?, PLI Corporate Law and Practice Course Handbook Series No. 8805/ 2006, at 120.

deliberately. Furthermore, in each of these cases, the CEO had allegedly been the driving force behind the misconduct.[918]

3.3.1.3 The SEC Sharpens Its Claws: No-Fault Liability of Executives?

The tide changed in 2010. For the first time since the passing of SOX, the SEC, in a case involving the CEO of ***CSK Auto Corporation,*** tried to force him to return his bonuses and other discretionary compensation he had received, *without* accusing him of any misconduct leading to the financial restatements.[919] The SEC basically argued vicarious strict liability with the simple reasoning that the accounting fraud happened while Jenkins, as CEO of the corporation, was the leading figure, under the authority of which the restatements were made, or in the court`s own words, he was "*the driver of that bus*."[920] The SEC notably failed to allege any misconduct, wrongdoing or fraud committed by Jenkins, but it still required to claw back around $ 4 million in bonus, and other equity and incentive based compensation.[921] Jenkins filed a motion to dismiss arguing, as typical in these cases, that the phrase "*as a result of misconduct*"[922] in Section 304 of SOX, was at best ambiguous, since it failed to define whose misconduct triggers the CEO and CFO reimbursement duties. He also argued that a CEO or CFO must take part in personal misconduct for such a liability to be found.[923]

The court however disagreed, stating that *"[t]he misconduct of the issuer is the misconduct that triggers the reimbursement obligation of the CEO and the CFO*."[924] The court

[918] Id.
[919] SEC v. Jenkins, CV 09-1510-PHX-JWS (D. Ariz. July 23 2009).
[920] SEC v. Jenkins Oral Argument 30, at 15–24, (April 30, 2010).
[921] SEC v. Jenkins Complaint 2, 38–41 (July 22, 2009).
[922] SEC v. Jenkins, Motion to Dismiss 17 (September 15 2009).
[923] Id.
[924] SEC v. Jenkins Order at 5, (June 9 2010).

also rejected the personal misconduct argument raised by Jenkins. Instead, the court for the first time, noted that an executive does not need to be personally aware of the misconduct, in order to profit from it.[925]

Another similar case which was ultimately settled happened very recently in March 2011.[926] According to the SEC announcement, the CEO of ***Beazer Homes USA, Inc***., who was never charged of any misconduct, agreed to reimburse to the company around $ 6.5 million in bonus payments and certain stock sale proceeds, as well as some more five figure sums in restricted stock units and shares of restricted stock.[927]

This recent awakening of the SEC with regards to seeking enforcement through section 304 clawback actions, witnesses the will to bolster the use of this mechanism to retake compensation sums from executives, regardless of such executive's knowledge of, or personal participation in the financial misconduct.[928] However, especially considering that the SEC has never made public the criteria it uses to establish whether or not to act in a case of executives` *no-fault* situations, it would be necessary to come out with such an explanation for the sake of transparency. Furthermore, especially considering the 2011 ***Beazer Homes*** settlement case, in which not all the claimed moneys in stock option compensation were received in the settlement,[929] it would be necessary to see the SEC break its silence and justify the methods it uses in calculating the amounts recoverable under this section.

It is clear from the above analyses, that the one provision of SOX intended to offer the most efficient mechanism for tackling some of the executive compensation problems that have

[925] Id. at 6.
[926] Quinlivan Steve, *SEC Settles Complaint with Beazer Homes CEO*, March 3 2011, electronic new article available at: http://dodd-frank.com/sec-settles-clawback-claim-with-beazer-homes-ceo/, (last visited March 14th 2011).
[927] SEC Press Release, SEC Obtains Settlement With CEO to Recover Compensation and Stock Profits He Received During Company's Fraud, 2011-61, March 3 2011, *available* at: http://www.sec.gov/news/press/2011/2011-61.htm, (last visited March 14th 2011).
[928] Id.; See also the Jenkins case reasoning, SEC v. Jenkins, CV 09-1510-PHX-JWS (D. Ariz. July 23 2009).
[929] *See supra* note 925.

persisted in the U.S., has been ignored the most. The lack of willingness on the side of the SEC to make use of this section prior to 2010, has been somewhat unexplained.[930] Perhaps other broader considerations such as the idea that SOX had become too costly and overreaching might have caused its influence.[931] Nevertheless, the change in attitude evidenced by the stricter approach taken in the last few cases from 2010 onwards, shows that the SEC has decided to wake up from its lethargic stance of several years. Be it as a reaction to the financial crisis, or for other reasons, what can be said for sure, is that problems of interpretation and enforcement have not ceased to exist simply because the SEC decided to sharpen its claws.[932] Even in so doing, it should nevertheless provide clear guidance as to what criteria it uses for the new no-fault liability findings, and for properly providing the *formula* it uses to decide what part of compensation is recoverable. It is a time of change and the first step should be to provide consistency and predictability.

<u>3.3.1.4 Prohibiting Personal Loans and "Freezing" Excessiveness?</u>

Not quite as controversial as the section 304 of SOX,[933] yet problematic in its interpretation, the second provision related to the issue of executive compensation is section 402 of SOX,[934] which prohibits personal loans to directors or executive officers. The basic inspiration

[930] One article explaining the denial of a private cause of action under section 304, has however characterized the SEC approach metaphorically as an "SEC Option", Bryant Morris & White Thomas, *It`s an SEC Option*: *Sarbanes-Oxley Disgorgement Section Creates No Private Claim*, 28 Legal Times 47, November 21, 2005.
[931] *See* Boodoo Maria & Boodoo Crystal, *Peering Into the Fog: The Emerging Consequences of Sarbanes-Oxley*, 78 Pennsylvania Institute of Certified Public Accountants Journal 1, [1-4], 2007.
[932] *See* Carlin Wayne M., *SEC Claws Back Again*, The Harvard Law School Forum on Corporate Governance and Financial Regulation, April 6 2011, Electronic Article, *available* at: http://blogs.law.harvard.edu/corpgov/2011/04/06/sec-claws-back-again/, (last visited April 7th 2011).
[933] SOX § 304 15 U.S.C. § 7243 (2006).
[934] SOX § 402 (k) 1 15 U.S.C. § 7243 (2006), in relevant parts reads: *"It shall be unlawful for any issuer […] directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer]*.". Id.

behind this provision was to address the common practices amongst some U.S. corporations, *Enron* and *WorldCom* included, where executives had continuously received big loans, at times even reaching hundreds of millions of dollars.[935] However, many interpretative issues were left unanswered for a lengthy period of time, as to what exactly constituted a personal loan and whether the courts would look at the substance of a transaction which had been labeled as different from a loan.[936]

In 2005, the SEC gave an answer to this concern when it decided to look at the substance of a transaction rather than its label.[937] Nevertheless, controversy surrounded the adoption of this provision, especially considering the fact that "*the permissibility of such transactions had been settled law for decades.*"[938] Even those that had advocated more stringent regulations were against the idea of an absolute prohibition of such loans, especially since some forms of loans served the benefit of a corporation.[939] The risk seen as a result of adopting a strict prohibition related to the fact that *"[i]t is extremely difficult to regulate managerial compensation, for if one form of compensation is restricted, then managers can renegotiate their contracts to make up for the loss.*"[940] Such a prohibition does not mean that the level of compensation an executive

[935] *See* for examples of huge loans taken from executives, Romano Roberta, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,* Yale Law & Economics Research Paper No. 297, 2004, *available at* SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=596101 (last visited on February 12th 2011), at 86-88.
[936] SEC Release No. 52865, In the Matter of Peter Goodfellow and Stamatis Molaris, December 1 2005.

[937] Id.
[938] Romano Roberta, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, Yale Law & Economics Research Paper No. 297, 2004, *available at* SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=596101 (last visited on February 12th 2011), at 87.
[939] Power Sean A., *Sarbanes-Oxley Ends Corporate Lending to Insiders: Some Interpretive Issues for Executive Compensation Surrounding the Section 402 Loan Prohibition*, 71 Univ. of Missouri Kansas City Law Rev., [911, 935] 2003, at 917.
[940] See supra note 935, at 88.

receives would necessarily be lower: it simply means that it will be more costly for shareholders to hire managers.[941]

The other SOX provision touching indirectly upon executive compensation, namely section 1103[942] which authorized the SEC to freeze any extra-ordinary payments in companies accused of account manipulations, also encountered some trouble in terms of defining what was to be considered "*extra-ordinary*" and had to go through the scrutiny of courts.[943] Three major cases related to this provision that are worth mentioning are the ***HealthSouth Corporation*** case,[944] ***Vivendi Universal***[945] and ***Gemstar-TV Guide International***.[946]

In the first case of ***HealthSouth***,[947] it is interesting to observe that the SEC did not identify any concrete payments that would be considered extraordinary but, referring to its CEO, Richard Scrushy, it stated: "*Scrushy remains in control […] and continues to have the ability to direct extraordinary payments to himself and others who may have participated in the violations*

[941] Id. at 89. Another issue raised with regards to this section has been whether advanced defense costs to executives, which are repayable upon realizing that indemnification is unavailable, are to be considered personal loans. The courts however gave a definite answer to this issue in 2006, stating that such advanced defense costs do not fall within the scope of section 402 as regards "personal loans", albeit it still denied giving a proper definition of what constitutes a "personal loan". See Envirokare Tech, Inc. v. Pappas, No. 05 Civ. 5515 (S.D.N.Y. March 10, 2006).
[942] SOX § 1103, 15 U.S.C. § 78u-3(c)(3)(A)(i). The section provides in relevant parts:
"Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days." Id.
[943] *See* Thomsen L. C. & Norman D., *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 Journal of Bus. & Tech. L., [393, 408], 2008, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/3_2/3_2_393_Thomsen.pdf, (last visited February 12th 2011).
[944] SEC v. HealthSouth, 261 F. Supp. 2d 1298 (N.D. Ala. 2003).
[945] SEC v. Vivendi Universal, S.A., C. No. Mll-03 (S.D.N.Y. 2003); *See also* SEC Litigation Release No. 18352 , SEC Files Sarbanes-Oxley Act Application for Temporary Order Compelling Vivendi Universal S.A. to Escrow Extraordinary Payments to its Former CEO Jean-Marie Messier, September 16 2003.
[946] SEC v. Gemstar-TV Guide Int'l Inc., 367 F.3d 1087 (9th Cir. 2004), (Gemstar 1) *[vacated]*, 384 F.3d 1090 (9th Cir. 2004); SEC v. Gemstar-TV Guide Int'l Inc. 401 F.3d 1031, 1036 (9th Cir. 2005) *[en banc]*, (Gemstar 2).
[947] SEC v. HealthSouth, 261 F. Supp. 2d 1298 (N.D. Ala. 2003).

alleged in the complaint."[948] With the consent of *HealthSouth,* the district court ordered the payment freeze, which was removed after the CEO and chairman of the Board were discharged from their positions.[949]

Another highly publicized case regarding extraordinary severance payments in the amount of $ 23 million, was the one involving the US - listed French media company ***Vivendi Universal S.A***.[950] In 2002, *Vivendi*`s CEO and Chair of the Board, *Messier*, resigned under the pressure created by the tumbling stock price of the company. However, prior to this resignation, *Messier* managed to negotiate a severance package worth around $ 23 million.[951] The new management of the company refused to pay such severance on the ground that it had not been approved by the Board. Since the agreement providing for such a severance pay was subject to arbitration and governed by New York law, Messier resorted to arbitration. The arbitration panel decided in his favor ordering the company to pay him his severance pay.[952] Later this decision of the arbitration panel was affirmed by a New York state court in favor of Messier.[953] However, in this background of procedural '*back and forth-s*', the SEC successfully petitioned under section 1103 of SOX to temporarily freeze the severance payment of *Messier*.[954]

---

[948] SEC v. HealthSouth, SEC Certificate Pursuant to Rule 65(b), SEC v. HealthSouth, Civil Action No CV-03-J-0615-
S (N.D. Ala. May 7, 2003).

[949] SEC v. HealthSouth, 261 F. Supp. 2d 1298 (N.D. Ala. 2003); *see also* SEC Press Release, SEC Obtains Emergency Relief Requiring HealthSouth to Place in Escrow All Extraordinary Payments to Officers, Directors and Employees, 2003-38, March 20 2003, *available* at: http://www.sec.gov/news/press/2003-38.htm, (last visited February 11th 2011).

[950] SEC v. Vivendi Universal, S.A., C. No. Mll-03 (S.D.N.Y. 2003); *See also SEC Asks That Vivendi Put Ex-Chiefs Money in Escrow*, N.Y. Times, Sept. 17, 2003.

[951] *SEC Asks That Vivendi Put Ex-Chiefs Money in Escrow*, N.Y. Times, Sept. 17, 2003, at C4.

[952] Jean-Marie Messier v. Vivendi Universal, S.A., AAA Arbitration No. 3-T-199-00205-94 (Am. Arbitration Assoc., June 27, 2003), at 7-8. Prior to this decision however, a Paris court froze the severance package waiting for an approval by the shareholders of Vivendi. This latter process was initiated at the request of France`s Exchange operating Commission [*Commission des Operations de Bourse*]. *Paris Court Freezes Messier's Severance*, WSJ., July 10, 2006, at B6.

[953] Jean-Marie Messier v. Vivendi Universal S.A., C. No. 50-T-116-00585-02 (N.Y. App. Div. Sept. 16, 2003).

[954] SEC Litigation Release No. 18352 , SEC Files Sarbanes-Oxley Act Application for Temporary Order Compelling Vivendi Universal S.A. to Escrow Extraordinary Payments to its Former CEO Jean-Marie Messier, September 16 2003.

The claims raised by Messier on the grounds that there was nothing extraordinary about the way he had negotiated payments, neither could such payment be considered as such when an arbitration decision and a state court had both declared it due, were rejected by the court.[955] The SEC filed later a settled action against Vivendi, Messier and the previous CFO of the company. From this settlement, Messier paid $ 1 million in penalties and gave up any severance packages, while Vivendi paid $ 50 million in penalties. [956]

The other major decision regarding the definition of extraordinary payments was the case of ***SEC v. Gemstar - Tv Guide Int'l. Inc***.[957] During an investigation by SEC concerning the overstatement of financial accounts by $ 107 million for the year 2001, the CEO and CFO of the company,[958] resigned in exchange for "*restructuring payments*"[959] at around $ 38 million, in addition to other stock and stock option around $ 6.7 million. The SEC petitioned for a freeze order, and the two executives intervened claiming the unconstitutional vagueness of the concept of "*extraordinary payments*"[960] and alternatively, that the payments in question were not extraordinary.[961] The district court found such payments to be extraordinary in nature, considering several factors such as "*the circumstances surrounding the termination, the*

[955] SEC v. Vivendi Universal, S.A., C. No. Mll-03 (S.D.N.Y. October 1 2003), referring to the Order Granting the Motion to Vacate of September 24th 2003.
[956] SEC Litigation Release No. 18523, SEC Files Settled Civil Fraud Action Against Vivendi Universal S.A., Its Former CEO, Jean-Marie Messier, and Its Former CEO, Guillaume, December 24 2003.

[957] SEC v. Gemstar-TV Guide Int'l Inc., 367 F.3d 1087 (9th Cir. 2004), (Gemstar 1), *[vacated]*, 384 F.3d 1090 (9th Cir. 2004); SEC v. Gemstar-TV Guide Int'l Inc. 401 F.3d 1031, 1036 (9th Cir. 2005) *[en banc]*, (Gemstar 2).
[958] SEC v. Gemstar-TV Guide Int'l Inc. 401 F.3d 1031, 1036 , (9th Cir. 2005) [en banc], (Gemstar 2), at 1037. Leung and Yuen had previously signed sworn statements providing that they were unable to certify as to the accuracy of the financials of the company. Id. at 1036-1037.
[959] Gemstar-TV Guide Int'l Inc., Current Report (Form 8-K), (Oct. 15, 2002), *available* at http://www.secinfo.com/dV179.31x4.d.htm , (last visited February 11th 2011), at 1.
[960] SEC v. Gemstar-TV Guide Int'l Inc., No. 03-56129 (9th Cir. July 30, 2003), Brief of Henry C. Yuen and Elsie M. Leung, Appellants at 1-2.
[961] Id.

lengthy negotiation of the payments, the size of the payments, and the ongoing Commission investigation."[962]

The case was appealed.[963] The 9th Circuit reversed this decision and remanded it for a determination of the extraordinary character of the payments, comparing them to termination payments made to similar executives of other publicly held corporations.[964] The reference to different criteria for determining what is *extraordinary* became a story of disagreement even later on, when the 9th circuit decided the matter *en banc* and confirmed that such payments qualified under this definition.[965] The court took a factual based approach and decided that a number of factors should be taken into account, although this list is not dispositive. Amongst the factors, the court mentioned the circumstances of the payment, its size and purpose; the link between the latter and the alleged wrongdoing, and whether there was a deviation from the industry standard.[966]

Of notable importance was the dissenting opinion, according to which, it would have been necessary to remand the decision to the district court for seeing whether there was anything extraordinary in this payment, as compared to the CEO-s and similar executives in other publicly held corporations (basically the result of the 9th circuit outcome, which was reversed by this decision *en banc*).[967]

---

[962] Thomsen L. C. & Norman D., *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 Journal of Bus. & Tech. L., [393, 408], 2008, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/3_2/3_2_393_Thomsen.pdf, (last visited February 12th 2011), at note 70 referring to Gemstar 1, at 1092-1095.
[963] Gemstar *1 [vacated]*, 384 F.3d 1090 (9th Cir. 2004).
[964] Id. at 1095.
[965] Gemstar 2.
[966] Thomsen L. C. & Norman D., *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 Journal of Bus. & Tech. L., [393, 408], 2008, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/3_2/3_2_393_Thomsen.pdf, (last visited February 12th 2011), at note 82, referring to Gemstar 2 at 1045.
[967] Id, at note 82, referring to Judge Bea J. dissent in Gemstar 2 at 1051.

The biggest criticize came for wrongly considering that a payment is extraordinary because it is made in extraordinary circumstances.[968] Indeed, there is an important issue worth raising here. The dissenting opinion critique on identifying extraordinary payments with payments made in extraordinary circumstances, and its agreement with the previous 9th Circuit decision, taken together, give the idea that the dissenting judge favored a viewing of "*extraordinary payments*"[969] as payments that deviate from the industry standard.[970] This was a standard mentioned by the majority opinion as well,[971] but the dissenting judge found it necessary for the case to have been remanded for such an evaluation.

Looked carefully, the opinion of the dissenting judge seems to favor the idea that, a compensation package is not extraordinary simply because of its size, or the circumstances under which it was awarded, but rather, whether this size is '*uncommon*' from an industry perspective.[972] The criteria emphasized in the dissenting opinion, indicates concerns related to the competitiveness of executive compensation levels with regards to the market for executive talent.[973]

Other problems related especially to the use of options as compensation menas, concerned their lack of reflection as an expense in the company books and the difficulty in placing a real value to them. One notable change that came to remedy this situation was the new accounting requirement, introduced in 2004, asking companies to expense stock options

[968] Id.
[969] Id.
[970] Id.
[971] Thomsen L. C. & Norman D., *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 Journal of Bus. & Tech. L., [393, 408], 2008, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/3_2/3_2_393_Thomsen.pdf, (last visited February 12th 2011), at note 82, referring to Gemstar 2 at 1045.
[972] Id, at note 82, referring to Judge Bea J. dissent in Gemstar 2 at 1051.
[973] For a discussion on the market for executive talent, *see* Gabaix Landier A., *Why Has CEO Pay Increased So Much?*, 123 Quart. J. Econ.1, [49, 100], 2008.

grants.[974] Therefore, one of the previously recognized advantages of stock options, which was their inclusion simply in the notes of the financial reports, was now abolished by the new expensing requirement. The natural question that comes to mind is however, whether this changed the situation considerably. This time around there was little protest to the introduced change, mainly because companies had already responded in practice to the suggested accounting principle. While the new rule was certainly a positive step unifying the playfield of corporate actions with regards to option accounting practices, its impact could be seen mostly in a shift towards other non-option based compensation schemes.[975]

3.3.2 The Disney case: Where Fiduciary Duties End?

The relevant SOX provisions are not the only mechanisms used to address problems of executive compensation in the U.S. In fact, SOX provisions have captured the problem from an account manipulation and prohibition of personal loans perspective. Case law in the U.S. has also employed the concept of fiduciary duties to tackle problems related to executive compensation.[976]

[974] *See* FASB Statement of Financial Accounting Standards 123 (Revised 2004), *Share-Based Payment*, December 2004, *available electronically at*: http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820928111&blobheader=application%2Fpdf, (last visited February 12th 2011). These rules applied to most public companies for the period after June 15, 2005, and for companies with a December fiscal year the new rules affected them after their first quarterly financial results, meaning after March 31, 2006.

[975] *See for instance*, Henry David, *Expensing Options: An Overblown Storm*, Bloomberg BussinessWeek Article, 1 April 2004, available at: http://www.businessweek.com/bwdaily/dnflash/apr2004/nf2004041_0928_db035.htm, (last Visited February 12th 2011), predicting little impact of the new rule.; See for the shift in non-option based compensation schemes, Carter M.E., Lych L. & Tuna A. I., *The Role of Accounting in the Design of CEO Equity Compensation,* Accounting Rev., March 2007 [vol.and issue no.omm.], available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=931695, (last visited on February 12th 2011).

[976] Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 available at SSRN: http://ssrn.com/abstract=1705686, (last visited on February 10th 2011), at 280-284.

From early on, courts have had a tendency to *deny* a breach of fiduciary duty for cases of excessive compensation.[977] The standard test has been to not question the reasonableness of pay, but rather ask whether the corporation was being run *"honestly and fairly […] by its directors, with the observance of the formal requirements of the law; […][deciding] what [was] reasonable compensation for its officers [was] primarily for the stockholders.*"[978]

Courts employed for a long time the doctrine of *waste*, aimed at distinguishing between wasteful and excessive compensation, with the first being unlawful, while the second not.[979] Waste was defined as failing to relate compensation to the needs of the concrete situation, in disregard of recognized practices and as a result of bad faith or complete neglect or indifference.[980] There was a brief period of time where U.S. Courts adopted a higher scrutiny to executive compensation, deviating, albeit not completely and formally, from the waste doctrine.

At a time when stock options became vital components of executive pay, Delaware courts started to take an "*un-Delaware-like approach*"[981] of heightened scrutiny.[982] In the ***Kerbs*** case,[983] the approach followed was fundamentally a quest for reviewing the *substance* of a compensation package, and not simply *the procedure* of its award.[984] The court held that whether a stock option plan is valid *"it depends directly upon the existence of consideration to the corporation and the inclusion in the plan of conditions, or the existence of circumstances which may be expected to*

---

977 See for instance the case of Rogers v. Hill, 289 U.S. 582 (1933); text of the case *available at* http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=us&vol=289&invol=582, (last visited on February 11th 2011); See also Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 113 (N.Y. Sup. Ct. 1934); See also, McQuillen v. National Cash Register Co., 112 F.2d 877 (4th Cir. 1940).
978 Heller v. Boylan, 29 N.Y.S.2d 653, 680 (N.Y. Sup. Ct. 1941), at 680.*[emph.add.]*
979 McQuillen v. National Cash Register Co., 112 F.2d 877 (4th Cir. 1940), at 653.
980 Id.; *See also* quoted definition in *supra* note 741.
981 Henn Harry G., Book Review, 49 Cornell L.Q. 14, [574, 576], 1964, at 576.
982 See Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 664 (Del. 1952); See also Kerbs v. Cal. E. Airways, Inc., 90 A.2d 652, 656–58 (Del. 1952).
983 Kerbs v. Cal. E. Airways, Inc., 90 A.2d 652, 656–58 (Del. 1952).
984 Id. at 656-657.

insure that the contemplated consideration will in fact pass to that corporation."[985] Under the *Kerbs* test, several elements could be considered sufficient consideration, what was important was the necessity of "*a reasonable relationship between the value of the services to be rendered […] and the value of the options granted as an inducement or compensation*."[986]

This period of heightened scrutiny approach was to be short-lived by Delaware courts. Starting from 1953, for several decades, court intervention happened only for extreme cases of no consideration,[987]or for cases when no reasonable business person could have entered the relationship under scrutiny.[988] As one scholar summarized it in 1990, referring to Delaware corporations, *"the business judgment rule protects almost any compensation decision made by a disinterested committee of the board*."[989]

Another more recent attempt of Delaware courts to deal with executive compensation via fiduciary duties was in the famous ***Walt Disney*** case.[990] The same case was also analyzed with regards to its role in defining *bad faith* in the previous chapter of fiduciary duties; here the discussion will focus on its treatment of executive compensation via fiduciary duties. The facts of the case are known by now, due to the previous discussion. At the heart of the case was the hiring, firing and excessive compensation around $ 130 million received by Ovitz, the president

[985] Id. at 656.
[986] Id.
[987] Michelson v. Duncan, 407 A.2d 211, 223 (Del. 1979).
[988] Lewis v. Vogelstein, 699 A.2d 327, 338 (Del. Ch.1997), at 336.
[989] Yablon Charles M., *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 Columbia Law Rev., [1867, 1904], 1992, at 1904.
[990] In re Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005), aff'd, 906 A.2d 27 (Del. 2006); In re Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del. Ch. 1998), aff'd in part, rev'd in part sub nom. Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

of Disney.[991] Ovitz had spent a very short time in such position and allegedly did not contribute much to the affairs of the corporation.

The plaintiffs in the case argued a breach of fiduciary duties, claiming that the directors had acted in bad faith (the latter to be considered as part of the duty of loyalty, and not a free-standing fiduciary duty, as clarified fully by a later case),[992] especially given the fact that there was no external expert advice on the compensation awarded, no reference to the industry standard, and the decision was taken within the flash time of one hour of '*deliberations*'.[993]

The case went through several phases of adjudication, remands and reversals, but in the end, a 2005 trial on the merits found no breach of fiduciary duties and no waste committed by directors.[994] The decision was upheld one year later by the Delaware Supreme Court.[995]

Although these decisions were fairly critical to the methods employed by the directors of the company, characterized as far from best practices, in the end, they evidenced that good faith as part of the fiduciary duty of loyalty, would not be an easy way to challenge negligent compensation decision making.[996] Mere inattentive director decisions would not mount to the necessary level of bad faith required to overcome the business judgment rule, and afford a chance to courts to scrutinize more closely executive compensation.[997]

The picture given above of fiduciary duties as a means to tackling problems of executive compensation, is a picture of long periods of reluctance to intervene in executive compensation

---

[991] Thomas Randall S. & Wells Harwell , *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, 95 Minn. Law Rev., [846, 903], February 2011, Available at SSRN: http://ssrn.com/abstract=1571368, (last visited March 12th 2011), at 875.
[992] Stone v. Ritter, 911 A.2d 362 (Del. 2006).
[993] In re Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del. Ch. 1998), at 64-68.
[994] In re Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005).
[995] In re Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).
[996] Randall S. & Wells Harwell , *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, 95 Minn. Law Rev., [846, 903], February 2011, Available at SSRN: http://ssrn.com/abstract=1571368, (last visited March 12th 2011), at 878.
[997] Id.

matters, interrupted only temporarily by some *awakenings* of higher scrutiny, that fade away quickly. Whether this is due to the idea that courts feel a certain obligation to react strongly usually in times of scandals and moral panic, if this is the case, then, there is no better time than the present aftermath of the financial crisis to test their stance.[998]

3.3.3 Angry America? Reactions to the Financial Crisis.

A constant feature that has accompanied the discussion on executive compensation be it by courts, legislators or academics, has been the problem of encouraging short-termism of executives through compensation incentives.[999] Short-termism and excessiveness of executive compensation were, yet again, the topic of the day in the reforms undertaken during and after the financial crisis of 2007, reforms which will be addressed here.[1000]

One important such reform had to do with the passing of the Emergency Economic Stabilization Act of 2008,[1001] (EESA), introducing new rules for the executive compensation of executives of the participating institutions receiving aid, and establishing later on, via the Treasury Guidelines for EESA, a cap of $ 500,000 for senior executives of these institutions, with some waiving possibilities provided for the latter.[1002] The above cap was put for the total

[998] Id. at 879.
[999] See Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues,*17 Journal of Applied Corporate Finance 4, [8, 23], 2005, *available at* SSRN: http://ssrn.com/abstract=761970, (last visited February 10th 2011).
[1000] *See for instance* Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat, 3765, October 3 2008, *available at*: http://www.govtrack.us/congress/billtext.xpd?bill=h110-1424 (last visited on February 12th 2011); *see also* American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115, February 17 2009, *available at:* http://www.govtrack.us/congress/billtext.xpd?bill=h111-1 (last visited on February 12th 2011).
[1001] Id. referring to EESA.
[1002] US Department of the Treasury Press Release, Treasury Announces New Restrictions On Executive Compensation, 4th of February 2009, *available online at* http://www.whitehouse.gov/the_press_office/TreasuryAnnouncesNewRestrictionsOnExecutiveCompensation/ , (last visited on February 12th 2011), at II A, 1, II B, 1. The waiver of these caps could be done for cases of senior executives of participating financial institutions in the generally available capital access programs (as opposed to

amount of compensation for senior executives, except for restricted stock. Also, any extra compensation awarded must be awarded in the form of restricted stock, or other long-term incentives and it will vest when the government has been repaid with interest.[1003] There is one exception to the vesting period, namely that such vesting can alternatively occur "*after a specified period according to conditions that consider among other factors the degree a company has satisfied repayment obligations, protected taxpayer interests or met lending and stability standards.*"[1004]

Lastly, CEOs must re-certify compliance with these restrictions on an annual basis, and the structure and strategy of such compensation must be disclosed and subjected to a non-binding say-on-pay shareholder resolution.[1005] The disclosure should include a rationale as to how is compensation tied to sound risk-management, and how does it not encourage excessive risk-taking.[1006]

The restrictive attitude of the American legislators towards executive compensation continued similarly with the enactment of the American Recovery and Reinvestment Act of 2009[1007] (also known as the Economic Stimulus Bill, hereinafter ARRA), for institutions receiving aid under the Troubled Asset Relief Program (hereinafter TARP)[1008] According to this bill, TARP recipients cannot give golden parachute payments to the senior executive officers and the next five most paid employees in the company.[1009] It also provides a '*shaming tool'* on

companies receiving exceptional financial recovery assistance) if done with full public disclosure and shareholder vote. Id. at II B, 1.

[1003] Id. at II A, 2.

[1004] Id.

[1005] Id. at II A 3, II B 1.

[1006] Id.

[1007] American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115, February 17 2009, *available at:* http://www.govtrack.us/congress/billtext.xpd?bill=h111-1 (last visited on February 12th 2011), (hereinafter ARRA).

[1008] The TARP became part of EESA, *see* EESA in supra note 997.

[1009] ARRA 2009, § 111 (b) 3 (C).

luxury perks enjoyed by executives, by requiring the board of directors to provide a policy regarding luxury and excessive expenditures.[1010]

3.3.3.1 A Time of Pay Czars?

A very interesting recent development that has demonstrated the intent of the federal government to intervene strongly in the financial industry, has been the appointment in June of 2009, of Kenneth Feinberg, as a so-called "*Pay Czar*"[1011] authorized to conduct government oversight, give advice and decide on the excessiveness of the executive pay of the 5 most senior, and the 25 top paid executives of the institutions receiving financial aid.[1012] Amongst the companies locked in the TARP falling under his scrutiny, were Citigroup Inc., American International Group Inc. and Bank of America Corp.[1013] The vesting of such authority to a single individual, clearly suggests that the federal government fully intends to intensify its role in corporate matters.[1014]

A lot of Wall Street curiosity surrounded the figure of the *Pay Czar* immediately, the main concern being whether, in deciding on excessiveness, he would look merely at the size of

[1010] ARRA 2009, § 111 (d).
[1011] Story Louise & Labaton Steven, *Overseer of Big Pay Is Seasoned Arbitrator*, New York Times, 11 June 2009, at 1, *available at:* http://dealbook.nytimes.com/2009/06/11/overseer-of-big-pay-is-seasoned-arbitrator/ , (last visited on February 12th 2011).
[1012]For a recent discussion on executive compensation in the financial industry sector, *see* Core J. E. & Guay W. E., Is There a Case for Regulating Executive Pay in the Financial Services Industry?, January 2010, Electronic Article *available* at: http://knowledge.wharton.upenn.edu/papers/download/Brookings_Core_Guay_1_25_10_SSRN.pdf, (last visited February 12th 2011).
[1013] Story Louise & Labaton Steven, *Overseer of Big Pay Is Seasoned Arbitrator*, New York Times, 11 June 2009, 1, *available at:* http://dealbook.nytimes.com/2009/06/11/overseer-of-big-pay-is-seasoned-arbitrator/ , (last visited on February 12th 2011).
[1014] Id. Feinberg had previously helped the Bush administration to settle possible lawsuits by the victim families of the terrorist attacks on September 11th 2001.

the compensation or at the fact whether the compensation mechanisms encouraged excessive risk taking.[1015]

After his first report in July 2010, Wall Street could breathe freely. Feinberg's report on the compensation practices of banks profiting from government help provided that 17 of these banks had given executives $ 1.6 billion in "*ill-advised*" compensation, but this happened before he was assigned his role in 2009.[1016] Albeit noting that some payments were in excess of $ 10 million per executive, he declined to request any return, since he didn't find them against the public interest, neither did he wish to engage into triggering private lawsuits or proposing additional congressional action.[1017] One suggestion given by Feinberg and which was completely voluntary, proposed that banks give to compensation committees in their boards, the right to restructure executive compensation during a period of crisis. However, the first reaction to this proposal was mere passivity from the banks.[1018] Indeed, considering the circumstances of the appointment of the *Pay Czar* and the attribution of considerable authority, the disappointment stemming from some academics with regards to his report and its recommendations, was not all unexpected.[1019]

3.3.3.2 Say-on-Pay

[1015] McGrane Victoria, *Feinberg Won`t Ask Firms to Turn $ 1.6 Billion in Payouts*, Dow Jones News, 23 July 2010, electronic article available at: http://www.advfn.com/news_2nd-UPDATE-Feinberg-Wont-Ask-Firms-To-Return-1-6-Billion-In-Payouts_43725304.html, (last visited February 13th 2011).
[1016] Id.
[1017] Id.
[1018] Core J. E. & Guay W. E., Is There a Case for Regulating Executive Pay in the Financial Services Industry?, January 2010, Electronic Article *available* at: http://knowledge.wharton.upenn.edu/papers/download/Brookings_Core_Guay_1_25_10_SSRN.pdf, (last visited February 12th 2011), at 14.
[1019] Id.

One of the most recent changes in the regulatory fury amidst the financial crisis and its consequences was the introduction of a proposal on the Shareholder Bill of Rights[1020] which has now been incorporated into a more comprehensive bill on financial services regulation, namely the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter Dodd-Frank Act).[1021] Another relevant previous bill that was consolidated in the above law was the Corporate and Financial Institution Compensation Fairness Act.[1022] One of the most important changes brought with regards to executive compensation, is the introduction of a non-binding shareholder vote, no less than every three years, to approve the compensation of a public corporation`s executive officers.[1023] It also requires a shareholder non-binding vote at least every six years, determining whether the above say-on-pay vote, should take place every one, two or three years.[1024] In January 2011, the SEC, as required by the Dodd-Frank Act, passed the rules approving shareholder say-on-pay votes on executive compensation, say-when-on-pay votes regarding the timing of the above votes, and say-on-pay votes for golden parachutes, effective as of April 4th 2011.[1025] The effects of these new rules are yet to be seen, but the hope of those concerned with their effectiveness, remains the belief that, although shareholders say-on-pay is non-binding, boards will find it somehow necessary to follow their recommendations.

[1020] A Bill to Provide Shareholders with Enhanced Authority over the Nomination, Election and Compensation of Public Company Executives, 111 S. 1074, 2009. (proposed legislation covered now by the Dodd-Frank Act), *available* at: http://thomas.loc.gov/cgi-bin/query/z?c111:S.1074:, ((last visited on February 12th 2011).
[1021] *See* Dodd-Frank Act of 2010, at supra note 777.
[1022] An Act To Amend the Securities Exchange Act of 1934 to Provide Shareholders with an Advisory Vote on Executive Compensation and to Prevent Perverse Incentives in the Compensation Practices of Financial Institutions, (Corporate and Financial Institution Compensation Fairness Act of 2009 incorporated now in Dodd-Frank Act), H.R. 3269, July 31 2009, information *available* at: http://www.govtrack.us/congress/bill.xpd?bill=h111-3269, (last visited February 12th 2011).
[1023] Section 951 of Dodd-Frank Act, amending Section 14A of the Securities Exchange Act of 1934.
[1024] Id. Dodd- Frank Act requires inclusion of the first of each of these resolutions in the proxy for the first annual or other shareholder meeting, after six months after its enactment. That means that all companies subject to it, holding a shareholder meeting after January 21st 2011, need to include these resolutions.
[1025] SEC Press Release, SEC Adopts Rules for Say-on-Pay and Golden Parachute Compensation as Required Under Dodd-Frank Act, 2011-25, 25 January 2011, *available* at: http://www.sec.gov/news/press/2011/2011-25.htm, (last visited 12th February 2011).

A last proposal, yet to be finalized by the rulemaking activity of the SEC, concerns acting on the introduction of a mandatory requirement for compensation committees to be composed solely of independent directors, and requirements regarding compensation advisors and their independence.[1026] In terms of the expected effects, given that many companies already provide for committees composed solely of independent directors, the new rule is not expected to cause a significant impact.[1027]

It is clear from the above analyses that the evolution of executive pay in the U.S. has undergone a long history. Regulating executive compensation, albeit a controversial issue for decades, has been a process characterized predominantly by the courts` reluctance to engage in higher scrutiny, limitation of the reach of fiduciary duties, and a passivity of the SEC to use the relevant SOX provisions in cases of account misstatements. More recently, a new trend has begun. The federal government has openly stated its intent to strengthen its intervention in the corporate affairs, (especially so in the financial industry), and has emphasized the necessity to provide long-term incentives for executives and not reward excessive risk-taking. Restrictions in the form of caps, limitations on the use of options, the recent SEC approach on finding liability of executives without their personal involvement in misconduct, and the proposed rules on increasing the independence of the process of setting executive pay, all these elements, witness the beginning of a phase of stricter regulatory approach to executive compensation.

[1026] SEC Press Release, SEC Proposes Rules Requiring Listing Standards for Compensation Committees and Compensation Consultants, 2011-78, 30 March 2011, available at: http://www.sec.gov/rules/proposed/2011/33-9199.pdf, (last visited April 2nd 2011). The SEC is expected to issue its final rule on the period of August-December of this year. The SEC rule-making schedule as provided by updates published on July 29, 2011, available at: http://www.sec.gov/spotlight/dodd-frank.shtml, (last visited on July 31st 2011).
[1027] See previously approved NYSE rules by the SEC, SEC Release No. 34-48745, Order Approving Proposed Rule Changes and Amendments on Listed Company Manuals of NASD and NYSE, [68 FR 64154], November 4 2003.

3.4. Executive Compensation in the Chosen EU Jurisdictions

As noted in the historical analysis of executive compensation in continental Europe,[1028] this discussion differs from the American one, due to the different patterns of concentration of ownership,[1029] the different board structures[1030] and due to the reform paths chosen, (or refrained from), as a result of the specific characteristics of the corporate governance approach.[1031] The next subsections will deal mainly with executive compensation in Germany and then, with relevant examples of the yet underdeveloped framework of regulating executive compensation in Romania and Czech Republic. The discussion will mainly analyze the process of setting executive compensation, assurance of independence in this process, German case law on fiduciary duties employed to tackle excessive executive compensation, and the fragmented framework of regulating aspects of executive compensation via Codes of Corporate Governance in the chosen CEE jurisdictions.

4.1.1 Setting Executive Compensation in Germany

In Germany, as the typical two tier board model, the executive pay of individual management board members is decided by the Supervisory Board,[1032] while the compensation of the members of the latter must be decided by a shareholders` resolution, or the Articles of

[1028] See supra section 3.2.3 and related discussion.
[1029] *See* Franks J. & Mayer C., *Ownership and Control of German Corporations,* 14 Rev. of Financial Studies 4, [943, 977], 2001; For CEE countries *see* Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe,* in: Cornelius, P.K., Kogut, B. (eds.), *Corporate Governance and Capital Flows in a Global Economy*, (267, 304), Oxford University Press, UK, 2003.
[1030] *See* Hopt Klaus J. & Leyens, Patrick C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy,* ECGI - Law Working Paper No. 18/2004, *available at* SSRN: http://ssrn.com/abstract=487944 or doi:10.2139/ssrn.487944, (last visited February 13th 2011).
[1031] For the factors fostering and withholding reforms regarding executive compensation in Germany, *see* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001
[1032] § 87(1) AktG.

Incorporation. Compensation must be reasonably related to the functions of the member and to the financial situation of the company.[1033] Here, the existence of the two-tier model might serve as an alleviation of the presumed bias in deciding compensation of executives, given that members of the Management Board are precluded from sitting on Supervisory Boards.[1034] However, there have been concerns about the proper exercise of this function by the Supervisory Board given its infrequent meetings.[1035] Furthermore, the amendment of the AktG in 2009[1036] no longer permits full delegation of new employment agreements for management to a committee. The decisions regarding structure, amount and adjustment of compensation, are now a duty of the Supervisory Board's plenum's obligations, while so called *personnel committees* have only a preparatory function.[1037]

The issue of independence of directors has been a controversial topic in Germany.[1038] Although aware that the efficiency of having independent directors, in terms of firm performance, has not yet been established empirically,[1039]for the purpose of tracing whether the compensation - setting process results from an unbiased, *arms` length* contracting position, (which can, at least, be presumed more so, in cases of directors free from conflicts of interest), it is important to have a look at the provisions regarding independence of those in charge of this decision. The following discussion points to certain features of the German corporate

[1033] § 113(1) No. 1, 2, 3 AktG.
[1034] §§ 105(1), 111(1) AktG.
[1035] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 529.
[1036] 107(3) No. 3 AktG as amended in 2009 by VorstAg. For VorstAG.
[1037] Id.
[1038] See Lieder Jan, *The German Supervisory Board on Its Way to Professionalism*, 11 German Law journal 2, [115, 158], 2010, available at: http://www.germanlawjournal.com/pdfs/Vol11-No2/PDF_Vol_11_No_02_115-158_Articles_Lieder.pdf, (last visited February 12th 2011).
[1039] Hopt Klaus J., *Comparative Corporate Governance: The State of the Art and International Regulation*, ECGI Law Working Paper No 170/2011, January 2011, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713750, (Last visited February 12th 2011), at 32.

governance approach, in order to see whether it favors an objective, unbiased decision on compensation of executives.

The 2005 EU Recommendation[1040] on independence of directors provided for a "*sufficient*"[1041] number of such directors in the Supervisory Boards. The recommendation further provided that, if allowed under national laws, the Supervisory Board should not be precluded for delegating part of its decision-making to special committees, which in turn should be composed mainly of independent directors.[1042]

The German approach does not follow strictly the recommended proposals. First, it is already stated that the duties of the compensation committees now involve merely preparatory functions.[1043] Second, the German Corporate Governance Code, (hereinafter GCGC),[1044] does not provide for a majority of independent directors, but instead for an "*adequate*" number of such directors.[1045] Given that compensation (personnel) committees do not have decision making powers regarding compensation, an independence requirement to this effect for such committees, would be moot. However, the GCGC approach means that, the decision of the Supervisory Board on setting compensation of executives would not necessarily stem from the *say* of a majority of independent directors. One can find the concern regarding the independence of those in charge of setting compensation, reflected in the provisions of the GCGC requiring members of the Supervisory Boards to disclose any conflicts of interest, especially material ones, in order to

---

[1040] Commission Recommendation 2005/162/EC, of 15 February 2005 On the Role of Non-Executive or Supervisory Directors of Listed Companies and On the Committees of the (Supervisory) Board, OJL 52/51, 29.02.2005, *available* at: http://www.corp-gov.gpw.pl/download/english_version/EC%20recommendation.pdf (last visited February 12th 2011).
[1041] Id. Sec. 8.
[1042] Id. Sec.(s) 10, 11.
[1043] § 107(3) No. 3 AktG as amended in 2009 by VorstAG.
[1044] Government Commission, German Corporate Governance, Code as amended on 26 May 2010, (hereinafter GCGC) *available* at: http://www.ecgi.org/codes/documents/cg_code_germany_may2010_en.pdf , (last visited February 12th 2011)
[1045] Sec 5.4.2 of GCGC.

assure that no member serves his own interests, at the expense of the company`s interest.[1046] Material and non-temporary conflicts of interest may even result in termination of a director`s mandate.[1047] This would mean that, since an interested member of the Supervisory Board would have to disclose such a conflict of interest in cases of a vote on compensation, in principle, he would have to be precluded from decision-making on compensation.

However, not only is this not provided in the above fashion in the provisions of GCGC, but also, such preclusion would ultimately be dependent on the specific member`s practical compliance with the duty to disclose such information. Practice has shown that German companies lag behind in terms of disclosing information regarding the independence of Supervisory Board members,[1048] and if such a practice prevails at an external disclosure level, it is not difficult to assume the possibility of inter-company disclosures following the same trend.

The requirements regarding the number of independent members of the Supervisory Board are not important if taken in isolation from the content of such independence.[1049] In Germany, the substance of the independence of Supervisory Board members is defined as lack of *"business or personal relations with the Company or its Management Board which cause a conflict of interests."*[1050]This recommendation remains relatively ambiguous and open to interpretation, with regards to what exactly would be considered as circumstances precluding independence.

[1046] Sec.(s) 5.5.2, 5.5.3 of GCGC.
[1047] Sec. 5.5.3 of GCGC.
[1048] Glass Lewis, *A Market-by-Market Preview of the 2010 Proxy Season Around the World*, 1 World Governance Focus 4, January 2010, available at: http://www.glasslewis.com/downloads/1220-126.pdf, (last visited February 12th 2011), at 14.
[1049] Hopt Klaus J., *Comparative Corporate Governance: The State of the Art and International Regulation*, ECGI Law Working Paper No 170/2011, January 2011, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713750, (Last visited February 12th 2011), at 32.
[1050] Sec. 5.5.2 of GCGC.

Furthermore, the GCGC provides that no more than two previous members of the Management Board can sit in Supervisory Boards,[1051] and as of 2010, even these ex-managers cannot do so within two years after their previous position has ended.[1052] The only exception provided to this rule, is in cases when their election is supported by shareholders representing at least 25% of the company`s share capital.[1053] Although a step forward in increasing independence, it is nevertheless difficult to imagine that this cooling-off period will manage to eliminate any previous relations and interests that ex-managers might have had.

The German reluctance to take a stronger stance with regards to the definition of independence and to provide for a majority of independent directors in Supervisory Boards, might also stem from a concern regarding the balance established via codetermination. Majority independence requirements would favor labor representatives as opposed to shareholder representatives.[1054]Unlike the EU recommended approach, Germany does not consider the representatives of large, controlling shareholders, as dependent.[1055]

Regarding the other group of employee representatives in Supervisory Boards where codetermination applies, as mentioned also in the historical part, their role has been considered as a potential counterbalance to excessive compensation, especially so given the concerns they would raise in cases of executive compensation being unfairly high compared to that of the employees.[1056] However, even this counterbalance has its own limits.

[1051] Id.
[1052] §100(2) of AktG as amended by VorstAG.
[1053] Id.
[1054] Hopt Klaus J., *Comparative Corporate Governance: The State of the Art and International Regulation*, ECGI Law Working Paper No 170/2011, January 2011, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713750, (Last visited February 12th 2011), at 27.
[1055] Lieder Jan, *The German Supervisory Board on Its Way to Professionalism*, 11 German Law journal 2, [115, 158], 2010, available at: http://www.germanlawjournal.com/pdfs/Vol11-No2/PDF_Vol_11_No_02_115-158_Articles_Lieder.pdf, (last visited February 12th 2011), at 132.
[1056] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 514-515.

First, there is no empirical study showing the influence of employees in deciding on executive compensation via representation in the Supervisory Board.[1057] Second, as the *Mannesmann* case will show, employee representatives are not always prone to providing such a counterbalance. [1058] As the case evidences, when employee representatives abstain from decisions on executive compensation, they basically give up from any Supervisory Board-related influence on the matter.[1059]

Other actors that might play a role in the compensation decisions of the Supervisory Boards of German publicly held companies are banks. One characteristic of German AGs is that banks control most of the small shareholders` votes through the proxy system[1060] and also, due to their seats in Supervisory Boards, they have informational advantage to become potential efficient monitors.[1061] However studies have shown that banks tend to focus more on advertising their lenders` status, rather than disciplining management.[1062]

Despite the deficiencies noted above regarding independence in the process of setting executive compensation, one cannot completely deny the role that the board structure of German Corporations and the participation of employees, can play in providing some kind of internal governance monitoring dynamic.[1063] These governance devices are not perfect, as the following section will reveal, yet they might have some explanatory effect on the traditional lower level of

[1057] Gevurtz Franklin A., *Disney in a Comparative Light,* Selected Works Publication, February 2007, *available* at: http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=franklin_gevurtz&sei-redir=1#search="disney+in+a+comparative+light", (last visited February 10th 2011), at 23.
[1058] Mannesmann AG BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1059] Id.
[1060] Haid A. &Yurtoglu B.B., *Ownership Structure and Executive Compensation in Germany*, 2006, electronic article *available at* SSRN: http://ssrn.com/abstract=948926 (last visited February 13th 2011) at 5.
[1061] Id.; In terms of independence, banks as lenders would not be deemed as such as per sec. 5.4.2 of GCGC.
[1062] *See* Dittmann I., Maug E. G. & Schneider C., *Bankers on the Boards of German Firms: What They Do, What They are Worth, and Why They are (Still) There,* 14 Rev. of Finance 1, [35-71], 2009, *available at* SSRN: http://ssrn.com/abstract=1093899, (last visited on February 13th 2011).
[1063] Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3, [497, 539], 2001, at 513-515, 529.

executive compensation in Germany, as compared to the U.S.,[1064] and they help to better understand the special nature of the German debate on executive compensation.

3.4.2 The Mannesmann Case: Judging Excessiveness?

The main issues regarding appropriateness of compensation, how can it relate to performance and whether it can be tackled via fiduciary duties, have all been epitomized in the landmark case of ***Mannesmann*** *AG*.[1065]

Known as the largest takeover in world history,[1066] the takeover of Mannesmann AG by Vodafone plc., led to what has been labeled as "*the biggest criminal trial in German corporate history*".[1067] The size of the companies and the reputation of the personalities involved in the case, made it go beyond the margins of the takeover event, and transformed it into an epitome for criminalizing German capitalism.[1068] Analyzing the legal claims of this case and the reasoning of the court, is a *sine qua non* for any discussion on executive compensation in Germany. The case involves a fundamental discussion on the German regime of executive compensation, the *criminalization* of excessive pay, and whether German courts can ultimately decide what constitutes appropriate compensation. Before analyzing the facts of the case, it is necessary to refer again to the concept of *Untreue*[1069] mentioned in the second chapter regarding fiduciary

[1064] Id. at 514-515.
[1065] Mannesmann Case, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1066] Clarke Thomas, International Corporate Governance: A Comparative Approach, Routledge, New York. 2007, at 404.
[1067] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at note 2 referring to Jenkins Patrick, *Germany on Trial*, Financial Times, 15 January, 2004.
[1068] Id. at 829.
[1069] § 266 I StGB

duties.[1070] *Untreue* refers to disloyalty or failure to attend to an interest when entrusted to do so, causing a disadvantage to the other party. As stated before, under the German Penal Code, the maximum penalty is five years, with the possibility of increasing it[1071] and both members of the Management and Supervisory Boards are subject to it[1072].

In the ***Mannesmann*** case,[1073] the concept of *Untreue* in the form of a breach of fiduciary duties, was at the heart of the problem. On February 2000, the CEO of Mannesmann AG, Klaus Esser agreed on the takeover by Vodafone plc., for the unprecedented price of € 178 billion, as opposed to the previous offer of € 101 billion.[1074] In the exact date of this finalized agreement, Esser was awarded a so-called "*appreciation award* "[1075] of € 15 million, while beforehand, he had spent around € 200 million to oppose the takeover.[1076] This, together with other bonuses and awards amounting to € 60 million, were approved only days later by the *Präsidium*, a structure to which the Supervisory Board had delegated powers to act as a non-executive compensation committee. The members of the committee were well-known business personalities and representatives of employees.[1077]

[1070] Conac P. H., Enriques L. & Gelter M., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, ECGI - Law Working Paper No. 88/2007, October 2007, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532221, (last visited on February 11th 2011). In Germany, *Untreue* basically means "disloyalty" referring to cases when *"...a person authorized to dispose over someone else's property or to bind another person abuses her authority to do so, or when a person subject to a duty to attend to someone else's financial interests violates the duty, and when this results in a disadvantage to the other person.*" Id. at 31

[1071] § 266 II StGB (as it refers to §§ 243 II and 263 III StGB).

[1072] Conac P. H., Enriques L. & Gelter M., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, ECGI - Law Working Paper No. 88/2007, October 2007, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532221, (last visited on February 11th 2011), at 31;.

[1073] Mannesmann AG 22.07.2004, Landgericht Düsseldorf, XIV 5/03, NJW 3275/2004; Mannesmann Case, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006. (the second referring to the Federal Criminal Court decision).

[1074] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 829.

[1075] Id. at 832.

[1076] Id.

[1077] The members of the committee consisted of *Ackermann* of *Deutsche Bank*, *Funk* as the supervisory board chairman, both representatives of stockholders; *Ladberg* as chairman of the shop council for the company and *Zwickel* of *IG Metall* as representatives of employees. Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of

The factual circumstances evidencing the way that the compensation assessment was reached, reveal that the decision was initially taken in a session attended by the two representatives of shareholders, without the presence of the other two employee representatives. Later on, the employee representative was called and informed on the decision, and considering the latter as *not* related to employee concerns, he agreed to participate by casting an abstain vote, meaning basically that he *approved* the awards.[1078] The main problem was therefore whether the former directors of *Mannesmann* had committed *Untreue* or breach of their fiduciary duties, when after the takeover, they approved in good faith, awards and pensions worth some € 60 million.[1079]Charges for *Untreue* were brought against the Supervisory Board members who were representatives of the stockholders and against one employee representative,[1080] while three other defendants, including the CEO, the chairman of the shop council for the company, and the chief of personnel, were charged with aiding the breach of fiduciary duties.[1081] The central question under scrutiny was basically, whether the compensation awards violated German law as a breach of fiduciary duties warranting criminal penalties, which, albeit labeled as such, evidenced a primary attack aimed at curbing the excessive 'size' of the executive payments awarded.[1082]

February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 8.

[1078] Id.; Amidst all this, there was also a media frenzy over bribery allegations regarding Esser`s payment. However, central to this discussion are not the bribery allegations, but rather the review by the courts of the legality of the payments awarded absent bribery. Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 832-833.

[1079] Id. Referring to Kolla Peter, at 830.

[1080] Claims for breach of trust were brought against Ackerman , Zweickel and Funk.

[1081] Namely, Esser, Ladberg and Ditmar were charged with aid to the breach of trust. Ditmar held the position of th chief of personnel. Gevurtz Franklin A., Disney in a Comparative Light, 26 February, 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 8-9.

[1082] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 830.

The defense, argued that the scope and stretch of *Untreue* was vague and overly broad and referred to the permissive language of the AktG, which provides for "*appropriate*"[1083] compensation.[1084] The question therefore became one of whether the courts were the proper venue for deciding on such appropriateness. The defense was certainly opposed to the idea with Ackerman, one of the defendants in the capacity of a stockholder representative, arguing that even if the CEO was to be paid € 1 billion,[1085] this payment would be appropriate, considering the 120% rise in the share price during the takeover battle under his leadership.[1086] According to him, what was crucial to the compensation decision was that, ultimately, the CEO`s conduct had served the interests of shareholders via the obvious increase in share prices and these interests were of primary importance.[1087]

Another defense line was to blame the attack on Mannesmann`s executives on the disclosures that had to be made because of Vodafone`s requirements under British law.[1088] Such disclosures made the payments public and open to attack, but this did not necessarily mean, according to the defense, that other companies refrained from awarding the same: they just didn`t disclose them. A final defense argument was to suggest that the sums awarded as compensation, when compared to executive pays elsewhere (implying the U.S.), were matters of everyday business.[1089]

All the defense arguments mentioned above are brought under discussion because they touch upon critical issues of German corporate governance. Claiming supremacy of shareholders in a stakeholder model, evaluating executives` performance via share prices, blaming disclosure

[1083] § 87 (1) i AktG.
[1084] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 834.
[1085] Id.
[1086] Id.
[1087] Id.
[1088] Id. at 836.
[1089] Id. at 835-836

as the reason why '*excessiveness'* becomes evident, and trying to define German '*excessiveness*' by American standards, were all crucial demands awaiting responses by the German courts.[1090] Especially of interest is the last defense argument regarding the definition of 'excessive' compensation, given the traditional German aversion towards excessiveness, which exists irrespective of whether the said manager has indeed created value for the company, as evidenced by the strong reactions from the prosecutors, the media and the public.[1091]

The German court deciding on the case was facing a big challenge.[1092] It ultimately had to decide on the criteria for considering executive compensations as *inappropriate enough* to warrant a criminal conviction, and distinguishing it from circumstances warranting a mere breach of the AktG provisions. The court had to basically set a benchmark on what constitutes *criminal pay.*[1093]

On one hand, the amount of the compensation awarded, clearly ran counter to the traditional German averse attitude towards excessiveness; on the other hand, it was impossible to decide on whether this compensation was inappropriate, without questioning evidence surrounding the event of the takeover, which would require a detailed analyses of crucial concepts such as codetermination, a shareholder model and beyond, Germany`s entire social welfare state.[1094] Courts would not be equipped to dive into tasks of this character and test such fundamental concepts.

[1090] Gevurtz Franklin A., Disney in a Comparative Light, 26 February, 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 27-31.
[1091] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 835; See also Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007 *available at* SSRN: http://ssrn.com/abstract=1705686 (last visited on February 10th 2011), at 515.
[1092] Mannesmann AG 22.07.2004, Landgericht [District Court] Düsseldorf, XIV 5/03, NJW 3275/2004.
[1093] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 830.
[1094] Id. at 847.

Furthermore, the outcome of this case would test Germany`s stance towards attracting international investors and accepting American levels of executive pay,[1095] and it would answer the dilemma between accepting the latter practices that had already entered the German corporate realm, or preserving the equality oriented German attitude towards pay.[1096]

The answer, at least framed as a choice between the above two options, did not come. The only clear answer derived was that this case would not put the foundations of the German corporate culture *under trial*.[1097] The defendants were acquitted on criminal charges, although the district court found that they had violated the provisions of the AktG by breaching their fiduciary duty when awarding the payments, with the main reason being that there was no longer any contractual duty to award the payments.[1098] Also given the control conferral to Vodafone plc., Mannesmann AG had nothing to gain from awarding these sums to executives that were leaving the company.[1099] In the court`s opinion, there was no criminal case since there was no "*aggravated*"[1100] breach of duty, sufficient to violate the *Untreue* concept. In trying to define the term "*aggravated*", the court referred to circumstances dictating the opposite, namely that the profits of the company were healthy, the decision was taken diligently and transparently, and there was no unlawful purpose by the members of the Supervisory Board.[1101]

[1095] The case gained enormous publicity in the media especially regarding concerns over the adoption of pays that were common elsewhere such as in the US. *See* All Acquitted in Mannesmann Trial, Deutsche Welle World, 22.07.2004, electronic article available at: http://www.dw-world.de/dw/article/0,,1273617,00.html, (last visited on February 22nd 2011).
[1096] Id.
[1097] Mannesmann AG 22.07.2004, Landgericht Düsseldorf, XIV 5/03, NJW 3275/2004; Rolshoven Max Philipp, *The Last Word? - The July 22, 2004 Acquittals in the Mannesmann Trial*, 5 German Law Journal 8, [936, 940], 2004, *available* at: http://www.germanlawjournal.com/pdfs/Vol05No08/PDF_Vol_05_No_08_935-940_Private_Rolshoven.pdf, (last visited February 22nd 2011), at 940.
[1098] Mannesmann AG 22.07.2004, Landgericht Düsseldorf, XIV 5/03, NJW 3275/2004.
[1099] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 9.
[1100] Id.
[1101] Id.

The case was appealed to the Criminal Division of the Federal Supreme Court,[1102] which reversed the acquittal on the ground that not only an "*aggravated*"[1103] breach of fiduciary duties violates the criminal code provisions, and ordered a retrial on an "*ignorance of the law*" defense.[1104] The defendants would avoid conviction if it could be established *"through unavoidable error, they did not know they were breaching their duty*."[1105] The case was in the end settled for € 5.8 million before retrial.[1106]

Despite the settlement, it is important to analyze the Federal Court`s approach[1107] in order to detect the level of deference that a German court would grant to business judgment decisions.[1108] Although the court recognized the protection offered under the business judgment rule, it stated that there was no advantage gained from Mannesmann AG by incentivizing its CEO.[1109] So far this seems like a German analogue of a U.S. waste claim.[1110] The court however went further.

First, it suggested that although recognizing the benefits that might generally come to a company through incentivizing its managers, Esser`s leaving, (scheduled mere months after the takeover), meant that this specific manager could give nothing more to the company.[1111]

Secondly, the court stated that, additionally, the bonus did not bring any further

[1102] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW, 522/2006.
[1103] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 9.
[1104] Id.
[1105] Id.
[1106] Simensen Ivar, *Trial of Mannesmann Six Set to Finish with Fines of €5.8m,* Financial Times, 25 November 2006, *available* at: http://www.ft.com/cms/s/0/5247cc98-7c2a-11db-b1c6-0000779e2340.html#axzz1JdhpTNxA, (last visited February 22nd 2011).
[1107] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1108] The German case law recognized the business judgment rule formally in the case of Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997. It was also provided for in § 93 II (2) AktG.
[1109] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 10-11.
[1110] *See* Heller v. Boylan, 29 N.Y.S.2d 653, 680 (N.Y. Sup. Ct. 1941).
[1111] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 10-11.

reputational effects of the company in the eyes of other managers, given that Vodafone plc. was taking over the management of Mannesmann AG.[1112] At this point, the court`s reasoning was not free of ambiguities, given that, it found the reputational benefits of Mannesmann AG irrelevant, due to the takeover event and in disregard of the business judgment rule, but at the same time, it insisted on considering it as a separate entity, when rejecting the defense that Vodafone plc. had agreed to these payments.[1113] The court also refused to see any reputational benefit passing to Vodafone plc., witnessing in this way a different standard of less deference to the business judgment rule and a tendency to second guess the protections offered under it.[1114]

Several interesting points derive from the outcome of this case.

First, regarding the potential deterrence role that employee representatives can have with regards to excessive compensation, the case is illustrative of a passive attitude. The abstain vote of the employee representative in the compensation decision, shows that employees will not always act as a counterbalance assuring some form of appropriateness of executive compensation.[1115] Although there was a strong employee opposition to the awards after the compensation award was made public,[1116] the case simply evidences the lack of employee power to have a say on executive compensation, when their representatives agree in most cases with the stockholders' advocates in Supervisory Boards.

Secondly, the case serves as an example of the difference in the paths chosen to address these cases in Germany and the U.S. In Germany, the case was considered under criminal law,

[1112] Id. at 11.
[1113] Id.
[1114] Id.; Also, even in the case known as the introduction of the business judgment rule in Germany, when it came to the decision of the company whether to pursue litigation against the chairman of the management board, the court paid little deference to this issue. See, Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997.
[1115] Id. at 21-22.
[1116] Id. at 22.

while in the U.S., it came in the form of shareholder derivative litigation.[1117] At first impression, the difference illustrates a potentially higher sense of seriousness or gravity attached to the breach of fiduciary duties for excessive executive compensation situations in Germany. This can be derived from the fact that *Mannesmann* was brought under the criminal concept of *Untreue*, and also from the reasoning of the Federal Criminal Court, providing that not only aggravated cases would be deemed sufficiently serious to warrant a conviction.[1118]

Lastly, German courts appear more skeptical, compared to their U.S. analogues, with regards to the standard of deference to the business judgment rule.[1119]The case raises another fundamental concern regarding the unanswered question of whether courts will go one step ahead with their low deference to the business judgment rule, and identify some clear guidance necessary to define appropriate compensation, rather than invade the protections of the same rule, to simply derive that no gain could come to the company from the bonuses awarded.[1120]The *Mannesmann* court had a chance to provide much needed interpretation on appropriate compensation, especially considering that the AktG provides a special provision that mandates a duty on the supervisory board, to provide a reasonable relation of the compensation of a member of management to his tasks and the situation of the company.[1121]This provision affords German courts a greater scrutiny power in cases of executive compensation, although the court in this

[1117] Id. at 32.
[1118] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006; However, the difference noted between the two jurisdictions, might also indicate a difference in the procedural aspects of the German litigation system, where civil litigation alternatives are not all too favored, as opposed to the U.S. In this sense, instead of viewing the German approach as one closer to criminalizing excessive pay, the case could be interpreted as more of a plea for procedural equilibriums that the civil and criminal litigation can provide for each other, in cases of a breach of fiduciary duties in Germany: when one is lacking in viability, the other will probably become more likely. Gevurtz Franklin A., *Disney in a Comparative Light*, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 36. For some procedural aspects of litigation in German corporate governance, *see* Paul Carsten A., *Derivative Actions under English and German Corporate Law – Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference*, 7 European Company and Financial Law Rev. 1, [81, 115], March 2010.
[1119] Id. (referring to the work of Gevurtz Franklin A.), at 14-15.
[1120] Mannesmann Case, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1121] § 87 (1) i AktG.

case declined to take the opportunity offered, perhaps also due to the fears of testing some fundamentals of the German legal culture.[1122]

The reason behind the silence of the court on this matter might have been of a more fundamental character, namely that, although the size of compensation did matter in this case (despite the label of the attack in the form of a breach of fiduciary duties),[1123] in a scenario where the sum awarded was to be less of a concern, what would have been the criteria to define 'good performance'? Would it be related to share prices or other considerations, such as preserving stakeholder protection and the principle of equality in their treatment?[1124] Could a German court be equipped to test such a complex issue?[1125] Even if the answers can not be found with certainty, it is exactly this nature of questions that sharpens a distinction between the U.S. and Germany with regards to executive compensation: namely, pointing out that a court, although opting not to decide on such matters, or not being equipped to do so, faces the challenge of whether it is *"more important to society to reduce inequality in wages, or to maximize wealth creation, if necessary, at the expense of greater inequality?*"[1126]It is no wonder then, that in the face of such questions, the court stated it would not put the German legal culture on trial.[1127]

[1122] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011). The author argued that: "*The question of the "appropriate" level of executive compensation is transcendental nonsense, because factors that are independent from the judgment of the court do not refer to the definition of "appropriate."",* Id. at 846.

[1123] It would take some compromised reasoning to imagine that the court would have acted the same for more modest compensations and in cases of no public panic. Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 26.

[1124] Id. 26-28.

[1125] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011). 845-846.

[1126] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 28.

[1127] *See* All Acquitted in Mannesmann Trial, Deutsche Welle World, 22.07.2004, electronic article available at: http://www.dw-world.de/dw/article/0,,1273617,00.html, (last visited on February 22nd 2011).

On the other hand, although avoiding some of the above questions, the finding by the court of a breach of fiduciary duties under AktG[1128] and the other characteristics of the case, point towards the tendency of preserving other critical German legal culture components. The public moral panic behind the way the case reached the court,[1129] the lower deference paid to the business judgment rule, the kind of empowered scrutiny that courts in Germany receive regarding appropriateness of compensation, and the fact that it would be difficult to presume a similar decision for more modest compensation amounts,[1130] all favor the idea that *the size* of executive pay *remains* a problem in German corporate governance and German legal cultural behaviors, which continue to emphasize the principle of equality and fairness with regards to compensation.[1131] Albeit the final outcome seemed as a triumph of the executives, the stages of the development of the case and the discussion around it, gave a somewhat implied verdict that attempted to preserve the German sense of aversion towards excessiveness, even though this came about without defining it in terms of appropriateness.

Having given this view on some fundamental issues of the German approach to executive compensation, the next section will deal with the most recent reforms passed in Germany and how they change (or aim to change) the executive compensation picture.

3.4.3 Reforming Executive Compensation in Germany

[1128] Mannesmann Case 22.07.2004, Landgericht Düsseldorf, XIV 5/03, NJW 3275/2004; Mannesmann Case, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1129] See All Acquitted in Mannesmann Trial, Deutsche Welle World, 22.07.2004, electronic article available at: http://www.dw-world.de/dw/article/0,,1273617,00.html, (last visited on February 22nd 2011).
[1130] Gevurtz Franklin A., Disney in a Comparative Light, 26 February 2007, Electronic Article available at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 25-29.
[1131] Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004, *available at*: http://www.germanlawjournal.com/article.php?id=460 (last visited February 14th 2011), at 830 -832.

In 2005, Germany passed the Board Member Monetary Compensation Disclosure Act (hereinafter VorstOG).[1132] This law mandated disclosure of individual compensations of members of the Management Board, and the GCGC was subsequently amended to accommodate these changes.[1133] The previous regulation via section 285(9) of the German Commercial Code (hereinafter HGB)[1134] prescribed disclosure of an aggregate number, i.e. total board compensation. The HGB however mandated firms to abstain from these disclosures if they would allow for inferences to compensation, based on privacy protection concerns.[1135] The first version of the Corporate Governance Code included merely a suggestion for companies to provide individualized disclosures of executive compensation,[1136] while from 2003 to 2005, it *recommende*d such disclosure, including therefore publicity with regards to its compliance or lack thereof.[1137] However, according to article 161 of AktG[1138] listed companies are required to disclose annually any deviation from the Code's recommendations and, as of 2009, they need to give explanations on this point, while suggestions need not be necessarily reported.[1139]

The new disclosure requirement has its own exception, given that companies may opt-out from such publications, if so decided by a three-quarters vote at the annual shareholders

---

[1132] Law on Board Member Monetary Compensation Disclosure Act [*Vorstandsvergütungs-Offenlegungsgesetz*] of 29.06.2005, published in the Lower House of the Parliament of the Federal Republic of Germany, [*Bundestag*] Official Printed Bulletin [*Bundestagsdrucksache (BT – Drs.)*] 15/5860, (hereinafter VorstOG).

[1133] German Commission on Corporate Governance, Amendment to the German Corporate Governance Code, 12 June 2006, available at: http://www.ecgi.org/codes/documents/cg_code_germany_june2006_en.pdf, (last visited February 12th 2011).

[1134] German Commercial Code [*Handelsgesetzbuch*] of 10 May 1897, published in Imperial Law Gazette [*Reichsgesetzblatt* (RGBI)]I S. 219, as amended most recently by the Act of 1.03.2011 BGBl. I S. 288, (hereinafter HGB), § 285 (9).

[1135] § 286 (4) HGB.

[1136]Berlin initiative Group, German Corporate Governance Code, 6 June 2000, *available* at: http://www.ecgi.org/codes/documents/gccg_e.pdf, (last visited February 12th 2011), sec. 6.

[1137] German Commission on Corporate Governance, Amendment to the German Corporate Governance Code, 21 May 2003, available at: http://www.ecgi.org/codes/documents/code_200305_en.pdf, (last visited February 12th 2011), sec. 4.2.4.

[1138] § 161 AktG.

[1139] Id.; *See also* Wymeersch Eddy, *The Enforcement of Corporate Governance Codes*, 21 Journal of Corporate Studies 1, [113, 138], April 2006, available at: http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Enforcement+of+CG+Codes/$FILE/EW_Enforcement+of+CG+Codes.pdf , (last visited February 13th 2011), at 126 et.seq.

meeting.[1140] Albeit from a legal perspective, a decision not to disclose can be made only through approval by shareholders, analyzing the cases of companies choosing this opt-out might discover a different dynamic to the decision process.[1141] It is understandable that from an economic point of view, the reasons to go unpublished will emanate from managers and the shareholders will have to back such a decision to opt-out. Therefore cases of resistance to disclosure can be explained only by *"[a] joint (consecutive) decision of managers and the majority of shareholders.*"[1142] Also, patterns of highly concentrated ownership in German AGs have been positively related to the resistance on disclosure.[1143] The passing of this new requirement is certainly a step forward from a legal perspective in improving transparency regarding individual compensations of board members, but the existence of the opt-out possibility leaves ample room for maneuvering.

The financial crisis had its effect on the regulation of executive compensation in Germany as well. Apart from the introduction of the German Financial Markets Stabilization Act,[1144] relating to executive compensation in companies in the financial sector, the new law on the Appropriateness of Executive Compensation, (hereinafter VorstAG),[1145] provided comprehensive restrictions for all German AGs, irrespective of the industry sectors. The new law amended the AktG, especially section 87 (1),[1146] which previously considered '*appropriateness*' as related to the tasks of the managing director and the status of the company. The new

[1140] §§ 285, 286, 314 of HGB.
[1141] Joerg-Markus Hitz & Werner Joerg R., *Why do Firms Resist Individualized Disclosure of Management Compensation?,* April 2010, electronic article, a*vailable at* SSRN: http://ssrn.com/abstract=1588186, (last visited February 12th 2011), at 11-16.
[1142] Id. at 8.*[emph.add]*.
[1143] Id.
[1144] German Financial Markets Stabilization Act [*Finanzmarktstabilisierungsgezetz*] of 17.10.2008 published in BGBl. I S. 1982, 46.
[1145] Appropriateness of Executive Compensation Act, [*Gesetz zur Angemessenheit der Vorstandsvergütung],* of 5 August 2009, published in BGBl. I S. 2509, 50.
[1146] § 87 (1) AktG as amended by VorstAG.

provisions add the obligation to consider also the managing director's *performance.*[1147] Although the GCGC version of 2009 already required such consideration, it is now stated clearly in the German law. [1148]

One crucial provision of the new law is the one requiring compensation not to exceed "*usual compensation*",[1149] absent good reasons, and to relate to customary compensations decided on an arms` length bargaining position.[1150] When deciding on compensation matters, the exact situation of the company shall be taken into account, and restrictions on compensation sums may result from negative company developments or extraordinary scenarios, such as liquidation or takeovers. Depending on these circumstances, if the level of compensation would be inappropriate, the Supervisory Board is supposed to reduce it *ex post*.[1151]

The new law also allows the option to cap compensation in cases of extraordinary circumstances.[1152] As already stated, the amended section 107 (3) of AktG, provides that no longer can parts of the process of decision-making on compensation, be referred to a committee.[1153] In terms of disclosure, VorstAG provides for additional disclosures of benefits paid in early and irregular termination cases, as well as disclosures on the compensation changes incurred during the term of one business year.[1154]

[1147] Id.
[1148] German Commission on Corporate Governance, German Corporate Governance Code, 18 June 2009, *available* at: http://www.ecgi.org/codes/documents/cg_code_germany_june2009_en.pdf, (last visited February 14th 2011), sec. 4.2.2.
[1149] § 87 (1) AktG as amended by VorstAG. The term used in German is "*übliche*"; *See also, Stricter Rules for Remuneration of Management Board Members in German Stock Corporations - Extended Liability for Members of the Supervisory Board*, A Gibson Dun & Crutcher LLP Informational Electronic Publication, 24 August 2009, *available* at: http://www.gibsondunn.com/publications/pages/StricterRules-BoardMembersinGermanCorporations.aspx, (last visited February 14th 2011).
[1150] Id.
[1151] § 87 (2) 1 AktG as amended by VorstAG.
[1152] Id.
[1153] § 107 (3) AktG as amended by VorstAG.
[1154] §§285, 314 HGB as amended by VorstAG.

The new law restricts the use of short term compensation schemes and is aimed at orienting the activities of the Management Board towards the sustainable, long-term, company interest.[1155] Variable compensation shall be aligned with the sustainable development of the company and, albeit not strictly prohibiting short-term payment incentives, the combination between the short-term and long-term performance schemes, will need to show that it serves the purpose of the sustainable development of the company as an overall result.[1156] VorstAG also requires the term of the exercise of stock options, granted to members of the management, to be four years.[1157]

In cases when the members of the Supervisory Board do not observe the restrictions set by this law when determining executive compensation, they will be liable for damages towards the company, as expressly defined now in Section 116 of the AktG.[1158] Breach of compliance with this article will include instances such as, agreeing on compensation high enough to be considered inappropriate, with the criteria for the last determination being in reference to the market standards, industry standards and firm standards, taking also into consideration the specific performance of the manager.[1159]

[1155] § 193 2(4) AktG as amended by VorstAG; See *Stricter Rules for Remuneration of Management Board Members in German Stock Corporations - Extended Liability for Members of the Supervisory Board*, A Gibson Dun & Crutcher LLP Informational Electronic Publication, 24 August 2009, *available* at: http://www.gibsondunn.com/publications/pages/StricterRules-BoardMembersinGermanCorporations.aspx, (last visited February 14th 2011).
[1156] Id.
[1157] §193 (2) 4 AktG as amended by VorstAG. The previous term used to be two years.
[1158] § 116 AktG as amended by VorstAG.
[1159] § 87 (1) AktG as amended by VorstAG.; See *Stricter Rules for Remuneration of Management Board Members in German Stock Corporations - Extended Liability for Members of the Supervisory Board*, A Gibson Dun & Crutcher, Electronic Publication, 24 August 2009, *available* at: http://www.gibsondunn.com/publications/pages/StricterRules-BoardMembersinGermanCorporations.aspx, (last visited February 14th 2011).

Lastly, VorstAG also introduced a non-binding, shareholder say-on-pay, according to which, shareholders are now entitled to have an advisory vote on the compensation reports of German publicly listed companies.[1160]

The law is still new, judicial cases referring to its interpretation have yet to come and the ambiguity in some of the definitions regarding *usual* compensation, as well as the criteria for determining it, will have to be addressed in the future. It does nevertheless bring some long-awaited changes to the German approach on executive compensation, at least from a regulatory perspective. To sum up, most importantly, it provides some reference points with regards to the *appropriateness* of compensation (an issue at the very heart of the ***Mannesmann*** case[1161]), on the discussion whether courts are equipped to define the concept, it provides for the necessity to link pay to individual performance, it increases the liability for directors and provides a non-binding say of shareholders on compensation.

Finally, it is worth noting a certain divergence between the U.S. and the German reforms during the financial crisis. Both have been concerned with problems of executive compensation and its link to long-term performance, reforms that have recently been in part dictated by the financial crisis.[1162] There is nevertheless a difference in the issues which have been emphasized the most by both jurisdictions. The recent American approach has focused more on the financial services industry, shareholder say-on-pay votes, finding liability of directors via the SEC no-fault recent actions and providing for independence of compensation committees.[1163] The German approach has been more concerned with providing an '*upper hand'* via legislation regarding appropriate compensation, the need to not deviate unreasonably from *usual* market and industry

[1160] § 193 (2) 4 AktG as amended by VorstAG.
[1161] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.
[1162] See supra section 3.3.4
[1163] See supra section 3.3.3 and related discussion.

standards, and the increase of directors' liability for failing to provide '*appropriate*' compensation.

3.4.4 Executive compensation in the chosen CEE jurisdictions

Executive compensation debates in the chosen CEE jurisdictions have been largely absent. This has been due to the newly introduced concept of executive compensation after the fall of communism[1164] and due to the fact that corporate governance issues have had to focus more on the immediate pressures of the aftermath of privatization.[1165] Given the effects of this privatization and a general pattern of high concentration of ownership, the traditional agency conflict has been one between large and minority shareholders.[1166] Little has been talked about executive compensation in general, and excessiveness of such compensation in particular. The latter is also a result of the fact that levels of executive compensation in the region are not comparable to the high levels in the main chosen jurisdictions, so as to attract proper attention of international academics.[1167] One other contribution that is missing is also a developed body of research and literature from local academics concerning the legal dilemmas inherent in the executive compensation discussion, such as the issue of incentivizing managers via performance related schemes or the issue of the appropriateness of compensation. The stage of academic

[1164] Eriksson Tor, *Managerial Pay and Executive Turnover in the Czech and Slovak Republics*, 13 The Economics of Transition, The European Bank for Reconstruction and Development, 4, [659-677], 2005, *available at*: http://www.hha.dk/nat/wper/03-3_te.pdf, (last visited February 15th 2011).
[1165] The studies in the region have focused more so on levels of concentration of ownership and its effects on corporate governance. *See for some of these studies,* see Meyer Klaus, Privatisation and Corporate Governance in Eastern Europe: The Emergence of Stakeholder Capitalism, in: Lang Reinhart (ed.) The End of Transformation? [11, 42] Hampp. Germany, 2005; See also Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe,* in: Cornelius, P.K., Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003.
[1166] Id. referring to the work of Berglöf, E. & Pajuste A. 2003.
[1167]See Frydman, R., Hessel, M. & Rapaczynski, A., *Why Ownership Matters? Human capital and Incentives in the Restructuring of Enterprises in Central Europe,* Columbia Law School, Law-Econ Working Paper No. 172, 1998, *available at* SSRN: http://ssrn.com/abstract=194574 (last visited February 15th 2011).

discussion is yet at an infant level and over-shadowed by other corporate governance problems typical of post-privatization, high concentration of ownership scenarios.[1168]

That little academic focus on executive compensation in CEE has mostly been in the form of economic studies of the transition process, comparing the compensation levels and the incentives of managers in state - owned companies and newly privatized ones, although there have now been enough years since the start of the privatization process to warrant qualitative legal research.[1169] One contribution that the economic studies give is however the clarification of the change in the role of managers from central planning to capitalist societies, pointing to the shift that transition managers would have to undergo, in order to uproot their previous mentality with regards to the purpose of the new private companies, and the different interests they ought to serve.[1170] This mentality shift and other region specific features of corporate governance in CEE, set a different tone to the discussion on executive compensation, a more basic and underdeveloped one.

As a matter of fact, if there can be a reference to executive compensation in CEE, it is mostly via looking at the Codes of Corporate Governance and reports on observance of such

---

[1168] Concentration of ownership has made the protection of minority shareholders and creditors important in CEE. See Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe*, in: Cornelius, P.K., Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003; see also Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, EBRD Working Paper No. 49, London, 2000, at 3-8.

[1169] *See* Mallin C. & Jelic R. M., *Developments in Corporate Governance in Central and Eastern Europe*, 8 Corporate Governance: An International Rev. 1, [18, 43], January 2000, available at SSRN: http://ssrn.com/abstract=236065 , (last visited February 14th 2011); *See* Eriksson Tor, *Managerial Pay and Executive Turnover in the Czech and Slovak Republics*, 13 The Economics of Transition, The European Bank for Reconstruction and Development, 4, [659-677], 2005, *available at*: http://www.hha.dk/nat/wper/03-3_te.pdf, (last visited February 15th 2011); see also the same author in a co-publication, Eriksson T. Gottvald J. & Mrazek P., *Determinants of Managerial Pay in the Czech Republic*, William Davidson Institute Working Papers Series No. 310, 2000, *available at*: http://wdi.umich.edu/files/publications/workingpapers/wp310.pdf, (last visited February 15th 2011).

[1170] Id. referring to Eriksson T., Gottvald J. & Mrazek P. 2005 publication, at 2.

codes.[1171] Provisions in the Codes include articles referring to the independence of directors, compensation committees and the link of pay to performance,[1172] all of which similar to the German stipulations in the GCGC. However, there is no interpretation of the provisions and no court cases that interpret them, neither is there a strong compliance with the recommendations by listed companies. It appears that some of the concepts introduced through the corporate governance reforms related to executive compensation, have been passed simply as claims of '*modern*' governance mechanisms, with little enforcement efficiency.[1173] The following short note on the relevant provisions of these codes will evidence the concern raised above.

In Czech Republic, the decision on compensation of executives is done by the Supervisory Board, decision which can be referred to a compensation committee as provided by the Czech Code of Corporate Governance.[1174] The supervisory board should be composed of a sufficient number of independent non-executive directors, with independence explained as lack

[1171] See Czech Corporate Governance Code 2004, *available at*: http://www.ecgi.org/codes/documents/czech_code_2004_en.pdf (last visited on February 15th 2011); See Romanian Corporate Governance Code 2009, *available at*: http://www.ecgi.org/codes/documents/bucharest_se_code_jan2009_en.pdf, (last visited February 15th 2011).; *See* ROSC Czech Republic, 2002, *available at*: http://www.worldbank.org/ifa/Czechrosc_cg0702.pdf (last visited February 15th 2011); *See also* ROSC Romania, 2004, *available at*: http://www.worldbank.org/ifa/rosc_cg_rom.pdf (last visited February 15th 2011).

[1172] See Czech Corporate Governance Code 2004 (the recommendations of which are divided and referenced via chapters, sections and then paragraphs, with annexes giving some samples of reference), especially provisions in Ch VI. Sec. E (2) allowing for the formation of remuneration committees, Ch. V .sec. A (4) regarding disclosure of compensation, Ch. VI., sec. D (4) on aligning pay with long term interests of company and shareholders and Ch. VI. Sec. E (1) regarding a sufficient number of independent directors.; See also Romanian Corporate Governance Code 2009, (consisting of principles and recommendations, and divided accordingly into articles containing the latter), art 6, rec. 21 and 22 on remuneration committees and a sufficient number of independent directors in such committees, rec. 24 regarding disclosure, art. 6 principle XI on suitable remuneration policies compatible with the company`s long-term interests.

[1173] This relates to enforcement problems evident in CEE but also to the bigger debate on the legal transplant effect. Three prominent scholars that have continuously published in the field of the legal transplant have provided in a concise statement one of the biggest problems pertaining also to the legal environment of CEE countries after the fall of communism. They state that: *"…while the transplanted law is now on the books, the enforcement of these new laws is quite ineffective. In fact, empirical analysis suggests that there is little correlation between the level of legal protection afforded by statutes on the one hand, and measures for the effectiveness of legal institutions on the other.*"Berkowitz D., Pistor K. & Richard J-F., The Transplant Effect, 51 American journal of Comparative Law 1, [163, 203], 2003, at 165.

[1174] Ch VI. Sec(s) D (3) and E (2) of Czech Code of Corporate Governance 2004.

of company employment ties and lack of close relations to the company or management.[1175] The commentary of the Code recognizes that the independence of directors has not been a common practice in Czech companies and it considers a requirement for a majority of independent directors, as overly harsh for the Czech society.[1176] There is no legal *mandatory* provision determining benchmarks for board independence, or mandating a sufficient number of independent directors.[1177]

The Czech Code also recommends the compensation committee to ensure that compensation is reasonable and not excessive.[1178] However, the only source that gives some guidance to this provision is the Annex commentary of the Code itself.[1179] For instance, the compensation committee should be aware of the bigger picture relating to other salaries within the company and the specific market sector, it should consider performance elements carefully and it should always consider compensation packages from the *fairness* point of view of shareholders.[1180] However, these provisions have little effect, if any, due to the voluntary nature of the recommendations, with the Prague Stock Exchange admitting companies to be listed without insisting on compliance. As of the end of 2010, there were only 13 reported companies evidenced as complying with the Code.[1181]

[1175] Czech code of Corporate Governance 2004, Commentary of Ch. V, at para. 5.
[1176] Id. , The commentary finds the best practice of a majority of independent directors in boards as overly harsh and proposes a compromise to recommend this requirement for Supervisory Boards of companies whose board of directors is executive. Id.
[1177] Heidenhain Stephan, Center for Business Research Extended Shareholder Protection Index, University of Cambridge, [36. 38], February 2009, *available* at: http://www.cbr.cam.ac.uk/pdf/Shareholder%20protection%20index%20references%2025%20countries.pdf, (last visited February 15th 2011), at 37.
[1178] Ch. VI., sec. D (4) of the Czech Code of Corporate Governance 2004.
[1179] Annex 2 (2) of the Czech Code of Corporate Governance 2004.
[1180] Id.
[1181] EBRD Corporate Governance Legislation Assessment Project: The Czech Republic, 2007, *available* at: http://www.ebrd.com/downloads/legal/corporate/czech.pdf, 9last visited on February 14th 2011), at 3.

With regards to compensation disclosures, the Act on Business Activities in the Capital Markets[1182] requires disclosure of the *total* amount of compensation for the boards and disclosure of the compensation principles and policies used.[1183]

The situation in Romania is not too different. The 2009 Romanian Code of Corporate Governance[1184] adopts a *comply-or-explain* approach which in principle is stronger than the Czech approach. Regarding decisions on executive compensation, the company law provides that pay limits are determined by the General Meeting of Shareholders, however, the exact compensation of executives is set by the Supervision Council.[1185] The Corporate Governance Code recommends compensation committees with a *sufficient* number of independent directors, albeit there is no mandatory legal provision in this regard, similarly to the Czech case.[1186] The Code also seeks to assure a suitable policy that serves the long term interests of the company.[1187] Company law provides only one provision regarding pay for performance compensation, by stating that it needs to be relevant to the specific powers of each director and in line with the *financial health* of the company.[1188]

The Code of Corporate Governance also recommends an annual disclosure of the total amount of direct and indirect compensation.[1189] Similarly to Czech Republic, there is a lack of judicial interpretations through court cases, and the regulation of issues pertaining to executive

[1182] Act On Business Activities in the Capital Market [*Zákon o Podnikání na Kapitálovém Trhu*] Act No.256/2004 Coll., 14.04.2004, as most recently amended by Act 409/201 Coll.1.01.2011.
[1183] Id. §§ 116 (3) c, d.
[1184] Corporate Governance Code Romania, Bucharest Stock Exchange, Bucharest, January 2009, *available at*: http://www.ecgi.org/codes/documents/bucharest_se_code_jan2009_en.pdf, (last visited February 15th 2011).
[1185] Romanian Company Law, art. 1531/1.
[1186] Supra note 1184, at recommendations 21, 22.
[1187] Id. art. 6.
[1188] Romanian Company Law art. 153/1(8); *See also* Vilau Dragos, Chapter on Romania in: Cross-border Corporate Governance and Directors' Duties Handbook, [165, 172], Practical Law Company, London, 2007, at 167.
[1189] Rec. 24, Romanian Code of Corporate Governance 2009.

compensation has been mostly a matter of providing non-mandatory, '*static*' rules with little interpretative guidance.

3.5 Conclusions

This chapter has focused on the regulation of executive compensation in the U.S. and the chosen EU jurisdictions. The history of regulating executive compensation in the U.S. has shown that, despite the variety of methods used to address issues of executive compensation over time, problems have yet managed to persist, and surprisingly so, at times, their complications have been even stronger after reform waves. U.S. has attempted different forms of regulating executive compensation, from fiduciary duties, to tax laws, to the enactment of SOX, to capping executive pay and recent say-on-pay resolutions. However, a majority of previous reforms have been questionable in terms of their results independent of the form or level of aggressiveness opted for. The SEC stance with regards to the SOX provisions related to executive compensation has been curiously passive until 2010. Recently however, the SEC made a drastic change in its approach, by providing for liability in no-fault scenarios. The cases illustrating this new shift are however very recent and whether this line of action will become a trend, remains to be seen.

Germany, despite comparatively lower levels of executive compensation, has shown a stronger sense of aversion towards *inappropriate compensation*, at least as a matter of principle. This opposition has been reflected not only in its legislative interventions regarding appropriateness of compensation, but also in its attempts to '*criminalize excessive pay*' through a breach of fiduciary duties in the form of committing *Untreue.* The *Mannesmann* trial, witnessed such a judicial will, even more so in the second decision, claiming that not only aggravated breaches would warrant criminal sanctions. However, its enormity, in terms of sums awarded and the publicity gained, considered as a *de facto* precondition for bringing the case in court, as well as the first decision of the regional court, show that criminalizing excessive pay is a mere exception rather than the rule. The Mannesmann trial possessed considerable potential for answering fundamental questions related to German corporate governance, such as the choice between keeping the traditional strong aversion towards excessiveness and inequality, or the adaptation of 'Americanized' practices that had already entered the German corporate world, but in the end, it managed to raise more questions than provide answers

On the other hand, the CEE jurisdictions have not been affected with the same intensity by the debate on executive compensation. Due to the special historical and political factors influencing the region, the whole conception of the duties and responsibilities of management in capitalism had to be 'reinvented' for the CEE societies under discussion. Also, despite the fact that Codes of Corporate Governance in the chosen jurisdictions have provided for some fragmented criteria regarding the relation of pay to performance, due to their nature and due to persisting enforcement problems, the effects of these provisions have remained negligible to say the least.

Looking at the whole picture presented by the comparison made in this chapter, one accompanying feature appears to be the question on the efficiency of reforms aimed at dealing with appropriate compensation. It is true that the historical trajectory of these reforms has included different tackling methods, yet, a definitive answer as to how can one link pay to performance and achieve appropriateness of compensation from a corporate governance perspective, is not one that can be attempted to be solved merely by legal analyses. This kind of endeavor would require a dive into other fields, such as managerial behavioral patterns and economics. However some piecemeal contributions of mandatory and voluntary corporate governance measures related to the regulation of executive compensation need to be recognized.

For instance, providing clear rules aimed at increasing the arm`s length bargaining position in the process of setting executive compensation and intensifying their observation, can influence the objectivity of decisions taken. Also, while promoting incentives that aim to align the interest of executives with the long-term interest of the corporation is in the agenda of all the jurisdictions covered, providing for unbiased systems of periodical monitoring and evaluation of these incentives might help in addressing the relation between pay and performance. Increasing the systematic disclosure of individual executive pay, albeit in itself insufficient as a regulatory means, it helps in providing the information necessary for monitoring and revising executive pay schemes. Also, the recently introduced shareholder say-on-pay votes, although of an advisory character, if combined with frequent, yet not overburdening exercise periods, might help to increase the sense of executive '*responsibility*'.

CHAPTER IV

STAKEHOLDER PROTECTION

4.1 Introduction

In the last few decades, there has been an ever increasing focus on the concept of stakeholders` protection in corporations.[1190] Recommendations[1191] and Green Papers[1192] have focused on enhancing the interaction between corporations and their stakeholders.

In the theoretical level, the discussion has usually been employed by corporate social responsibility advocates.[1193] There has been a certain polarization between the *presumably conservative* shareholder-sided stream belonging to the narrow corporate governance school of thought, and the more liberal stakeholder theory of the firm stream.[1194] One can distinguish between these two approaches: the first corresponds to the narrow definition of corporate governance conceptualized only around the main agency conflict and aimed at regulating the

[1190] *See*, Freeman Edward R., *A Stakeholder Theory of the Modern Corporation*, in: Pincus Laura (ed.), Perspectives in Business Ethics, [171, 181], McGraw-Hill, Singapore, 1998; Freeman defines stakeholders as: "*groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions*." Id at 174. According to him apart from shareholders, the concept of stakeholders refers to creditors, employees, suppliers, customers and the community at large. Id.; *See* also Clarkson Max B. E., *A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance*, 20 Academy of Management Rev. 1, [92, 117], 1995.
[1191] *See* for instance, OECD Guidelines for Multinational Enterprises 2008, *available* at: http://www.oecd.org/dataoecd/56/36/1922428.pdf, (last visited February 22nd 2011).
[1192] *See* EU Commission Green Paper COM(2001)366, Promoting a European framework for Corporate Social Responsibility, 18 July 2001, *available* at : http://eur-lex.europa.eu/LexUriServ/site/en/com/2001/com2001_0366en01.pdf (last visited February 22nd 2011).
[1193] Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007, *available* at: http://ejbo.jyu.fi/pdf/ejbo_vol12_no1_pages_5-15.pdf, (last visited February 23rd 2011), at 6.
[1194] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 109.

relationship between managers and shareholders;[1195] the second concerns the very broad approach of corporate social responsibility which revolves around the idea of running the corporation for the interests of a wide group of stakeholders, amongst which the community at large.[1196] In between these two limits of the spectrum, as already stated in the introduction to this thesis, one can find a hybrid version in the form of a broader concept, which does not refer simply to the agency conflict between shareholders and managers, but includes also considerations related to the stakeholder constituencies.[1197] According to this view, the shareholder value maximization remains the main objective of the company, but that does not necessarily entail an opposition against all actions undertaken or to be undertaken by corporations, that also protect stakeholder groups.[1198] The protection of the interests of these stakeholder constituencies would be seen as an internally conflicting pattern, only if one confines it to the definitional limits that cause corporate governance to be viewed narrowly. However, when corporate governance goes beyond the strict limits of the previous definition, it *relates* to concerns relevant for the protection of stakeholders. For instance, such a feature of corporate governance can be seen in the recognition that the OECD Principles of Corporate Governance[1199] give to the stakeholders, especially so creditors and employees.

[1195] *See* Friedman Milton, *The Social Responsibility of Business is to Increase its Profits*, *The New York Times Magazine*, September 13, 1970; *See also* Levitt Theodore, *The Dangers of Social Responsibility*, 33 Harvard Business Rev. 5, [41-50], 1958.
[1196] Freeman Edward R., *A Stakeholder Theory of the Modern Corporation*, in: Pincus Laura (ed.), Perspectives in Business Ethics, [171, 181], McGraw-Hill, Singapore, 1998.
[1197] *See* for contemporary authors who defend shareholder value maximization as constituting the one objective function, but do not necessarily oppose the social responsibility actions undertaken by companies, Coelho, P. R. P., McLure, J. E. & Spry, J. A., *The Social Responsibility of Corporate Management: A Classical Critique*, 18 Mid-American Journal of Business 1,[15, 24], 2003; *See* also Sternberg Elaine, *The Defects of Stakeholder Theory*, 5 Corporate Governance: An International Rev. 1, [3, 10], 1997.
[1198] Id.
[1199] Organization for Economic Co-operation and Development (hereinafter OECD) Principles of Corporate Governance, 2004, *available* at: http://www.oecd.org/dataoecd/32/18/31557724.pdf (last visited February 23rd 2011), at group V of Principles.

Furthermore, even characterizations of different corporate governance approaches are also made in the form of stakeholder-oriented and shareholder-oriented regimes, such as in the comparison between Germany and the U.S.[1200] The inclusion of such analyses in this work is however not to the effect of favoring a normative broad stakeholder theory of the firm, or a managerial strategy of stakeholder engagement;[1201] it is more so to reveal what kind of protection is offered by the relevant jurisdictions to stakeholders, and how do they differ in their protection levels in order to complete the comparison between the selected corporate governance regimes.

For the purpose of the analyses in this part, examples will be devoted to creditors and employees, with the main reason for such consideration being the traditional view of these two groups as *closely* positioned towards the corporation.[1202] Such enhanced affinity of employees and creditors has also captured more attention within corporate governance discussions related to stakeholders' protection.[1203] As one scholar has put it, "*[a] crucial element of corporate governance is how well shareholders, creditors and workers are protected*."[1204] The following chapter will therefore provide a comparison on the positioning of the relevant corporate governance regimes towards stakeholder protection, starting with the U.S. and then continuing with the chosen EU jurisdictions.

[1200] *See* Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 The American Journal of Comparative Law 3,[497, 539], 2001.

[1201] Stakeholder engagement is a term that is used to refer to an ongoing broader dialogue and inclusion of stakeholders with a corporation. *See* the definition given by the International Financial Corporation, World Bank Group. Stakeholder engagement has emerged as "*a means of describing a broader, more inclusive, and continuous process between a company and those potentially impacted that encompasses a range of activities and approaches*" IFC World Bank, Stakeholder Engagement: A Good practice Handbook for Companies Doing Business in Emerging Markets, May 2007, *available* at: http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StakeholderEngagement_Full/$FILE/IFC_StakeholderEngagement.pdf (last visited March 1st 2011), at 2.

[1202]*See* Siems Mathias M. , *Convergence in Corporate Governance: A Leximetric Approach*, Electronic Article, June 07, 2010, *available* at SSRN: http://ssrn.com/abstract=1444860 ,(last visited February 22nd 2011), at 4 et.seq.; *See* also Orts E.W.& Strudler A., *Putting a Stake in Stakeholder Theory*, 88 Journal of Business Ethics, [605, 615], 2009, at 606-607.

[1203] Id. (referring to Siems Mathias` work 2010) at 4.

[1204] Id.

4.2 Stakeholder Protection in U.S. Corporations

Protection of stakeholders by U.S. corporations is not a new concept.[1205] The end of the 19th century witnessed a group of corporate law reforms that ultimately loosened the traditional bonds of managerial actions responding to shareholder interests, giving rise to concerns by corporate lawyers that such an increased managerial autonomy would weaken the owners` monitoring capacities, and would ultimately result in managerial opportunistic conduct.[1206]

Progressives at the time started to denounce the practices of uninhibited authority that managers had over investors. Hence, the famous separation of control and ownership had already happened much to the detriment of shareholders, yet, not only to them.[1207]

Indeed, the idea that duties were owned to groups other than shareholders was not a foreign concept, even amongst business leaders of the time. In the 1920s, for example, *Owen* Young, the President of General Electric stated that he acknowledged his duty to the shareholders, but at the same time, he also had a duty to customers, workers and the public.[1208] *Berle* and *Means* themselves realized that other constituencies, such as employees, consumers and capital suppliers, were all influenced by such transformations.[1209]

It is exactly at this point however, that a divergence started to take form with regards to the proper venues followed in order to '*curb*' such control.[1210] The *Berle* and *Means* group of

[1205] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 112.
[1206] Id. at 112-114.
[1207] Berle A. & Means G., The Modern Corporation and Private Property, (rev.ed.) Transaction Publishers, New Brunswick-London, 1968.
[1208] Dodd Merrick E., *For Whom are Corporate Managers Trustees?*, 45 Harvard Law Rev., [1145, 1932], at 1154.
[1209] *Supra* note 127 at 349.
[1210] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 113.

proponents chose the path of reforming corporate law, such as for instance, via fiduciary duties, while others referred to other bodies of law aimed at minimizing the effects of managerial '*excess*'.[1211] One of these sets of laws, which had as its central contention the increase of transparency, was the Securities Exchange Act of 1933.[1212] According to one prominent scholar, the solution to bringing some discipline on managers` behavior would be to require disclosure of the corporate financial activities to the market, with its effects being not only in the favor of shareholders, but also for the public at large.[1213] Hence, the passing of the Act was not aimed simply at discouraging fraud and increasing transparency for the benefit of shareholders, but also to *"enable a measure of social control over corporate activity.*"[1214] The legislative history of the Act itself, which considers the public at large as one of its intended beneficiaries, supports the idea of social control over corporations.[1215] During this period, protection of stakeholder constituencies was also reflected in another important legislative enactment, such as the passing of the National Labor Relations Act of 1935.[1216]

Later on, the '60s and '70s, witnessed a wave of social welfare laws aimed, amongst others, at benefiting corporate stakeholders.[1217] The main focus of these laws was to provide some influence on corporate managers through the establishment of better criteria related to hiring practices, safety of operations, and protection of consumers. Although outside of the

---

1211 Id. at 113-114.
1212 Securities Exchange Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2006)).
1213 Brandeis Louis D., Other People`s Money and How Bankers Use it, 1914, (Urofsky Melvin I (ed.)) , Bedford, St Martin`s 1995, at 62-65.
1214 Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 114.
1215 Id.
1216 Id. at note 33 referring to the National Labor Relations Act ch. 372, sec. 1 of 1935, Pub. L. 74-198, 49 Stat. 449, July 5 1935, (29 U.S.C. §§ 151-66 (2004)).
1217 See for instance the Consumer Credit Protection Act, Pub.L. 90-321, 82 Stat.146, June 29, 1968.; See also the Fair Packaging and Labeling Act, Pub. L. 89-755, 80 Stat. 1296, July 1 1967, 15 U.S.C.§§ 1451–1461.

corporate law realm, these new restrictions influenced the behavior of corporate managers.[1218] The tendency of expanding the protection from identifiable groups to the community at large was also reflected in the enactment of environmental laws.[1219] Environmentalists at this time had gained increasing popularity and Congress acknowledged their concerns via numerous legislative acts.[1220]

Reform initiatives that influence corporate stakeholders are numerous and continuous, yet, although they have they have an impact on restricting managerial behavior in favor of stakeholder constituencies, most of them fall outside the contours of corporate law.[1221] While they are necessary in order to complete the regulatory picture on corporate stakeholder protection, the natural question that arises is however, whether corporate law "*permits corporate social responsibility*"[1222] (hereinafter CSR), and stakeholder protection as an essential core idea within CSR,[1223] and if yes how. The next section will therefore analyze corporate stakeholders under a corporate law perspective.

[1218] *Supra* note 1214 at 119-121.

[1219] *See* National Environment Policy Act, Pub. L. 91-190, 83 Stat. 852, 42 U.S.C. § 4321 et. seq., January 1 1970; *See also* Resource Conservation and Recovery Act, Pub. L. 94-580, 90 Stat. 2795, 42 U.S.C.§ 6901 et.seq., October 21 1976.

[1220] Id.; *See also* Vogel David, Fluctuating Fortunes: The Political Power of Business in America, (rev.ed.) Beard Books, New York, 2003, at 65, 72-84.

[1221] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 120-122, 126-127.

[1222] Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February 22nd 2011), at 338.

[1223] Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007, *available* at: http://ejbo.jyu.fi/pdf/ejbo_vol12_no1_pages_5-15.pdf, (last visited February 23rd 2011), at 6-7.

4.2.1. Corporate Law: CSR as a Paradox?

The traditional corporate law attitude to stakeholder interests has been predominantly skeptical.[1224] *Bainbridge* states that "*Corporate law does not mandate corporate social responsibility. To the contrary, the real question is whether the law even permits corporate social responsibility.*"[1225] This inevitably brings the discussion into the issue of fiduciary duties, and the question for whose benefit should the corporation be run.[1226] An analysis of fiduciary duties of directors has been provided in the previous discussion in Chapter 2, and some of its observations derived from case-law, are relevant even here.[1227] However, the elaboration here is more stakeholder specific and it will draw, when relevant, upon previously cited cases but also others, especially so with regards to fiduciary duties in cases of insolvency or near insolvency.

4.2.1.1 Stakeholders and Fiduciary Duties?

Traditionally, corporate law has stayed truthful to the idea that "*[a] corporation is organized and carried on primarily for the profit of stockholders*",[1228] meaning that directors` fiduciary duties run to stockholders. This was the outcome of the famous ***Dodge v. Ford***[1229] case where the Supreme Court criticized Henry Ford's "*plan to benefit mankind*"[1230] expressed in the intention to making cars affordable and available to the broad public. This decision was upheld

[1224] *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007.
[1225] Id. at 338.
[1226] Id. at 338 et.seq.
[1227] *See* supra sections 2.2 and 2.3 and related discussion.
[1228] Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. S. Ct.1919) at 684.
[1229] Id.
[1230] Id. at 684.

in another case many years after Dodge, namely in ***Katz v. Oak Industries***[1231] where the court stated that "*[i]t is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders.*"[1232]

However, a landmark case that raised some concerns regarding the treatment of stakeholder interests was ***Shlensky v. Wrigley***.[1233] The case involved a claim brought by a minority shareholder against a majority shareholder of the *Chicago Cubs*. The basis of the claim was the refusal of the majority shareholder to provide for lights installed in the baseball field of the Club, since baseball played at night might have a negative effect on the neighborhood.[1234] The minority shareholder claimed that the defendant was more concerned with non-shareholder, rather than shareholder interests and his evidence was uncontested. The Court however dismissed the case for failure to state a claim under which it would be possible to grant relief.[1235]

Initially, the outcome of the case as '*in favor'* of the majority shareholder decision to respect non-shareholder interests, would give the idea that the verdict legitimizes considerations of the latter at the expense of the former. However, this would call for a superficial interpretation of the result of the case.[1236] The court`s decision in this case was based on a simple application of the business judgment rule, where the court did not second guess the business decisions of the corporation.[1237] Even here, a stakeholder advocate would perhaps be able to see some intention of the court to provide that, under the business judgment rule, directors are allowed to make trade-

[1231] Katz v. Oak Indus. Inc., 508 A.2d 873 (Del. Ch. 1986), *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February 22nd 2011), at 340.
[1232] Id. at 879.
[1233] Shlenksy v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968); Id. (referring to Bainbridge Stephen M. 2007 at 341).
[1234] Id. (referring to Bainbridge Stephen M. 2007).
[1235] Id.
[1236] Id. at 342.
[1237] Id.

offs between shareholder and non-shareholder interests.[1238] This might in certain cases be true, but more so as a side effect of the application of the business judgment rule. It does not however mean that the deference offered to the rule does not rest on policy choices aimed at benefiting shareholders.[1239]

Another central point of the discussion of corporate case law regarding stakeholders, is the issue of whether fiduciary duties are owned to creditors in cases of insolvency, or *vicinity of insolvency*[1240] and the following subsection deals with this issue.

4.2.2 Fiduciary Duties to Creditors: From Footnote 55 to Trenwick?

For many years, American Courts have struggled with regards to defining the relationship between boards and corporate creditors.[1241] Before the '90s, the approach was rather simple: creditors could pursue claims against directors and managers for breach of a fiduciary duty, only

[1238] Blair Margaret M., & Stout Lynn A., *A Team Production Theory of Corporate Law*, 85 Virginia Law Rev., [247, 303], 1999. The authors argue first that the essential function of the public corporation is beyond the simple agency conflict, so as to provide for a means for other corporate "stakeholders" to jointly relinquish control of resources to the board, hence team production theory. The authors also believe that trade-offs between interests of different stakeholders are provided for by the business judgment rule.
[1239] Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_335_Bainbridge.pdf (last visited February 22nd 2011), at 342-343. Here, as Bainbridge puts it, there is the distinction between intent and effect of the business judgment rule. The undesired effects of such rule might be a shield from liability or unintended protection of stakeholder constituencies, however the introduction of the business judgment rule has been with shareholder interest policy choices in mind. Id. at 343.
[1240] For discussion on the concept of *vicinity of insolvency*, see infra section 4.2.2.; *See* Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims,* 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008.
[1241] The expression '*footnote 55*' in the title of this subsection, refers to the opinion of Chancellor Allen in the case of *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp,* 1991 WL 277613 (Del. Ch. 1991), at 34, n.55. Given that much of the controversy regarding whether fiduciary duties are owned to creditors in cases of a "*vicinity* of insolvency" stemmed from his reasoning in footnote 55, he is referred to now symbolically as a Footnote 55 Chancellor. Id. at 65.; The case referred to in the title is *Trenwick America Litigation Trust v. Ernst & Young,* LLP, et al, 906 A.2d 168, (Del Ch.2006).

in limited cases, and most often in cases of insolvency.[1242] This derived from the principle that once a corporation became insolvent, the fiduciary duties of corporate managers included corporate creditors. Once actual insolvency happened, these duties were owned to creditors. The dividing point was therefore the moment of actual insolvency.[1243]

This was all about to change. In one case quoted most often as producing results that might have not been intended, the whole picture was turned upside down. In the case of ***Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp***,[1244] in footnote 55[1245] that became famous amongst legal circles, Chancellor Allen provided that, in cases when a corporation is in the vicinity of insolvency, a board of directors should consider the group of interests that this corporation represents, and act in the best interest of the corporation,[1246] despite the fact that the path so chosen might differ from the path that individual constituencies, such as "*stockholders (or the creditors, or the employees, or any single group interested in the corporation),"*[1247] would choose.

This footnote was quickly interpreted as making new law,[1248] to the effect that directors of financially distressed companies in the vicinity of insolvency, assumed fiduciary duties to creditors.[1249] The issue raised several problems.

[1242] *See* Geyer v. Ingersoll Publications Co., 621 A.2d 784, 787 (Del. Ch. 1992). Here the general rule is there are no duties absent beyond contractual terms absent fraud, insolvency or cases of violation of a statute S.ee also In re Hechinger Investment Co. of Delaware, 274 B.R. 71, 89 (D. Del. 2002).
[1243] Id. referring to Geyer case at 790; *See* also Kidde Industries, Inc. v. Weaver Corp., 1994 WL 89013 (Del. Ch. 1994), at 2.
[1244] Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp, 1991 WL 277613 (Del. Ch. 1991).
[1245] Id. at 34, n.55.
[1246] Id.
[1247] Id.
[1248] It is worth noting that there is no mention in *Credit Lyonnais* of a fiduciary duty to creditors beginning when the corporation is in the *vicinity* of insolvency. Also, the same Chancellor in a previous case had provided that the relation was of a contractual nature and it didn`t contain any fiduciary duties. Katz v. Oak Indus. Inc., 508 A.2d 873 (Del. Ch. 1986), at 879.; Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims,* 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008, at 68-69.
[1249] Id.

First, there was no guidance as to what is "*vicinity of insolvency*."[1250] Second, there was no clear idea as to what was the very nature of this new fiduciary duty, meaning whether it allowed now for a direct or derivative claim.[1251] Third, would directors be able to make use of the protection offered under the business judgment rules or exculpatory defenses from relevant corporate charters?[1252] How about cases when two competing constituencies, to which the board owned fiduciary duties, differed considerably?[1253]

The Supreme Court of Delaware ended the confusion in the case of ***Gheewalla***,[1254]where it stated that: "*No direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency*."[1255]The Court further asserted that: *"[W]hen a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."*[1256]

Certainly, when a corporation is insolvent, creditors take the place of stockholders and can assert derivative claims, however, in either case they cannot assert direct claims against corporate managers on the basis of a breach of fiduciary duties.[1257] The main rationale behind the decision in *Gheewalla*, was that boards should not be restricted by uncertainties in cases of near

---

1250 Id. at 68.; *See* also Tung Frederick, *Gap Filling in* the *Zone of Insolvency*, Emory Public Law Research Paper; Emory Law and Economics Research Paper No. 07-3, 2007, *available* at SSRN: http://ssrn.com/abstract=957635 (last visited February 22nd 2011).
1251 Id. at 69.
1252 Id.
1253 Id.
1254 North American Catholic Education Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007), (hereinafter Gheewalla, 930 A.2d 92, 101); *See* also Andersen Bryan, *Gheewalla and Insolvency: Creating Greater Certainty for Directors of Distressed Companies*, 11 University of Pennsylvania Journal of Business Law 4, [1031, 1051], 2009.
1255 Id. at 101.
1256 Id.; *See* also Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims*, 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008, at 69.
1257 Gheewalla, 930 A.2d 92, 101, at 102-103.

insolvency[1258] and moreover, there already was a vast array of laws already offered for the purpose of protecting creditors, amongst which, covenants of fair dealings and good faith, commercial laws and bankruptcy laws, which mitigated the necessity to add yet another group of protection via fiduciary duties.[1259]

4.2.2.1 Different Concepts, Same Results?

The story of creditor protection claims under breach of fiduciary duties did not end with ***Gheewalla***.[1260] Another interesting concept that came of fashion was the concept of "*deepening insolvency*",[1261] referring to the case in which creditors were allowed to pursue claims against officers and directors of a corporation, on the allegation that the latter, either acting fraudulently[1262] or negligently,[1263] prolonged the existence of the corporation via incurring increased debts.

Those courts that followed the trend of allowing *deepening insolvency* claims did not provide an analysis as to the problems pertaining to this concept.[1264] If it were to be accepted, *deepening insolvency* would create a new duty on the fiduciaries of a company to liquidate upon insolvency, basically finding them liable for a duty that doesn`t even exist.[1265]

[1258] Id. at 103.
[1259] Id.; *See* also, Production Resources Group L.L.C. v. NCT Group, Inc., 863 A.2d 772 (Del. Ch. 2004).
[1260] Gheewalla, 930 A.2d 92, 101.
[1261] *See* Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 38 Bankr. Ct. Dec. (CRR) 147 (3d Cir. 2001), (hereinafter Lafferty 267 F. 3d. 340), defining deepening insolvency as "[t]he fraudulent and concealed incurrence of debt" and also "prolonging an insolvent corporation's life through bad debt", Id. at 349-350.; *See* also In re Exide Technologies, Inc., 299 B.R. 732 (Bankr. D. Del. 2003);
[1262] Lafferty 267 F. 3d. 340, at 349-350.
[1263] In re LTV Steel Co., Inc., 333 B.R. 397, 421-23 (Bankr. N.D. Ohio 2005).
[1264] For two interesting cases, *See* Hannover Corp. of America v. Beckner, 211 B.R. 849, 854 (M.D. La. 1997); Corporate Aviation Concepts, Inc. v. Multi-Service Aviation Corp., 2004 WL 1900001 (E.D. Pa. 2004).
[1265] Lafferty 267 F. 3d. 340, at 350; *See* also In re In re LTV Steel Co., Inc., 333 B.R. 397, 421-23 (Bankr. N.D. Ohio 2005), at 418.

However, the Delaware Supreme Court in the case of ***Trenwick***[1266] took a similar stance as in the case of ***Gheewalla***.[1267] Basically, the central issue in this case was a *deepening insolvency* claim against the directors and officers of *Trenwick*, alleging that directors had engaged in imprudent business strategies dictated by the parent company that resulted in the insolvency of both, the parent and the subsidiary.[1268] The Court stated that, "*deepening insolvency is no more of a cause of action when a firm is insolvent than a cause of action for 'shallowing profitability' would be when a firm is solvent.''*[1269] The Court continued by saying that: *"[I]f the board of an insolvent corporation acting with due diligence and good faith in following the strategies it deems best for the corporation value, but [which] also include additional debt incurrence, this board does not become a guarantor of that strategy's success.''*[1270]

It follows that, much as creditors attempted to enter the realm of fiduciary duties via these vague, ill-defined concepts that left room for contradictory interpretations, Delaware courts would not allow an exclusive venue reserved for the corporation's value to become overpopulated. Yet, despite the clear intent to not extend fiduciary duties in these specific cases to creditors, the referral to the *corporation`s value* is not unproblematic.[1271] *Bainbridge* in particular, argues that this is an odd concept, difficult to define, since the corporation is fictional and it would basically mean for directors to owe duties to themselves.[1272] He claims that the

[1266] *Trenwick* America Litigation Trust v. Ernst & Young, LLP, et al, 906 A.2d 168, (Del Ch.2006), (hereinafter referred to as Trenwick , 906 A.2d 168).
[1267] Gheewalla, 930 A.2d 92, 101.
[1268] Trenwick 906 A.2d 168, at 175.
[1269] Id. at 205 *[sic]*, *[emph. orig.]*.
[1270] Id. *[emph.add.]*
[1271] *See* Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007. at 352-355.
[1272] Id. at 353-354.

reference to the interest of the corporation has stemmed from the wrong conceptualization of corporations as "*societal institutions freighted with the goal of responsible wealth creation.*"[1273]

4.2.3 A Note on Employees in American Corporations

In the U.S., the venue for addressing most worker-related issues, has traditionally been labor law, while shareholder-related concerns have been referred to corporate law.[1274] Despite this division, a note on the stance that corporate law takes towards employees of a corporation is due at this point.

There is no codetermination in U.S. corporations[1275] and unions have traditionally refused to support the idea, staying truthful to the old conception of considering managers as *"thinkers"* and workers as *"doers.*"[1276] In 1979 for instance, the stockholders of Chrysler elected Douglas Fraser, the then president of the Auto Workers Union, to its Board of Directors.[1277] Although he was selected by the stockholders and did not represent all the employees, since not all of the latter were represented by the union, the event gathered a lot of attention, just to show how novel and strange the concept was.[1278] Courageous ideas of adopting a form of codetermination, or at

[1273] Id. at note 91.

[1274] O'Connor Marleen, Labor`s Role in the American Corporate Governance Structure, 22 Comparative Labor Law and Policy Journal 1, [97, 134], 2000, at 99.

[1275] *See* Summers Clyde W., *Codetermination in the United States: A Projection of Problems and Potentials*, 4 Journal of Comparative Corporate Law and Securities Regulation , [155, 191], 1982, *available* at: http://www.law.illinois.edu/publications/cllpj/archive/vol_22/issue_1/o'connorarticle22-1.pdf, (last visited February 23rd 2011),1982.

[1276] O'Connor Marleen, *Labor`s Role in the American Corporate Governance Structure*, 22 Comparative Labor Law and Policy Journal 1, [97, 134], 2000, *available* at: http://www.law.illinois.edu/publications/cllpj/archive/vol_22/issue_1/o'connorarticle22-1.pdf, (last visited February 23rd 2011), at 102.

[1277] Summers Clyde W., *Codetermination in the United States: A Projection of Problems and Potentials*, 4 Journal of Comparative Corporate Law and Securities Regulation , [155, 191], 1982, *available* at: http://www.law.illinois.edu/publications/cllpj/archive/vol_22/issue_1/o'connorarticle22-1.pdf, (last visited February 23rd 2011),1982, at 155.

[1278] Id.

least viewing the possible potential for it, have not been missing,[1279] yet they did not gain popularity.[1280]

American courts have not considered the use of fiduciary principles to protect workers, and the route chosen has been mainly through contracts (or of course through applicable labor law rules).[1281]One case related to workers and the interests of local communities, was the ***Ypsilanti v. General Motors Corporation***.[1282] General Motors obtained a tax relief from the town of Ypsilanti, in order to make investments and improvements to its factories. When applying for this relief, General Motors declared, especially with regards to one of the plants, that it would continue to keep it profitable for employees depending on market conditions.[1283] Subsequently however, it closed the plant and transferred its production to another factory.

Although the first decision of the lower court, which was based on promissory estoppel, required the corporation to keep the plant open,[1284] the appeal court reversed the decision,[1285]considering General Motors` statement as a simple *business expectation*, rather than an enforceable contractual promise.[1286] It is important to note that the court did not consider

1279 Id; *See* also Gilson Ronald J., *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 Washington University Law Quarterly 2, [327, 341], 1996; *See* also Ewing David W., Who Wants Corporate Democracy?, 49 Harvard Bus. Rev. 5, [12, 28,], [146, 149], 1971.

1280 *See* for instance, Prentig Theodore O., Co-determination: Its Practice and Applicability to the U.S., 57 Society for The Advancement of Management Journal 2, [5, 17], 1992. Here the author states that the voluntary character of the collective action in the US might be one overriding obstacle. Id. at 9.

1281 O'Connor Marleen, *Labor`s Role in the American Corporate Governance Structure*, 22 Comparative Labor Law and Policy Journal 1, [97, 134], 2000, *available* at: http://www.law.illinois.edu/publications/cllpj/archive/vol_22/issue_1/o'connorarticle22-1.pdf, (last visited February 23rd 2011), at 105. The author, although proposing a way how such introduction can be achieved by courts, recognizes that courts have not employed the concept of fiduciary duties in cases concerning employees.; *See* also for an article arguing strongly against the introduction of such fiduciary duties, Dent George W. Jr., *Stakeholder Governance: A Bad Idea Getting Worse,* 58 Case Western Reserve Law Rev. 4, [1107, 1144], 2008, *available* at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1368947&, (last visited February 23rd 2011).

1282 Charter Township of Ypsilanti v. General Motors Corp., 506 N.W.2d 556, 201 Mich. App. 128 (Mich. App. Ct. 1993).

1283 Id. at para. 5.

1284 Id. at para. 12-13.

1285 Id.

1286 Id.; *See* for an analyses of the case, Yellin David S., *Masters of Their Own Eminent Domain: The Case for a Reliance Interest Associated with Economic Development Takings,* 99 Georgetown Law Journal 2, [651, 676], 2011, using the concept of fiduciary duties, reconfirming the approach of addressing issues related to workers through other protective laws, such as contract or labor law, as opposed to corporate law.[1287]

4.2.4 Corporate Charity?

One concept, claimed to have somewhat *liberalized* the approach of corporate law towards stakeholders, has been the allowance of corporate charity.[1288] Irrespective of the question whether corporate charities are undertaken due to genuine charitable aspirations, or merely for purposes of window-dressing, from a corporate law perspective, case law on corporate charity has indirectly recognized a certain corporate responsibility of acknowledging social demands.[1289] That was the case in ***A.P. Smith Manufacturing Co. v. Barlow***.[1290] The main issue in this case was whether the management decision to offer a donation to Princeton University ran counter to the advancement of the interests of shareholders. The management justified the advancement of such interests via the goodwill benefits of the company and the court found such a justification reasonable.[1291] However, the court went further on, stating that the charity in question was necessary for the "*vigor of [...] democratic institutions [and][…] modern conditions require that corporations acknowledge and discharge social as well as private responsibilities*."[1292]

---

available at: http://www.georgetownlawjournal.com/issues/pdf/99-2/Yellin.pdf, (last visited February 23rd 2011), at 662.

1287 Id. at 664-668.

1288 Corporate charity was prohibited since contributions used to be considered *ultra vires*, due to the fact that they benefitted the public rather than incorporators. According to Parkinson, social activism: "*refers to conduct which is putatively beneficial to society or particular interest groups, but falls outside the scope of the company's ordinary commercial operations*", Parkinson John, Corporate Power and Responsibility: Issues in the Theory of Company Law, Clarendon Press, UK, 1995, at 261; *See also*, Millon David, *Frontiers of Legal Thought: Theories of the Corporation* I, Duke Law Journal, [201, 262], 1990, at 218.

1289 A.P. Smith Manufacturing Co. v. Barlow , 98 A.2d 581 (N.J. 1953)

1290 Id.

1291 Id. at 583-586.

1292 Id. at 586.*[emph.add.]*

Although the court realized that these donations might be beneficial to shareholders in the long run, making the justification of charity contributions conditional upon shareholder value maximization,[1293]it is questionable whether the strong wording regarding the social responsibilities of corporations, was merely incidental. Without wanting to overemphasize the importance of a minority stance of courts,[1294] it is not however unreasonable to think that the court intended to suggest some form of corporate recognition of societal values.[1295]

The present expansion of corporate charity is however often not due to an enhanced recognition of these values, but due to profits of capitalizing on the goodwill related to charity, by trading on the so-called "*halo effect*".[1296] "*Halo effect*" basically refers to the idea that there are higher perceptions of corporate social responsibility for firms that give more, even if they had been in violation of antitrust statutes or other infringements. Hence, charitable giving provides a "*halo effect*" for previous transgressions.[1297]

Corporate charity has nevertheless its own limits. For instance, Delaware corporate law provides for a ceiling established under a 'reasonableness' test. Courts will hold contributions reasonable if they can be deducted under the Internal Revenue Code (hereinafter IRC).[1298] One might argue that if these contributions were intended to benefit shareholders, why then such

[1293] Id. at 586, where the court stated: "*The benefit may reflect managerial long-term strategic conceptions*…".
[1294] Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007, at 340.
[1295]It is worth noting however, some broader social concerns here. By the mid-1960s, critics became vocal in opposing reforms of corporate law that allowed corporate charity or the wider promotion of the interests of non-shareholder constituencies. It was a time filled with the fear of communism. No one was as fierce in such criticism as Milton Friedman. In his work Capitalism and Freedom, he stated: "*Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible*." Friedman Milton, Capitalism and Freedom, University of Chicago Press, Chicago, 1962, at 133.
[1296] Grossman Hugh Alexander, *Refining the Role of the Corporation: The Impact of Corporate Social Responsibility on Shareholder Primacy Theory*, 10 Deakin Law Rev. 2, [572, 596], 2005, at 588.
[1297] Id.
[1298] *See* Kahn v. Sullivan, 594 A.2d 48 (Del. 1991); Internal Revenue Code of 1986, Pub. L. 99-514, 100 Stat. 2085, October 22 1986, § 170(b)(2) 2006. *See* Kahn v. Sullivan, 594 A.2d 48 (Del. 1991).

restrictions?[1299] One possible explanation can be the need to prevent executive abuses.[1300] Abuses related to charities, but also in general, have been a constant concern with regards to stakeholder debates that came with the expansion of managerial power.[1301] Concrete scenarios witnessing this expansion involve for instance, some takeover defenses which were intended to provide for stakeholder considerations.[1302]

4.2.5 Takeovers and Stakeholders

The vibrant takeover market of the 1980s[1303] revived once again the debate between the advocates of shareholder primacy and those favoring a stakeholder approach,[1304] much to the benefit of a third '*set of actors'*, namely the expansion of the powers of managers.[1305] This time was characterized by the allowance of anti-takeover defenses,[1306] and the passing of constituency

---

[1299] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 118.

[1300] *See* for instance, Barnard Jayne W., Corporate Philanthropy, Executives' Pet Charities and the Agency Problem , 41 NYU Law School Law Rev., [1147, 1178], 1996-1997. While Barnard recognizes that corporate giving has become institutionalized and complete with standardized procedures, he argues that such giving is even today "*…often driven by the personal preferences of highly placed executives. Executives' "pet projects" have not disappeared*. "Id. at 1148.

[1301] *See* for instance, Bainbridge Stephen M., *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green,* 50 Washington & Lee Law Rev., [1423, 1447], 1993, *available* at SSRN: http://ssrn.com/abstract=303780 (last visited February 22nd 2011). Here Bainbridge analyzes the problems of a multi-fiduciary approach to directors` duties. He argues that such *"…approach is less likely to encourage managers to pursue the collective interests of the firm's various constituents than it is to encourage management to pursue their own self-interest*." Id. at 1441.

[1302] Id. at 1145-1146.

[1303] Holmstrom B. & Kaplan S.N., *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s,* 45 Journal of Economic Perspectives 2, [121, 144], 2001, at 123.

[1304] *See* Coffee John J. Jr., *The Uncertain Case for Takeover Reform: An Essay on Stock- holders, Stakeholders, and Bust-Ups,* Wisconsin Law Rev., [435, 447], [vol. and issue no. omm]1988; *See* also Johnson L. & Millon D., *Missing the Point about State Takeover Statutes,* 87 Michigan Law Rev., 4,[846, 857], 1989.

[1305] *See* Macey Jonathon R., *State Anti-Takeover Legislation and the National Economy,* Wisconsin Law Rev. [vol. and issue no. omm], [467, 490], 1988.

[1306] *See* Baysinger B. D. & Butler H.N., *Antitakeover Amendments, Managerial Entrenchment, and The Contractual Theory Of The Corporation*, 71 Virginia Law Rev. 8, [1257, 1303], 1985; *See* also Gilson Ronald J., *The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept,* 34 Stanford Law Rev. 4, [775, 836],1982.

statutes,[1307] which, although in a majority of cases, are supposed to apply generally to all corporate decisions, are interpreted by some as limited to takeover scenarios.[1308]

The rush in '*hostile'* takeover activity'[1309] provided for fears of worker layoffs, wage reductions and closing of factories and plants. [1310]The latter fueled debates over new regulations across states and the final result was the adoption of statutes that permitted,[1311] or required[1312] management to take into account the effect their decisions would bear on stakeholders.[1313]

Constituency statutes were enacted starting from 1983 onwards and provided, mostly in a permissive language, for managerial consideration of the interests of groups such as employees, customers and other larger groups of interest.[1314]

Some forty American states have enacted these statutes with the prevailing idea being the permission of the welfare of constituencies other than shareholders and for some of them, a '*move away'* from the strictest application of the shareholder value principle.[1315]

[1307] Bainbridge Stephen M, *Interpreting Nonshareholder Constituency Statutes,* 19 Pepperdine Law Rev. [971, 1025], 1992.

[1308] Id. at 994-995.

[1309] As already stated in *supra* note 391, the use of the adjective *hostile* to describe such takeovers is of a practical rather than legal character, due to the connotation of '*hostility*' towards the management of the target corporation, given that it refers to the takeover of a corporation, whose management opposes it. This opposition stems also due to the inherent conflict of interest that management has regarding bids, given that if a takeover was to go ahead, it could risk their position. However, shareholders benefit from such offers, not only due to the bid premium, but also due to the managerial alert that the threat of a takeover can cause. Romano Roberta, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 Cincinnati Law Rev., [457, 506], 1988-1989, at 457.

[1310] Daniels Ronald, *Stakeholders and Takeovers: Can Contractarianism Be Compassionate*?, 43 The University of Toronto Law Journal 3, Special Issue on Corporate Stakeholder Debate: The Classical Theory and Its Critics, [315, 351], 1993, at 319-323. The author notes however that empirical studies did not find unequivocal evidence to support the claim that for instance, employees suffered actual losses due to the increase in the activity of mergers and acquisitions. Id. at 319-320.

[1311] *See* for instance Indiana, Ind. Code, s.23-1-35-1(d) (2008); Ohio, Ohio Rev. Code Ann, s.1701.59(E) (Supp 1989).

[1312] *See* for instance Connecticut, Conn. Gen. Stat s.33-313 (2003); Arizona, Ariz. Rev. Stat s.10-1202 (2002); Idaho: Idaho Code s.30-1602 (2002).

[1313] Keay Andrew R., *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?,* University of Leeds Working Paper No. 4, January 2010, *available* at SSRN: http://ssrn.com/abstract=1530990, (last visited February 22nd 2011), at 9.

[1314] Id.

[1315] Id. at 8-9.

Upon their first enactments, some stakeholder advocates were hopeful that the statutes would have a real potential to significantly alter the shareholder primacy concept.[1316] One of them took it as far as to consider the statutes as "*the most significant change in United States corporate law since the New Deal securities*."[1317]

This was however an overly optimistic idea. Apart from their prevalent permissive nature, there were ambiguities as to the scope and application of these statutes.[1318] Interpreting the scope of the statutes, the American Bar Association (hereinafter ABA) Committee on Corporate Laws, has stated that they merely confirm the existing common law, namely that directors may only take into account the interests of these constituencies, to the extent that such an action will accrue benefits to the interests of the shareholders and the corporation.[1319] As to their application, it has been argued that they would be limited to takeover scenarios, despite the fact that on their face, a majority of them provide for a broader applicability to all corporate decisions.[1320]

The statutes offered more questions than answers as to the exact duties of directors in the absence of specific guidelines.[1321] Examples include, amongst others, whether directors would have to be fully informed on all the various interests of the protected constituencies,[1322] what would be the consequence in cases of failure to do so and the requirements necessary for a

[1316] Bainbridge Stephen M, *Interpreting Nonshareholder Constituency Statutes,* 19 Pepperdine Law Rev. [971, 1025], 1992, at 973.
[1317] Id.
[1318] Keay Andrew R., *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?,* University of Leeds Working Paper No. 4, January 2010, *available* at SSRN: http://ssrn.com/abstract=1530990, (last visited February 22nd 2011), at 10-12.
[1319] Committee on Corporate Laws of the Section of Business Law of the American Bar Association, *Other Constituency Statutes: Potential for Confusion*, 45 Bus Law 2253, 1990, at 2269.
[1320] Bainbridge Stephen M, *Interpreting Nonshareholder Constituency Statutes,* 19 Pepperdine Law Rev. [971, 1025], 1992, at 994-995.
[1321] Id.
[1322] Hanks James J. Jr., *Playing With Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 Stetson Law Rev. 97, [97, 119], 1991, at 101-109.

particular person or group to be qualified as a protected constituency.[1323] Moreover, there were ambiguities regarding the balance of interests to be achieved, if that was the intended consequence of the statutes, and how were courts to review such cases.[1324]

The central concern regarding the statutes has always been the risk of expansion of managerial powers and the danger of inducing opportunism.[1325] The outcome of the application of the statutes would risk a softening effect on board accountability, simply because any manager could foster self-interest by claiming to serve the interest of any constituency group.[1326] In the absence of guidance as to the exact duties of directors, and in the absence of means to measure the various interests of constituencies, these statutes provided little practical effect for stakeholders and an unintended plea for expanded managerial powers.[1327]

4.2.5.1 Cases Affecting Stakeholders?

Delaware, the all important '*home*' of corporate law, has not adopted a constituency statute.[1328] It has however at times evolved so as to raise questions regarding the consideration of other interests, especially so in takeover scenarios.[1329]

As already discussed in the second chapter,[1330] another line of cases that have touched upon the issue of stakeholder constituencies, have been the cases referring to takeovers, abd nist importantly, the two landmark cases of ***Unocal***[1331] and ***Revlon.***[1332]

[1323] Id.
[1324] Supra note 1320 at 988.
[1325] Campbell Rutheford B. Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era*, 23 Florida State University Law Rev.,[561, 624], 1996, *available* at: http://www.law.fsu.edu/journals/lawreview/downloads/233/campbell.pdf , (last visited February 22nd 2011) at 622.
[1326] Id.
[1327] By 2000, only in one case had a court referred to a constituency statute in finding in favor of a management decision. *See* Georgia-Pacific Corp v Great N. Nekoosa Corp 727 F. Supp. 31 (Me, 1989).
[1328] *See* Barzuza Michal, *The State of State Antitakeover Law*, 95 Virginia Law Rev., [1973, 2052], 2009, *available* at SSRN: http://ssrn.com/abstract=1532427 ,(last visited February 22nd 2011), at 1977.
[1329] Id. at 1980-1987.
[1330] *See* supra sections 2.2 and 2.3 and related discussion.

Despite the special reference the court made in ***Unocal***, with regards to considerations of interests of groups such as employees, creditors, customers or the community,[1333] it was not entirely clear what this reference meant.[1334] Also, the situation was simple given the fact that due to a strong coercive bid, the management was presumed to not face any opposition between the interests of the constituencies involved.[1335]

However ***Revlon***[1336] later made it clear that the board of a targeted company could not do so at the expense of the shareholders, but only in cases when the observance of these interests accrues benefits to shareholders.[1337] The Court was of the opinion that in cases when a sale or break-up cannot be avoided, then the role of the board changes *"from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders*."[1338]

In the subsequent 1989 case of ***Paramount Communications v. Time***,[1339] the court took a different approach and tried to limit *Revlon*`s holding.[1340] Instead of a profitable tender offer made by Paramount Communications, Time`s directors agreed to merge with Warner Brothers, leaving the shareholders of Time as minority shareholders in a company that was burdened by considerable debt due to the merger.[1341] The directors argued that the Warner deal was better for the corporation, as the court stated: "*[t]he board's prevailing belief was that Paramount's bid*

1331 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), (hereinafter for this section Unocal 493 A.2d); The cases have been dealt with in other parts of this work, therefore, here only the outcomes relevant to the purpose of this chapter will be dealt with).
1332 Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986), (hereinafter for this section Revlon 506 A.2d 173).
1333 Unocal 493 A.2d at 953-955.
1334 Bainbridge Stephen M, *Interpreting Nonshareholder Constituency Statutes*, 19 Pepperdine Law Rev. [971, 1025], 1992, at 981.
1335 Id. at 981-982.
1336 Revlon 506 A.2d 173.
1337 Id. at 182.
1338 Id.
1339 Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989), (hereinafter for this section Time 571 A.2d 1140).
1340 Barzuza Michal, *The State of State Antitakeover Law*, 95 Virginia Law Rev., [1973, 2052], 2009, *available* at SSRN: http://ssrn.com/abstract=1532427 ,(last visited February 22nd 2011), at 1986.
1341 Time 571 A.2d 1140.

posed a threat to Time's control of its own destiny and retention of the 'Time Culture'".[1342] The culture referred to in this statement related to the "*journalistic integrity*"[1343] of the corporation.

The Court limited Revlon by stating that this case did not trigger *Revlon duties* since it was a merger of equals.[1344] Basically, according to this view, absent a strict Revlon scenario, directors are not in a *per se* obligation to attend to the shareholder maximization value.[1345] The decision of the directors was upheld giving them broad authority to refuse to put a tender offer up to a vote, even though shareholder wealth would be maximized in the short run.[1346]

This two-fold attack on the shareholder maximization value, meaning the adoption of constituency statutes and allowance of anti-takeover defenses by boards, has nevertheless disappointed both, the conservative shareholder primacy scholars and the liberals of the stakeholder school of thought.[1347] One commonality in such disappointment is that it has come at the expense of expanded managerial powers, feared by the first and '*to be'* feared by the second, if not already done so. This is not to say that acknowledgment of stakeholder interests should be dismissed at any cost, it is more so to acknowledge that a multi-stakeholder duty imposed on boards has the potential of creating a shield of liability.[1348] In the end, some corporate law efforts to accommodate stakeholder interests, sporadic as they might be, in the absence of proper board accountability standards, run the risk of allowing managers to protect one constituency above all

[1342] Id. at 1148.
[1343] Id. at 1143, n.4.
[1344] Supra note 1340 at 1986.
[1345] *See* also Harper Ho Virginia E., *'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 Journal of Corporation Law, 1, [59, 112], 2010, *available* at SSRN: http://ssrn.com/abstract=1476116, (last visited February 22nd 2011), at 75.
[1346] Time 571 A.2d 1140.
[1347] Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004, *available* at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=805505, (last visited February 23rd 2011), at 124.
[1348] Bainbridge Stephen M., *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 Washington & Lee Law Rev., [1423, 1447], 1993, *available* at SSRN: http://ssrn.com/abstract=303780 (last visited February 22nd 2011), at 1432-1437.

others, which is themselves. The reforms aimed at increasing stakeholder protection in corporations, could easily be translated into further managerial immunization from liability and scrutiny.[1349] Given the multiple stakeholder groups, given also the difficulty in balancing their interests, there is likely to always be some constituency, under the name of which management can justify serving its own interest.

4.3 Stakeholder Protection in the Chosen EU Jurisdictions

The stakeholder debate has been considered to breathe more freely in certain parts of Europe.[1350] What is important to the focus of this analyses, is however the protection granted to stakeholders such as employees and creditors in the chosen jurisdictions, especially so via the locus of company laws and corporate governance codes. In Germany, the inclusion of employee representatives in the internal company decision-making apparatus via seats in Supervisory Boards and other considerations regarding the purpose of a company, have caused the model to be often characterized as a typical stakeholder model.[1351] Special considerations need to be reserved for the CEE chosen jurisdictions, where again, the level of stakeholder protection has been shaped by region specific features.[1352]

Having this in mind, and also drawing parallels with the U.S. analyses, the next section will proceed initially with a discussion of stakeholder protection in German AGs, focusing first

[1349] Id.
[1350] Enriques L., Hansmann H. & Kraakman R., The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [33, 70], Oxford University Press, USA, 2004, at 61-65.
[1351] Id. at 61.; *See* for Codetermination, Co-Determination Act, (Law on Employee Participation), [Gesetz über die Mitbestimmung der Arbeitnehmer , Mitbestimmungsgesetz] of 4 May 1976, published in Federal Law Gazette BGBI I S.1153.
[1352] *See* Berglöf, E. & Pajuste, A., *Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in*: Cornelius, P.K. & Kogut, B. (eds.), *Corporate Governance and Capital Flows in a Global Economy*, [267, 304], Oxford University Press, UK, 2003.

on codetermination, given its importance in German corporate governance and then with the protection of creditors. The final section will then address some stakeholder perspectives in the chosen CEE jurisdictions.

4.3.1 Stakeholder Protection in German Companies

Different from the U.S., Germany devotes employees a special role within the company.[1353] There are indeed two forms of codetermination, the so-called management codetermination,[1354] although the more exact term would be supervisory codetermination, via participation at Supervisory Board levels and social codetermination,[1355] which is participation at shop-floor level, via work councils, productivity committees, and so on. Regarding supervisory codetermination, the form that applies to companies in the industry and commerce sector (as distinguished from the mining, iron and steel industry),[1356] was established via two acts: the Works Constitution Act of 1952,[1357] as superseded now by the One Third Participation Act of 2004[1358] and the 1976 Codetermination Act (hereinafter MitbestG).[1359] With regards to the first Act, one third of the Supervisory Board members are to be composed of employee

[1353] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007.
[1354] Id. at 112.
[1355] Id. at 113.
[1356] The Mining, Iron and Steel industry Codetermination Act, [Gesetz über die Mitbestimmung der Arbeitenhemer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie], (Montan-MitbestG), of 21 May 1951, published in the Federal Law Gazette BGBI I S. 347.
[1357] Works Council Constitution Act, [Betriebsverfassungsgesetz, (BetrVG)], of 11 October 1952, published in the Federal law Gazette BGBl I 43 S.681.
[1358] One Third Participation Act [Drittelbeteiligungsgesetzes (DrittelbG)] of 18 May 2004, published in the Federal Law Gazette BGBI IS. 974.
[1359] *See* for Codetermination, Co-Determination Act, (Law on Employee Participation), [Gesetz über die Mitbestimmung der Arbeitnehmer , Mitbestimmungsgesetz] (hereinafter MitbestG)of 4 May 1976, published in Federal Law Gazette BGBI I S.1153.

representatives for companies with 500 up to 2000 employees.[1360] Regarding MitbestG, all AGs, limited liability companies (GmbHs), cooperatives and companies with one or more general partners limited by shares, are subject to the Act, if they employ more than 2000 employees.[1361]

The codetermination provided by MitbestG, is however called a system of quasi-parity co-determination due to two main reasons. First, in cases when there is disagreement as to the chairperson of the board, the shareholders' representatives will elect such a chairperson.[1362] This in turn is significant due to the additional vote a chairperson has when there is a deadlock.[1363] The second reason is that, at least one of the workers' representatives, has to be elected from the senior *managerial employees*, called "*Leitende Angestellte*".[1364] Considering that the interests of managerial employees might diverge from those of the '*normal*' workers, there is a presumption that there is no real parity in codetermination.[1365]

One has to distinguish here the reasons behind the introduction of the two-tier board structure and codetermination. While the first was introduced by the predecessor of the German Commercial Code (HGB) of 1897,[1366] namely the General German Commercial Code of 1861,[1367] the appearance of codetermination, even its earliest form, was much later.[1368]

[1360] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, *German Corporate Governance in International and European Context*, [111, 144], Springer, Berlin, Heidelberg, 2007, at 118; It is to be noted that MitbestG provides for election by employees in companies with less than 8000 employees or from delegates of employees if the number is higher than 8000, §§ 9(1), (2) MitbestG.
[1361] Id at 116-118; § 1 (1) 1 MitbestG. The full name for limited liability companies: Gesellschaft mit beschränkter Haftung, GmbH; for cooperatives: Genossenschaften, for companies with one or more general partners but limited by shares: Kommanditgesellschaften auf Aktien, KGaA). Id. at 116-117.
[1362] § 27(2) MitbestG.
[1363] § 29(2) MitbestG.
[1364] Gorton G. & Schmid F., *Class Struggle inside the Firm: A Study of German Codetermination*, NBER Working Paper Series, No. 7945, 2000, *available* at SSRN: http://ssrn.com/abstract=245742, (last visited February 24th 2011), at 7; Additionally, in a typical situation, around one-third of the employee representatives are also members of the works council, while the remaining 2/3 are usually external trade union representatives. Id.
[1365] Id.
[1366] German Commercial Code, [Handelsgesetzbuch (HGB)] of 10 May August 1897, published in Imperial Law Gazette, RGBI S. 219.
[1367] German General Commercial Code, [Allgemeines Deutsches.Handelsgesetzbuch**,** (ADHGB)] of 31 May 1861, (publication gazette info omitted). The Act was made compulsory in 1870. *See*, Du Plessis J. J. & Sandrock O., *The*

The idea of a Supervisory Board was in fact, at its inception, considered as an exclusive forum for shareholders, in order to be properly able to monitor the activities of the Management Board. Originally, it was not stated on behalf of whom, was the supervision to be done, but it was presumed that it was to be done "*on behalf of the corporation, as personified by all the shareholders.*"[1369] It is clear therefore that, as per interpretations of the time, the original idea was that of serving shareholders` interest through the corporate interest, a concept which would not go all too well with a model characterized traditionally as a stakeholder one.[1370]

The situation nowadays is different however. The GCGC states that members of the Supervisory Board serve in the best interest of the corporation.[1371] As for the members of management, it is interpreted by scholars that they need "*to take into consideration the interests [not only] of the shareholders […][but also] of the employees*."[1372] If this is applicable to the Management Board, then the Supervisory Board is also bound by the same interests.[1373]

The changes in perceptions as to whom were these duties owned, were also radically transformed by the introduction of codetermination, albeit the latter was simply transposed within the two-tier board structure, without any clear modifications so as to adapt this structure to the new introduction.[1374] This certainly raised suspicions at the time, but it was alleviated later

---

German System of Supervisory Codetermination by Employees, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 119, note 52.

1368 Id. (referring to the work of Du Plessis J. J. & Sandrock O., 2007) at 119-120.

1369 Id. at 120.

1370 *See* for such characterization, Enriques L., Hansmann H. & Kraakman R., *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [33, 70], Oxford University Press, USA, 2004, at 61-65.

1371 Art. 5.5.1. GCGC

1372 Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 121, note 63, referring to Schmidt Karsten, Gesellschaftsrecht, (Company Law), 4th ed., Carl Heymanns Publishing House, 2002, at 805.*[emph.add]*

1373 Id. at 121.

1374 Id.

on into praise and a certain sense of German pride by business leaders and politicians alike.[1375]

Before continuing with some of the early claims regarding the constitutionality of the introduction of MitbestG,[1376] a note on the legislative intent of the MitbestG and its early history is necessary in order to understand what German legislators considered as appropriate treatment of employees and what the role of companies would be in this regard.

The legislative history of MitbestG, enumerates certain considerations as justifications behind the introduction of the Act: namely, "*the protection of human dignity, the necessity to grant equal rights to the providers of labor and capital, the democratization of corporate decision-making and the necessity to limit entrepreneurial power in general*."[1377] At the time, it was considered a violation of the human dignity concept to "*treat the individual worker as a mere "cog in the wheel."*"[1378]

As per the legislative history of the Act, those who provide capital and labor need to be treated equally in terms of rights. Whether this was a goal in itself is debatable,[1379] however, this equal treatment was seen as an imperative so as to protect employees from "*adverse*" corporate decisions[1380] and to limit "*entrepreneurial power in general*."[1381] Lastly, the democratization of decision-making argument raised above, related to the belief that just like politics, the power of companies needed "*democratic legitimacy*"[1382]

1375 Id. at 121-122.
1376 Id. at 123-125.
1377 Dammanns Jens C., *The Future of Codetermination After Centros: Will German Corporate Law Move Closer to the U.S. Model?*, 8 Fordham journal of Corporate & Financial Law, [607, 681], 2003, *available* at: http://law2.fordham.edu/publications/articles/600flspub9103.pdf, (last visited February 24th 2011), at 651.
1378 Id. at 652 [emph.orig.]
1379 Id.
1380 Id.
1381 Id.
1382 Id.

With this framework in mind, we now turn to see how German courts responded to claims that MitbestG was unconstitutional.[1383] Some of the largest German Companies lodged a complaint before the German Constitutional Court alleging that codetermination at levels of parity or quasi-parity infringed property rights of the company.[1384] The outcome of the case is crucial in that it shows an embrace of social considerations at a level which U.S. stakeholder scholars would consider ideal. The Court stated that not only was MitbestG constitutional, but by referring to the explanations associating the Act, the latter was necessary for the protection of the common good.[1385]

Another similar case in 1982 found the passing of bylaws that violated MitbestG requirements as null and void, and it stated that MitbestG was aimed not only to serve the public good but to serve the entire national economy,[1386] making German courts` completely loyal to the legislative intent and justifications behind MitbestG.

<u>4.3.1.2 Empowered Employees?</u>

Every empowerment comes with a potential for abuse and scandals involving employee representatives in Supervisory Boards have not been missing. We have already mentioned the role of the representative of employees in the ***Mannesmann AG*** case,[1387] where his abstention was effectively a green light for the grant of the 'appreciation award' to the CEO of the

[1383] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 123-125.
[1384] Id., at 123, note 80, referring to the Collection of Decisions of the German Federal Constitutional Court (BVerfGE) 50, s. 290 et seq.
[1385] Id. at 123-124; *See* also the reference at 123, note 80, BVerfGE 50, at 250 et seq.
[1386] Id. at 124, note 81, referring to the decision of German Federal Supreme Court (Civil matters) BGHZ 83, s. 106 et.seq., (at s. 110 et seq.)
[1387] Mannesmann AG, BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.

company.[1388] Another scandal involving representatives of employees happened at *Volkswagen* AG.[1389] In 2003, two members of the parliament of Lower Saxony, who were also previous employee representatives of Volkswagen, continued to receive salaries despite the fact that they no longer served the company.[1390] The luxurious trips and other extra benefits to representatives of employees with invoices of more than € 1 million, resulted in a strong public dissatisfaction upon their reveal.[1391]

These cases and 'incidents are only some examples of the problems raised with regards to codetermination, but other concerns are persistent as well, such as the issue of the balance of powers within Supervisory Boards from a fiduciary duty perspective. As one scholar has put it: "*Codetermination legitimate[d] at least two sets of interests - those of the shareholders and those of employees - that must be reflected in the law's conception of directors' fiduciary obligations.*"[1392] It is also clear that especially representatives of employees would be inclined to preserve more directly the interests of the constituencies that elected them.[1393] Yet, business decisions would involve situations, under which a company`s best interest is not necessarily

[1388] Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007, Electronic Article *available* at SSRN: http://ssrn.com/abstract=965596 (last visited February 12th 2011), at 21-22.

[1389] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007, at 133-137.

[1390] Id. at 134.

[1391] Id. at 134-135; *See* also Landler Mark, Scandals Raise Questions Over Volkswagen Governance, NY Times, July 7th 2005, electronic article *available* at: http://www.nytimes.com/2005/07/07/business/worldbusiness/07volkswagen.html?_r=1, (last visited February 24th 2011).

[1392] Cioffi John W., *Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002, *available* at SSRN: http://ssrn.com/abstract=513743, (last visited February 24th 2011), at 8.*[emph.add.]*

[1393] Id. at 8-9.

served by preserving employee considerations at any cost. The conflict inherent in such scenarios is evident.[1394]

Aware that a non-compromise style of decision making would not prove efficient, decisions through consent have become standard procedure. In most cases it has meant that both classes of representatives have had to sacrifice a proper representation of shareholder and employee interests they were elected to represent.[1395]

Moreover, other critiques have been raised regarding issues such as the fact that social and employee matters usurp a lot of the time that should have been devoted to monitoring management,[1396] and the high number of members of the Supervisory Board mitigates its efficiency.[1397] It has also been argued that employee representation causes passivity in the boards with greater power for employees, meaning that shareholder representatives had not the same incentives of becoming active.[1398] Earlier court decisions have effectively prohibited the creation of committees which consistently failed to include employee representatives, and this in turn has meant that there have been no efficient means of addressing the problems caused by the large size of the boards.[1399]

Other perceived problems have referred to the role of codetermination with regards to takeover scenarios.[1400] Especially so before the 1990s, Germany has traditionally been

[1394] Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, *German Corporate Governance in International and European Context*, [111, 144], Springer, Berlin, Heidelberg, 2007, at 127, at note 100.
[1395] Id. at 127.
[1396] Id. at 125-126.
[1397] Cioffi John W., *Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002, *available* at SSRN: http://ssrn.com/abstract=513743, (last visited February 24th 2011), at 8.
[1398] Id.
[1399] Id.
[1400] Jackson G. & Höpner M., *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance*, Max Planck Institute for the Study of Societies (MPIfG) Discussion Paper No. 01/4, 2001, *available* at: http://www.mpifg.de/pu/mpifg_dp/dp01-4.pdf, (last visited February 24th 2011), at 14-23, 32-39.

characterized by a low merger activity.[1401] There have been several reasons for this, amongst which, high ownership concentration levels and the influence of banks.[1402] In the latter case, one proposed reason concerned the fact that private banks were usually also widely held companies, and thus, they would have little incentive in being exposed to '*hostile*' bids themselves.[1403] Another central argument has evolved around the effects of employee rights under codetermination in the takeover market for Germany.[1404]

It has been argued that employee representation on the Supervisory Boards weakens the direct influence that shareholders could have.[1405] Even more so, employees could have a strong say in takeover activities, in cases when the shareholder side of the representatives is fragmented into competing fractions.[1406] Employee representatives would also be most likely to support the types of defensive actions taken by management in cases of takeover battles.[1407] Lastly, other cultural elements, such as the traditional German public and media perceptions, have not been very prone to viewing stock market activity favorably, given its characterization as risky.[1408] Although the number of *hostile* bids increased with the globalization of markets and the liberalization of EU takeover activity,[1409] codetermination and the public skepticism especially in the past, have played a role in the overall attractiveness of German AGs.

[1401] The early 1990s saw a wave of mergers with East German firms following the reunification of Germany. In the late 1990s, the number of cross-border mergers increased considerably given the liberalization of the European markets. Id. at 14.
[1402] Id. at 16-18.
[1403] Id. at 18.
[1404] Id. at 18-19.
[1405] Id. at 18.
[1406] Id.
[1407] Id.
[1408] Baums Teodor, *Corporate Governance in Germany: System and Current Developments,* University of Osnabrück Paper No. 70, 1998, *available* at http://www.jura.uni-frankfurt.de/ifawz1/baums/Bilder_und_Daten/Arbeitspapiere/paper70.pdf, (last visited February 24th 2011), at 13-14.
[1409] Jackson G. & Höpner M., *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance*, Max Planck Institute for the Study of Societies (MPIfG) Discussion Paper No. 01/4, 2001, *available* at: http://www.mpifg.de/pu/mpifg_dp/dp01-4.pdf, (last visited February 24th 2011), at 14.

4.3.1.3 Protection of Creditors in German AGs

It has been said that European jurisdictions in general, and Germany in particular, are more creditor-friendly than the U.S., the latter often characterized as a debtor-friendly jurisdiction.[1410]

There are fiduciary duties owed to creditors in cases of insolvency in German companies. Management has a specific duty of care with regards to managing the estate of the company in such cases.[1411] What is special however is that like most jurisdictions, but unlike the U.S., Germany has a requirement imposed on boards to start bankruptcy proceedings, "*upon the onset of insolvency*".[1412] Therefore, there is an increased form of liability expressed as a special duty to file for insolvency.[1413] At the moment a company cannot pay its debts while they become due, the management board should "*without undue delay but in no event later than three weeks*,"[1414] enter insolvency proceedings. Otherwise, directors can be held personally liable.[1415] This obligation expressed specifically in the AktG, although referring to members of the Management Board, brings implications for the Supervisory Board as well, given that failure to prompt the former to start insolvency proceedings, might run counter to the duty to act with proper

[1410] Merkt, Engert, Feldman, Huff, & McKenzie-Skene, *Twilight in the Zone of Insolvency: Fiduciary Duties and Creditors of Troubled Companies*, 1 Journal of Business and Technology Law 2,(Conference Publication), 2007, (Engert Andreas' discussion), *available* at: http://www.law.umaryland.edu/academics/journals/jbtl/issues/1_2/1_2_313_Engert.pdf, (last visited February 24th 2011), at 6.
[1411] Id.
[1412] Hertig G. & Kanda H., Creditor Protection, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [71, 99], Oxford University Press, USA, 2004, at 73.
[1413] § 92(2) AktG; *See* also *Cheffins* Brian R. & Black Bernard S., *Outside Director Liability Across Countries,* ECGI Law Working Paper No. 71/2006, *available* electronically at http://www.cgscenter.org/library/Board/OutsideDirectorLiability.pdf ,(last visited February 24th 2011), at 1429.
[1414] Id.; *See* § 92(2) AktG.
[1415]Id. *See* also Bröhmer Jürgen *Germany, in:* Omar Paul J., Directors` Duties and Liabilities, [51- 56], Ashgate Publications Ltd., New York, 2000.

diligence.[1416] Such statutorily provided duty exists therefore for cases considered as "*in the vicinity*" of insolvency.[1417]

Characteristic of the German model is the appointment of an administrator in cases of insolvency,[1418]changing in this way the procedural elements of the right to sue the members of a Supervisory Board. While the administrator might be believed to have more willingness to sue, actual cases of such actions have been scarce, mostly due to procedural cost-benefit concerns.[1419]

One delay might come from the administrator waiting for a creditor approval before commencing litigation.[1420] Furthermore, concerns about litigation costs and the fear about covering legal fees for directors in cases of a failed action, serve as deterrents for liquidators.[1421] Moreover, Directors' & Officers' liability insurance policies might incite an administrator to claim from the policy rather than follow the path of suing a director and going after him personally.[1422] Although there was only one such (rather vaguely) reported case until 2006,[1423] in which an administrator in insolvency sued a member of the Supervisory Board and the latter was asked to pay damages stemming from his breach of duty owned to the company, a subsequent settlement for far less than the initial damages, ended the case.[1424]

[1416] §§ 93, 116 AktG; Id.
[1417] Hertig G. & Kanda H., Creditor Protection, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [71, 99], Oxford University Press, USA, 2004, at 73 - 74.
[1418]Isolvency Statute [Insolvenzordnung, (hereinafter InsO)], of 5 October, 1994, BGBl. I at 2866, §§ 80, 148(1). (For an English translation, *See* electronic form *available at* http://www.iuscomp.org/gla/statutes/InsO.pdf
[1419] Cheffins Brian R. & Black Bernard S., *Outside Director Liability Across Countries,* ECGI Law Working Paper No. 71/2006, *available* electronically at http://www.cgscenter.org/library/Board/OutsideDirectorLiability.pdf ,(last visited February 24th 2011), at 1430.
[1420] Id., Such an approval is required if there is "considerable value in dispute. *See* § 160(2) InsO.
[1421] Id.
[1422] Id.
[1423] Id, at 1430, note 261 referring to Landergericht Stuttgart DB 1999, 2462 ASS AG/OLG Stuttgart OLGR Stuttgart 2003, 55.
[1424] Id.

Germany imposes a risk of personal liability on directors, when a company is insolvent, or close to it.[1425] Although for a majority of jurisdictions that doesn`t translate into a right of creditors to take legal action against directors prior to a filing for insolvency, Germany does not deny standing to creditors "*to sue the directors of a solvent company.*"[1426] However it has been noted that creditors do not usually take legal action in the pre-insolvency state.[1427] Directors "*who act negligently on the brink of insolvency*"[1428] can be held personally liable in Germany. Directors would be considered *per se* negligent by failing to properly observe the capital maintenance requirements.[1429]

However this liability is less far-reaching than it appears to be for several reasons. First, the idea behind the legal capital doctrine assumes in a misleading way, that the fixed legal capital[1430] will inform the creditors of those resources that can not be distributed to shareholders. This is misleading given that as soon as a company starts to operate, it can use its capital to purchase assets that decline in value.[1431] The fact that a company can immediately incur loses, makes the initial paid-in capital sum meaningless. As a result of the losses that can be so incurred, creditors willing to inform themselves, need to examine the entire balance sheet to see

---

[1425] Hertig G. & Kanda H., Creditor Protection, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [71, 99], Oxford University Press, USA, 2004, at 88-89.
[1426] §93 AktG. Id. at 89.
[1427] Id. at 89; *See also* Hopt Klaus J., *Shareholder Rights and Remedies: A View from Germany and the Continent*, 2 Company Financial & Insolvency Law Rev., [261, 272], 1997.
[1428] Id. at 90.
[1429] Id. at 85, 90.
[1430] §7 AktG requires a minimum capital for establishing AGs in the value of € 50.000; For capital requirements, s*ee also* Second Council Directive 77/91/EEC of the Council of European Communities of 13 December 1976 on Coordination of Safeguards which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, in Respect of the Formation of Public Limited Liability Companies and tie Maintenance and Alteration of Their Capital, with a View to Making Such Safeguards Equivalent, 1977 OJL 26/1 and 1992 OJL 347/64 13.12.1976 (hereinafter 2nd Company Directive), *available* at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31977l0091:EN:HTML , (last visited February 24th 2011), art. 6.
[1431] Macey J. R. & Enriques L., *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules,* 86 Cornell Law Rev., [1166, 1204], January 2001, at 1186-1187.

the real equity level protections offered by the company and they have to consider the current value of the company`s assets, not the one at the time of the purchase.[1432] In other words, the value of the stated capital and earned surplus of a company, reflect only *historical* facts regarding the company, and do not provide any significant indicators of its current financial situation.[1433] In practice, therefore, German AGs usually have exhausted the capital by the time financial distress is revealed.[1434]

Moreover, there are procedural difficulties related to bringing a suit for these failures. It is usually difficult to show that there was a failure to act, for instance, by calling for a meeting of shareholders or filing for insolvency, at the moment when the company failed to comply with capital requirement rules.[1435] Valuation methodologies in the past have also given directors some window within which to act without violating their duties to creditors.[1436] Furthermore, even if there was a violation of a duty, it is difficult to show that they caused an injury to creditors and the latter would be unable to recover, if the violation did not increase their consolidated damages.[1437] All the procedural considerations and the potential escape routes of liability for directors, make this form of protection less attractive than initially thought.[1438]

[1432] Id. at 1186-1187.
[1433] Id. at 1187.
[1434] Hertig G. & Kanda H., Creditor Protection, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [71, 99], Oxford University Press, USA, 2004, at 85.
at 84-85.
[1435] Id. at 90
[1436] Id.
[1437] Id.
[1438] Recently, there has also been one exception to the liability for failure to file for insolvency of over indebted financial companies. Directors of these financial companies would not be liable for not filing for insolvency within a "*cure*" period, due to the 2008 amendment of the Insolvency Code, as a result to the financial crisis. *See* Financial Markets Stabilization Act [*Gesetz zur Umsetzung eines Maßnahmenpakets zur Stabilisierung des Finanzmarktes Finanzmarktstabilisierungsgezetz (FMStG)*] of 17.10.2008 published in BGBl. I S. 1982, 46.According to these amendments, directors in Germany are not required to file for insolvency of a company which is over indebted, if there is a "*predominant probability*" that the activity of the company could continue despite its financial distress. FMStG § 5; However this amendment was restricted in time in terms of its application and it applied only till December 31st 2010. FMStG §§ 3 to 7.

We have seen that the German system differs from the U.S. in several points. First, there was the early historical shift with regards to the interests to be served by directors, from the idea of serving the interests of shareholders to those of the company, with the latter not being the equivalent of shareholder interests alone.[1439]

Second, the inclusion of employee representatives in the Supervisory Boards, up to levels of quasi parity, is a straightforward adoption of a stakeholder model of governance. However, several concerns with regards to the problems pertaining to codetermination exist. The risk of turning empowered employee representatives towards opportunism, the fact that the efficiency of the board might be undermined due to the high number of members, the existence of various, often conflicting sets of interests represented, and the risk of sacrificing the interests of both, employees and shareholders alike, due to the compromise style of decision-making, are a few of them.[1440]

With regards to protection of creditors, we have seen in this subsection a stricter approach in Germany, mostly via the statutory provision of a duty to file for insolvency and the presumption of negligence in cases when capital maintenance requirements are violated. Nevertheless, concerns of a procedural and litigation costs character have influenced in mitigating the potential efficiency of pursuing such claims.[1441]

4.3.2 Stakeholder Protection in CEE

CEE jurisdictions present a specific scenario in terms of stakeholders' protection. In a time where the idea of shareholder value maximization had not yet been crystallized and was being

[1439] *See* supra section 4.3.1 and related discussion.
[1440] *See* supra section 4.3.1.2 and related discussion.
[1441] See supra section 4.3.1.3 and related discussion.

pushed for more recognition, at the same time, pressures to strictly follow the OECD Principles of Corporate Governance,[1442] including recommendations on stakeholder protection, resulted in a web of standards full of ambiguities and no clear applicability potential.[1443]

In order to provide some insight on the current *regime* of stakeholder protection (if it can be called as such), the following section will proceed first with a general view on the conclusions that can be drawn from the Codes of Corporate Governance, dealing with those provisions that relate to fiduciary duties which have been left ambiguous by company laws. The second purpose of looking at the Codes of Corporate Governance is to see what kind of provisions they offer for the protection of stakeholders, even if clarity on the content of fiduciary duties with regards to stakeholders cannot be established with certainty. The second part will then deal with the regime for protection or participation of employees in Supervisory Boards (where applicable) and lastly, with the protection of creditors.

4.3.2.1 Fiduciary duties and Stakeholders in CEE?

In Romania, there is no equivalent debate on the scope and content of fiduciary duties as seen in the advanced economies of the U.S. and Germany. As a matter of fact, company law provides little guidance as to such scope. Company law has some provisions devoted to a duty of due managerial care, a duty to avoid conflicts of interest, and a business judgment rule discharging liability in cases when a director was reasonably entitled to consider that he was

[1442] OECD Principles of Corporate Governance, 1999, (changed since then into the 2004 version) *available at*: http://www.oecd.org/dataoecd/32/18/31557724.pdf (last visited February 11th, 2011).

[1443] *See* for an example of ambiguous interpretations the commentaries on the Czech Corporate Governance Code regarding the necessity to further develop a shareholder value concept, which has been unknown for a large part in Czech Republic. Czech Corporate Governance Code 2004, *available at*: http://www.ecgi.org/codes/documents/czech_code_2004_en.pdf (last visited on February 15th 2011), (hereinafter for this section Czech Corporate Governance Code), Commentary at 42.

acting in the company`s best interest.[1444] The latter gives some guidance as to the interest to be furthered by the acts of the boards, that is the *company*`s interest. Some form of guidance can also be sought in the provisions of the recent Romanian Code of Corporate Governance.[1445] This Code states that boards are under a duty to serve the company`s best interest, and protect the general interests of shareholders, with a view to the sustainable development of the company.[1446] Yet, if you look at the concrete recommendations following this principle, there is no interpretation as to what is this best company interest, whether it translates only into a shareholder interest, or whether the reference to sustainable development includes stakeholders` protection as well.[1447] Another recommendation proposes some consideration for stakeholders such as employees and creditors in the form of managements` '*best efforts*' to enhance stakeholders` role in the development of CSR policies.[1448] This is however a mere mentioning that stakeholder constituencies might be important, but no concrete requirement is imposed on the boards.

Czech Republic is a bit different in this regard. While the Commercial Code provides for a duty of managerial care and a duty to not disclose information that is detrimental to the company`s interest, it doesn`t help much the purpose of this discussion.[1449] However, the 2004 Code of Corporate Governance provides some guidance when stating that *"[m]embers of the*

[1444] Law No. 441/2006 On Amending and Supplementing the Provisions of Law No. 31/1990 On Commercial Companies and of Law No. 26/1990 On the Register of Commerce Registration Procedures. *[Lege pentru Modificarea Legii nr. 31/1990 Privind Societãtile Comerciale, Republicata, si a Legii nr. 26/1990 Privind Registrul comertului]*, OG No. 955, 31.10.2006, (hereinafter Romanian Company Law 2006), art. 144.; *See* also Iancu Monica & Statescu Monica, *Obligations and Civil Liability Incumbent under Romanian Law, Corporate and Commercial Legal Developments*, August 2008, electronic article *available* at: http://www.worldservicesgroup.com/publications.asp?action=article&artid=1909, (last visited February 24th 2011).
[1445] *See* Romanian Corporate Governance Code 2009, *available at*: http://www.ecgi.org/codes/documents/bucharest_se_code_jan2009_en.pdf, (last visited February 15th 2011), (hereinafter for the purpose of this section, Romanian Corporate Governance Code).
[1446] Art. 3 , Principle V of Romanian Corporate Governance Code.
[1447] Id. Rec.(s) 10 to 13.
[1448] Id. Rec.(s) 37, 38.
[1449] Czech Commercial Code *[Obchodní zákoník]* Act. No. 63/2001 Coll., 1.01. 2001, as most recently amended by Act 409/201 Coll.1.01.2011. art. 194.

board of directors and supervisory board must act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders."[1450] In the commentary to this provision, it is admitted that there has been little understanding of the concept of shareholder value and a predominant feature of Czech companies has been to improve the position of the management.[1451] Yet, the comment on the Annex, states that directors owe a duty of loyalty to the *company*. What such interest of the company would be is considered difficult to define, and as the commentary provides, courts would have to decide what the interest of the company would be.[1452] However there have been no reported cases so far that have decided on this issue.

The same Code also provides a recommendation with regards to ethical standards stating that the boards must apply high ethical standards considering also the interests of stakeholders.[1453] In the accompanying commentary, this is translated as a requirement on the boards to "*take due regard of, and deal fairly with, stakeholder interests including those of employees, creditors, customers, suppliers and local communities*."[1454] Yet again, it is unclear what would happen if a board fails to do so or how is a board to pursue shareholder value as recommended in the first provision, while at the same time paying due regard to stakeholder interests.[1455]

In the special part devoted to stakeholders, the Code provides that just like other countries, stakeholder rights in Czech Republic are established by law, such as business law, labor law, and insolvency law, implying in this way that the typical venue for stakeholder protection has been

---

1450 Chapter VI (A) Czech Code of Corporate Governance.
1451 Id. Commentary at 27.
1452 Id. Commentary at 55.
1453 Chapter VI (E), Chapter IV, Czech Code of Corporate Governance.
1454 Id. Commentary at 30.
1455 Id. Commentary at 26, 55 et.seq.

outside of company law and fiduciary duties.[1456] The commentary further provides an interesting analysis of the rights of shareholders as opposed to those of the stakeholders. It stipulates exactly that stakeholders *"have a relationship with the company that is based on contract but heavily modified by statute. [The company] has a further and most important relationship with its shareholders […]who enjoy, or hope to enjoy, property rights.]*"[1457] This differentiation clearly provides that the relation of a company with its shareholders is *more important* or, said differently, stakeholder interests would not be considered on an equal footing, if not mandated by other laws. Moreover, it is provided that although companies might make extra commitments beyond the requirements imposed by law, they are not required to provide more protection than the legal minimum.[1458]

Having given this general view on stakeholder considerations in the chosen CEE jurisdictions, the next section will address protection of employees and creditors.

4.3.2.2 Employees as Stakeholders in CEE Companies

Some of the existing literature that touches on the topic of employees as stakeholders in CEE jurisdictions has been in the form of the *Varieties of Capitalism* literature.[1459] A note on this concept and some '*categorization*' ideas that can derive from its literature, would be helpful to see the bigger picture of employee protection in CEE companies. The *Varieties of Capitalism* literature makes two central arguments: first, that despite globalization, "*there are distinct*

[1456] Id. Commentary at 19.
[1457] Id. Commentary at 42, *[emph.add.]*.
[1458] Id. at 19.
[1459] *See* Crowley S. & College O., *East European Labor, the Varieties of Capitalism and the Expansion of the EU,* Council for European Studies at Columbia University Paper, 2006, Electronic Article *available* at: http://www.ces.columbia.edu/pub/papers/Crowley.pdf, (last visited February 24th 2011); *See* also Roderick Martin, *Segmented Employment Relations: Post-Socialist Managerial Capitalism and Employment Relations in Central and Eastern Europe,* 17 International Journal of Human Resource Management 8, [1353, 1365], 2006.

national types of capitalism",[1460] and second, varieties of capitalism are for the most part, resistant to transformations.[1461] Related to the CEE discussion, the main focus has been to answer what type of capitalism has emerged in the region after the 1990s.

In a simplified way, the literature has divided the varieties of capitalism into two main groups when referring to advanced capitalist societies, namely, the coordinated model and the liberal model.[1462] In terms of employee protection, the factors considered are bargaining agreements for wages and work conditions, vocational trainings and employee relations in general.[1463] Based on these criteria and others, the first coordinated model is characterized by "*high levels of union membership, [and] highly articulated mechanisms of social dialogue with well organized employers*."[1464] The second model is characterized by "*low levels of union density,[…] [and] little or poorly-functioning mechanisms of social dialogue*".[1465]

Studies have shown that a major part of the CEE region after the 1990s, has been characterized by a general weakness of employers as to act in an organized form for the protection of their interests.[1466] This is the higher employee societal level of the discussion. What is even more important for our discussion is its second component, namely the workers` participation in the workplace. In coordinated capitalist societies, there are usually institutions of participation of employees in the firm level. Germany is a typical model in this regard.[1467] After communism, not all CEE countries maintained worker participation via councils, exceptions

[1460] Id. (referring to Crowley S. & College O.) at 3.
[1461] Id.
[1462] Id. at 4.
[1463] Id.
[1464] Id. at 4.
[1465] Id.; *See* also Meardi Guglielmo, *Trade Union Activists, East and West: Comparisons in Multinational Companies*, Gower, UK, 2003.
[1466] Even in cases of successful agreements reached at a state level, due to weaknesses in such organization, there have been few means *available* to guarantee enforcement at the work place. Id. at 13-14.
[1467] *See* Berger Suzanne (ed.), Organizing Interests in Western Europe, Cambridge University Press, UK 1981.

being Slovenia and Hungary.[1468] Later on, Czech Republic introduced worker participation at the company level via legislation.[1469]

In terms of the concrete jurisdictions chosen for our analysis, there is divergence considering worker participations at the company level. Based on this component alone, Romania seems to fall into the *liberal* variety, due to the lack of mandatory provisions for participation of employee representatives in board levels and work councils.[1470] On the other hand, Czech Republic shows a closer affinity to the *coordinated* variety, by providing for mandatory participation of worker representatives at one third of the seats in the Supervisory Board.[1471] Having provided this general background, the next part will analyze the protection and involvement of employees, (when applicable) in Romanian and Czech companies.

In the first stages of transition, Romania followed mass privatization and Management and Employee Buyout (MEBO) privatization methods.[1472] While these forms of privatization had an impact on the growth of employees' share ownership, with MEBO also influencing employee profit-sharing, its impact was lessened in the following years due to the reallocation of focus to foreign investors.[1473] Furthermore, as stated, there is no mandatory employee representation in the Supervision Council of two-tier publicly held companies. Indeed, company law has not been the traditional venue chosen for the protection or involvement of employees. Instead, the Labor

[1468] Crowley S. & College O., *East European Labor, the Varieties of Capitalism and the Expansion of the EU,* Council for European Studies at Columbia University Paper, 2006, Electronic Article *available* at: http://www.ces.columbia.edu/pub/papers/Crowley.pdf, (last visited February 24[th] 2011), at 16.; *See* also Roderick Martin, *Segmented Employment Relations: Post-Socialist Managerial Capitalism and Employment Relations in Central and Eastern Europe,* 17 International Journal of Human Resource Management 8, [1353, 1365], 2006.
[1469] Czech Commercial Code art. 200.
[1470] *See* Romanian Company Law 2006.
[1471] Czech Commercial Code art. 200.
[1472] Albu L.L. & Borman A., *Extended Country Report: Financial Participation of Employees in Romania*, Inter-University Centre Split/Berlin, Institute for Eastern European Studies, Free University of Berlin Paper, 2006, Electronic article *available* at: http://www.intercentar.de/fileadmin/files/PEPPER_III/Extended_Country_Report_Romania.pdf, (last visited February 24[th] 2011), at 17-20.
[1473] Id. at 20-21.

Code[1474] and other labor legislation establish the main legal grounds for supporting the rights of employees as stakeholders.[1475] The new Labor Code of 2003 for instance, required companies to consult with unions or representatives of employees about decisions that could influence their rights in a significant way.[1476] Other than this, the traditional labor law prerogatives continue to apply to employees and unions, such as allowance of strikes and seeking for redress through competent courts.[1477] Information to stakeholders in general and employees in particular, is usually given through the formal means of the Trade Registry, in the typical form granted to all interested parties, with employees having a right to get informed on matters concerning labor relations.[1478]Beyond this static framework however, there is little in the governance framework of companies regarding employee interests.

Different from other CEE countries, due to the special Czech privatization process features, very few concessions were given to insiders, including employees.[1479] The mass privatization scheme conducted via several means, the most important of which was the voucher form, provided no special incentives for employee ownership.[1480] In general, the share of employee ownership stemming from the mass privatization strategies was quite low. Statistics have

---

[1474] Labor Code [Codul Muncii] Law No. 53 of 5 February 2003, published in OG No. 72/1 of 5 February 2003. It entered into force on 1 March 2003. For an English translation of the Labor Code *See* http://www.codulmuncii.ro/en/title-1/page-1 (last visited February 25th 2011), (hereinafter Romanian Labor Code 2003)

[1475] Law No. 467 of 12.12.2006 On Establishing the General Framework for Informing and Consulting Company Employees, [*Privind Stabilirea Cadrului General de Consultare a Angajatilor]* published in OG No. 1006 of 18.12.2006. It entered into force on 1 January 2007).

[1476] Romanian Labor Code 2003.

[1477] Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Romania, World Bank-IMF, September 2002, *available* at: http://www.worldbank.org/ifa/RomaniaROSC.pdf (last visited January 12th, 2011) at 10-11.

[1478] Id. at 11.

[1479] *See* Lízal L., Heidenhain S. & Vychodil O., *Extended Country Report: Financial Participation of Employees in Czech Republic,* Inter-University Centre Split/Berlin, Institute for Eastern European Studies, Free University of Berlin Paper, 2006, Electronic article *available* at: http://www.intercentar.de/fileadmin/files/PEPPER_III/Extended_Country_Report_Czech.pdf, (last visited February 24th 2011).

[1480] Id. at 4.

revealed that the average stake of those companies that offered employee shares was at about 4.4%.[1481] Czech Republic permits performance enhancing incentives and profit sharing to align the interests of employees with those of the company. Despite this, such mechanisms are not widespread and profit sharing is hardly implemented.[1482]

Different from Romania, however, Czech Republic appears to present, at least from a law-on-the-books perspective, a higher consideration for employees' interests, due to its mandatory inclusion of employees in Supervisory Boards of publicly held companies at the 1/3rd level of representation, whenever their number exceeds fifty.[1483]

The statutes may provide for a higher number of employee representatives in the Supervisory Board, however, this number cannot be higher that the number of shareholder representatives.[1484] The legislation therefore sets only a minimum representation requirement at 1/3rd of the Supervisory Board and its language is permissive of parity level codetermination if the company so chooses. However, there are no guidelines as to what happens in cases of a vote tie if such parity is provided for. Instead, the default rule is for one member-one vote,[1485] and the rest of the provision simply deals with duties of registering dissenting opinions by representatives of employees and presenting them to the general meeting of shareholders.[1486] Given the permissive nature of allowing for such parity, it can however be presumed that company statutes, even in the rare event of opting for increased level of employee participation,

[1481] There were only three such companies where employees had acquired a considerable stake. Wilke, Maack & Partners, *Country Reports on Financial Participation in Europe*, 2007, Electronic article, *available* at: http://www.worker-participation.eu/National-Industrial-Relations/Countries/Czech-Republic/Financial-Participation, (last visited February 24th 2011).

[1482] Art.158 Czech Commercial Code providing for employees stock options; *See also* Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002, *available* at: http://www.worldbank.org/ifa/Czechrosc_cg0702.pdf (last visited February 25th 2011), (hereinafter for the purpose of this section ROSC Czech Republic) at 9.

[1483] Art. 200 (1) Czech Commercial Code.

[1484] Id.

[1485] Art. 201 (3) Czech Commercial Code.

[1486] Id. Art. 201 (2)

would provide some guidance in this regard. This however cannot alter the one member-one vote mandatory provision.[1487] It remains unclear how a situation like this would be resolved, although the fact that no such cases have been reported, simply shows that companies do not tend to opt for higher participation than the minimum requirement.

Outside company law, the Labor Code in 2007 also regulates several aspects of employee protection, such as working and health conditions in the workplace, or the settlement of labor disputes.[1488] However, there is no report that has analyzed whether there has been any increase in the level of protection and its enforceability through courts, after the passing of the new Labor Code.[1489]

4.3.2.3 Creditors as Stakeholders in CEE companies

Insolvency proceedings were a recent novelty for CEE jurisdictions and the enactment of proper regulations came quite late. Again, after the passing of the first laws, enforcement of creditor claims by courts has been described as consistently lengthy, weak and deficient.[1490]

The new Romanian Insolvency Law of 2006[1491] tried to enhance the participation of creditors in insolvency proceedings, via providing for a creditors' committee to be comprised of

[1487] Id. Art. 201(3).

[1488]Labor Code *[Zákoník Práce]* Act No. 262/2006 Coll. of 21.04.2006. The law became effective as of 1 January 2007, *available* at: http://www.mpsv.cz/files/clanky/3221/labour_code.pdf (last visited March 18th, 2008).

[1489] Before the passing of this law, reports on observance of standards and codes have provided that protection of employees as stakeholders, remains only partially observed and although as a matter of principle they can exercise their rights in court, the framework has been "*slow, inefficient and costly*." ROSC Czech Republic 2002, at 8-9.

[1490] *See* Uttamchandani Mahesh, *Insolvency Law and Practice in Europe`s Transition Economies*, 10 Butterworths Journal of International Banking and Financial Law, [452, 456], December 2004, *available* at: http://www.ebrd.com/downloads/legal/insolvency/insolve.pdf, (last visited February 25th 2011).

[1491] Law No. 85 of 20 April 2006 On Insolvency, *[Legea Insolventei]*, published in the OG No. 359 of 20 April 2006, (hereinafter for this section Romanian insolvency Law). The Law entered into force on 21 July 2006. For an overview of the amendments of the law in 2006 *See* Maxim Mihaela, *Romania: New Insolvency Law, 7 International Financial Law Reiew.*, July 2006, Electronic article *available* at: http://www.iflr.com/?Page=10&PUBID=33&ISS=22114&SID=638375&TYPE=20 (last visited February 25th, 2010).

a fixed number of members, the decisions of which could be challenged by any creditor.[1492] The new law provided also that, a creditor holding at least 50% of the total value of the debtor's obligations, had the possibility to appoint a judicial administrator at the first meeting of the Creditors' Assembly.[1493] A board would be under a duty to file an application for opening insolvency procedures, when insolvency has been ascertained and might do so when its threat is imminent.[1494] Failure to act in the first case, results in liability, however given the *permissive* nature of the requirement in cases of *imminent threat* of insolvency, one would think that no such liability would result. There is no further guidance with regards to this issue.

Furthermore, similarly to Germany, rules on capital maintenance have also been employed to provide some form of creditor protection. Creditors are also entitled to challenge the resolution of shareholders on reduction of capital and ask the court to oblige a company to offer appropriate security, in cases when it can be reasonably considered that such reduction adversely affects their ability to recover.[1495] Despite the capital maintenance requirements and the new reforms in the field of insolvency, Romania is still considered as a *debtor favoring* system, more so by the adverse reason of not ensuring proper protection of creditors due to weak enforcement procedures, a predominant characteristic that has caused its ranking amongst the weak creditor protection group of countries.[1496]

[1492] Art. 16 (1) of Romanian Insolvency Law.
[1493] Id. Art. 19 (2); For details and comments *See*: Rubin, Meyer, Doru & Trandafir, *New Insolvency Law May Improve Debt Recovery*, 11 The Romanian Digest 7, [28,36] August 2006, *available* at: http://www.hr.ro/digest/200608/digest.htm#link2 (last visited February 25th 2011).
[1494] Hrisafi I. & Şerban I., *Essential Aspects of the Romanian Insolvency Law*, 14 International Case –Law Alert II, 2007, *available* at: http://www.eir-database.com/insolvency-caselaw-alert.php, (last visited February 24th 2011), at 14.
[1495] Nitescu Delia, *Romania: Enhanced Creditor protection*, International Financial Law Rev., February 2009, electronic article, *available* at: http://www.iflr.com/Article/2091342/Enhanced-creditor-protection.html, (last visited February 25th 2011).
[1496] Protection of creditors in insolvency cases in Romania is evaluated to be at a recovery level of less than 30% of the claim. (The average recovery index is 29 cents out of a dollar). The recovery rate stands even lower than in the case of Bulgaria, rating at 32.4. *See* Doing Business Project, World Bank Group Report, 2008, *available* at: http://www.doingbusiness.org/ExploreTopics/ClosingBusiness/ (last visited February 25th, 2011).

The past insolvency regime in Czech Republic, similarly to Romania has generally favored debtors as compared to creditors and the enforcement of contracts has often been lengthy and difficult.[1497] Practice has also revealed that there have been cases of delaying performance of loans secured by real estate collateral, because of difficulties of courts in giving expeditious decisions.[1498] Reports by Czech credit firms have repeatedly stressed the enormous problems of obtaining redress through courts, having to resort to a myriad of complex contracts in order to ensure their claims.[1499] The Czech Code of Corporate Governance has also stressed the importance of creditors, by providing that creditors would risk a violation of their normal right to be paid out, if no special regime existed for their protection.[1500]

Confronted with the task of enhancing the protection of creditors, the Insolvency Law was reformed in 2006.[1501] According to this law, the company is obliged to file for insolvency without delay, after it is aware, or should have been aware, about its insolvency.[1502] The new law provides for the concept of '*imminent insolvency*', which exists if *"it could be reasonably assumed that the debtor will not be in a position to settle a substantial part of its financial*

[1497] *See* Report on Observance of Standards and Codes (ROSC), Czech Republic, Compliance with Basel Core Principles for Banking Supervision, IMF Publication, July 2000, *available* at: http://www.imf.org/external/np/rosc/cze/bank.htm#footer (last visited on February 25th, 2011) at 7; For a comprehensive case-law analyses of enforcement of contracts in CEE, *See* Messmann Stefan & Tajti Tibor (eds.), The Case Law of Central and Eastern Europe – Enforcement of Contracts, European University Press, Bochum, Germany, 2009.

[1498] Id. (referring to the ROSC report), at 7.

[1499] Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002, *available* at: http://www.worldbank.org/ifa/Czechrosc_cg0702.pdf (last visited February 25th 2011), at 9.

[1500] Czech Code of Corporate Governance, Commentary at 19.

[1501] Act of Bankruptcy and Compensation *[O Úpadku a Způsobech Jeho Rešení]* Act No. 182/2006 Coll. of 9 May 2006. The Law came into effect on 1 July 2007.

[1502] Myslil Stanislav, *Doing Business in Czech Republic*, (Doing Business in Europe Series), Center for international Legal Studies in Salzburg, 2010, Electronic article *available* at: http://www.taglaw.com/files/Doing%20Business%20Guides/Doing%20Business%20in%20the%20Czech%20Republic_0710.pdf, (last visited February 25th 2011), at 19.

obligations in an orderly way and on time."[1503] Hence, regard to the creditors` interest, should, as a matter of principle, be enhanced for this situation.

Furthermore, the law provides that following the declaration of insolvency, creditors have the power to vote at the creditor's meeting to decide on the commencement of bankruptcy proceedings immediately, or to give the debtor a chance to attempt reorganization.[1504] Similarly to Germany and Romania, capital maintenance rules also provide that the capital cannot be reduced below minimum requirements, and such reduction cannot impair the ability of creditors to recover from the company.[1505]

Given the insolvency reform undertaken, the EBRD in 2009 gave a "*highly compliant*"[1506] evaluation for Czech Republic, especially regarding the provisions on creditor rights and reorganization clauses.[1507] Lastly, however, it is important to note that the above evaluation concerned simply the content of the law and it did not assess its effectiveness or application. Neither did it asses the institutional capacities for such application.[1508]

[1503] Id.

[1504] Id. at 20-23; For a detailed analyses on the law, *See* Richter Tomas, *The New Czech Insolvency Act - New Insolvency Regime for Czech Corporate Debtors and their Creditors,* 21 Butterworths Journal of International Banking and Financial Law 6, [271, 276], June 2006.

[1505] Minimum capital for stock corporations without public offer is CZK (Czech Koruna) 2 million, (around € 72,000, while for stock corporations with public offer is CZK 20 million. Czech Commercial Code art. 162 (3); *See* also art. 211 for capital maintenance requirements.

[1506]EBRD Insolvency Law Assessment project – 2009: Czech Republic, *available* at: http://www.ebrd.com/downloads/legal/insolvency/czechre_ia.pdf, (last visited February 25th 2011).

[1507] Id.

[1508] Also note that as per previous evaluations, the insolvency indicator for creditor-initiated and debtor-initiated procedures has put Czech Republic at a lower rate than Romania. The Insolvency Legal Indicator Survey, EBRD Report, 2004, *available* at: http://www.ebrd.com/country/sector/law/insolve/insolass/lis/index.htm (last visited February 25th 2011). The recovery rate of creditors in insolvency cases in Czech Republic was also lower than Romania as evidenced by a 2008 World Bank Report. The Doing Business Project, World Bank Group Report, 2008, *available* at: http://www.doingbusiness.org/ExploreTopics/ClosingBusiness/ (last visited February 25th, 2011).

4.4 Conclusions

This chapter has focused on the protection of stakeholders in publicly held corporations in the U.S., Germany and the chosen CEE jurisdictions. Apart from the general discussions on the protection of all stakeholders, special consideration has been given to two groups, namely employees and creditors.

With regards to the U.S., the debate between the shareholder primacy and stakeholder theory of the corporations has been vivid. U.S. has shown a traditional tendency to leave matters pertaining to stakeholders mostly outside the realm of corporate law and regulate them via other law venues, such as labor and bankruptcy law. Delaware Courts have traditionally favored a finding that fiduciary duties run to the corporation. Ambiguous concepts such as "*vicinity of insolvency*" and "*deepening insolvency*"[1509] have attempted to enter the realm of fiduciary duties, causing controversy for almost two decades. However, Delaware Courts have refused to find fiduciary duties to creditors for such cases and have reaffirmed that, at this point, directors exercise their duties in the best interest of the corporation and its stockholders.

U.S. does not recognize the concept of codetermination and has consistently refused its applicability to corporations. Furthermore, the permissive nature of constituency statutes and the ambiguities regarding their scope and methods of application have persisted. Cases of takeover scenarios have also revealed that the observance of stakeholder interests, was to be conditional upon the accrual of benefits to shareholders, albeit later, such statements were limited to cover only strict *Revlon* situations.

[1509] *See* for definitions and related discussion, supra section 4.2.2.

In the evolution of the stakeholder debate and, especially so, in its plea for treatment within corporate law, both, shareholder and stakeholder theories' advocates, have been disappointed by the unintended effect of the expansion of managerial powers. This is not to say that corporations should disregard stakeholder interests at any cost, however, adopting a multi-stakeholder approach, has presented a fundamental problem in the form of an inherent conflict within the interests to be served, which in turn can very easily be translated into a shield for managerial liability.

Germany on the other side, has favored a stakeholder approach to fiduciary duties, even if not initially intended right after the creation of the two-tier board system and the early perceptions regarding the interests to be served by the boards. Its stakeholder model is also featured in the concept of Codetermination in publicly held companies. Employee participation in Supervisory Boards up to quasi-parity levels and the analyses of the legislative intent of MitbestG, have shown that *the interest of the company* in the German context, cannot be equaled with *the interests of shareholders* alone. However, problems predicted for the adoption of a stakeholder model for U.S. corporations, seem to have appeared in the German system of codetermination, with scandals involving empowered stakeholder representatives, compromises that run at the risk of not serving the interests of neither shareholders, nor employees, and considerations about the possible negative impact that such a model has on the attractiveness of German companies in the takeover market. Germany has witnessed that a stakeholder approach after all, is not unproblematic.

Furthermore, although considered as a *creditor friendly* jurisdiction as opposed to the U.S., what Germany makes up mostly in terms of providing for a mandatory duty to file for insolvency and minimum capital maintenance requirements, it lacks in terms of cumbersome procedural aspects and cost of litigation. Hence, characterizations based solely on an analyses of respective rules, are not sufficient for a generalization that Germany is, as a matter of practice, a more creditor friendly jurisdiction.

Lastly, the CEE scenario is different. The chosen CEE jurisdictions have been characterized by a constant ambiguity in terms of defining fiduciary duties. Romania has provided little discussion in this aspect, with the Codes of Corporate Governance giving only a formal recognition as to the need to serve the interest of the company. Czech Republic has tried to stand in between, providing that there is a need to recognize the shareholder value concept, while at the same time, stating that the interest of a company might include *several components*, if stakeholders are to be properly protected. While the difficult task of identifying *the interest of the company* is left to Czech courts, the latter have not yet provided any clarity.

Employee participation has also shown divergences between the two CEE chosen jurisdictions. Moreover, Czech Republic, closer to the German model, has provided for mandatory participation at 1/3rd of the Supervisory Board, while Romania has opted not to do so. In terms of creditor protection, despite recent reforms regarding the recognition, at least formally, of the concept of *imminent insolvency* and despite the rules on capital maintenance requirements, the weaknesses of enforcement procedures have been a constant deterring factor.

If we were to visualize the situation presented by the differences in terms of stakeholder protection, on one side there is the U.S., where the shareholder value maximization has been traditionally favored and views on the inclusion of stakeholder issues within corporate law, have been skeptical. On the other side we have Germany, where stakeholders and especially employees enjoy higher protection. Yet again, the benefits that Germany has achieved in terms of materializing a stakeholder model are not unquestionable. The same is true for the formal recognition of Germany as a *creditor favoring* country, especially when the result of some of its rules cannot support such characterization. Then, we have the CEE jurisdictions, characterized by either an almost complete lack of debate on the issue, or by a confused, in-between position looking both into shareholder value maximization and inclusion of stakeholders` interest into the interest of the company, with the net effect being a mixture of formal standards that lack clarity and have little practical effects.

Predicting what the future would bring in this aspect is difficult. From the above analyses, prevalent practices and routes followed in terms of stakeholders' protection appear to be rooted deep in the respective legal systems.

At the same time, if one was to derive an idea especially for the advanced capitalist jurisdictions chosen, the recent trends of recognizing the long-term interests of companies would imply a certain higher level of consideration for stakeholders when they contribute to such interest.[1510] Especially so would be the need for American corporations, where such considerations have lacked the kind of materialization they have received (albeit not always satisfactorily) in Germany. Yet, even here, there is another mitigating factor. Given the enhanced recent focus on the necessity to control managerial power,[1511] deciding when (and if) the long-term vision of the company should include stakeholder interests, needs to be done without the risk of expanding managerial power. This concern in itself would however result in lowering the potential for an earlier stakeholder approach adaptation.

As for Germany, despite the recent concerns regarding its stakeholder system, the latter

[1510] *See* Harper Ho Virginia E., *'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 Journal of Corporation Law, 1, [59, 112], 2010, *available* at SSRN: http://ssrn.com/abstract=1476116, (last visited February 22nd 2011).

[1511] *See* Rosen Carl, *Corporate Governance Still a Matter for Shareholders*, in: Corporate Governance in the Wake of the Financial Crisis, United Nations Conference on Trade and Development Publication, [109, 118], 2010, *available* at: http://www.unctad-docs.org/files/CG-in-Wake-of-Fin-Crisis-Ch5.pdf, (last visited February 25th 2011).

remains strong, especially with regards to codetermination, but whether it will evolve so as to increase the safeguards against managerial power abuses is still questionable.

As for the CEE jurisdictions, it seems that another feature is becoming increasingly prevalent with regard to the introduction of new stakeholder oriented concepts, namely the lack of clarity amidst reforms pursued. That doesn`t mean that a halt should be put to reforms on importing concepts, yet, taking the time to digest and interpret the already introduced ones, would be a reasonable move.

CONCLUSIONS

This thesis has analyzed, compared and critically assessed shareholder rights, executive compensation and stakeholder protection in the U.S. and chosen EU jurisdictions, namely Germany, Czech Republic and Romania.

Following a functional comparative approach, it has focused on key components of each of the aspects analyzed, providing an analysis on the current regulation of the aspects so far, comparing the commonalities and differences in the approaches followed by the selected jurisdictions, and discovering the pertaining dilemmas with regards to each of them. The central comparison between the U.S. and Germany, as main jurisdictions, has been complemented by the inclusion of the auxiliary jurisdictions, a choice that has contributed in giving a fuller picture of the EU approach and the divergences within it.

In terms of shareholder rights, the thesis has analyzed their rights on election of directors and fundamental corporate transactions, coming to several conclusions regarding the balance of powers between shareholders and directors on both sides.

First, regarding shareholder rights on the election of directors, U.S., has been captured by the move from plurality to majority voting, which, accompanied with other rules on permitting shareholder nominees to be included in proxies, were aimed at increasing shareholder power. Despite this trend, weak forms of the majority rule and restrictions on shareholder nominee rights, still allow for board influence with regards to the election of directors.

The EU jurisdictions on the other hand, where the majority rule is prevalent, focus more on improving the information regarding the voting process and do not see the U.S. style debate on the election of directors with the same intensity.

Shareholder *powers* regarding fundamental transactions present similarities in terms of their limitations on both sides, despite the paths followed that resulted in such limitations. In the U.S., these rights remain restricted in terms of the boards' discretion to play with the forms and labels of transactions, and also due to supermajority requirements for charter amendments.

Similarly, in Germany, shareholder approval is considered an exception from the rule that management independently runs the company. In the auxiliary CEE jurisdictions chosen for the discussion, the problems pertaining to shareholder rights have consisted of weak protection of minority shareholders and the lack of a shareholder litigation culture.

As regards the dynamics of power between shareholders and directors in takeover scenarios, the approaches on both sides differ in terms of protection focus, a difference that reflects the divergence in the respective agency conflicts based on ownership structures. While the U.S. appears to afford wide discretions to boards to adopt defensive measures, the EU-level *attempted* approach in this regard, in principle, vests to controlling shareholders the power of approving or disapproving defense measures, albeit there exist issues as to its implementation.

The thesis has continued with an analysis of fiduciary duties as owed to the corporation and its stockholders in the second chapter, a chapter envisioned as an aid to the first one on shareholder rights, but which also serves as a bridge between the first part and discussions related to executive compensation and stakeholder protection.

The review of directors' fiduciary duties in the U.S. and the chosen EU jurisdictions, has pointed to some divergences as well. The dominant feature of the U.S. approach seems to be the strong preservation of the business judgment rule, which has often provided an escape from liability for directors. In the meantime, the German approach, although opening itself to the introduction of this rule, has shown a lower level of deference to it. Here, while in the first financial crisis cases that reached the courts concerning monitoring duties, the American stance has been strong in not second-guessing business judgments, the German approach has been stricter in '*punishing*' directors for failure to properly assess future risks.

In terms of the CEE discussion on the fiduciary duties presented, the latter has pointed to the merely formal approach to such duties and the introduction of unfamiliar concepts without proper complementary elaborations, which in turn runs the risk of making these introductions inapplicable in practice.

The other central focus of this thesis has been the regulation of executive compensation. While U.S. has attempted different forms of regulating executive compensation, from fiduciary duties, to tax laws, to the enactment of SOX, to capping executive pay and recent say-on-pay resolutions, many previous reforms have been questionable regarding their effects. Furthermore, the SEC, although vested with authority to act under the SOX provisions, has shown a fundamentally passive attitude until recently.

Germany, albeit differing in terms of lower levels of executive pay, at first impression has presented a stronger stance with regards to regulating executive compensation. This is seen through legislative interventions addressing issues of *appropriate* compensation, through lower deference standards to the business judgment rule and through attempts to criminalize excessive compensation via the concept of *Untreue*. Nevertheless, the results of the new law dealing with appropriateness are yet to be seen, while using the concept of *Untreue* represents the exception rather than the general rule, especially so given its likelihood of being employed mostly in high profile cases, with the caveat that even for such cases, there is a lack of clarity in terms of situations of breach of fiduciary duties that warrant criminal treatment.

As for the regulation of executive compensation in CEE countries, the latter lacks in terms of scope and depth compared to the two main jurisdictions. Apart from some mechanical listings of the necessity to link pay with performance, there is little discussion on problems of executive compensation, one of the reasons being that a class of professional managers is yet under formation, shifting the focus more into these jurisdiction-specific demands.

Lastly the thesis has dealt with stakeholder protection, focusing concretely on two stakeholder groups, namely creditors and employees, given their closer affinity to the corporation. The discussion has highlighted the divergences between the selected jurisdictions, while at the same time it has raised fundamental questions regarding the suitability of corporate law to address stakeholder concerns. The assessment has been critical, in that it has analyzed specific components of the protection of these two stakeholder groups in particular and stakeholder approaches in general, with their respective restrictions and the problems they present, going beyond the subjectivity that may be derived from the initial categorizations into shareholder-oriented and stakeholder oriented models.

The analyses with regards to the U.S. has shown the reluctance of corporate law to regulate the relationship with corporate stakeholders, this being affirmed also by the recent decisions from U.S. courts, refusing to recognize fiduciary duties owed to stakeholders, especially so creditors. Moreover the permissive nature of constituency statutes and the lack of clarity regarding their scope and interpretation, reinforce the idea that directors exercise their duties in the best interest of the corporation and its stockholders, with protection of stakeholders gaining momentum outside the realm of fiduciary duties.

Germany on the other side, with its codetermination system, has shown stronger features of a stakeholder approach to corporate governance, where the interest of the company cannot be identified with the interests of shareholders. However, the analyses has revealed that despite the above, protection of employees does not come automatically via having their representatives seat on Supervisory Boards. Board practices have revealed previous instances of opportunistic behavior by employee representatives, and a compromise style of decision making, that have often run counter to employee interests. As for creditor protection, Germany represents a more protective approach from a law-on-the-books perspective, via the duty to file for insolvency and capital maintenance requirements, although procedural and litigation cost concerns, have made creditor claims more difficult to pursue and hence, less likely.

With regards to the chosen CEE jurisdictions' protection of stakeholders in general, and the two stakeholder groups of creditors and employees in particular, there have been some sharper distinctions between the two, as compared to the other aspects followed, although even here, there are common considerations applicable to both countries. While Romania has provided little discussion with regards to using fiduciary duties for protecting stakeholders and define what constitutes *'company interest'*, Czech Republic has elaborated comparatively more in this regard, by referring, albeit ambiguously, to the shareholder value concept and the need at times to define the corporate interest as composed of a number of elements, which refer to stakeholder groups` interests. The other difference is also the stronger employee emphasis reflected in the Czech provision of employee representation up to one third of the Supervisory Boards, applicable when certain conditions are met. The main commonality of these two jurisdictions however rests in the lack of interpretation of those few corporate governance provisions that appear to give consideration to stakeholders.

The conclusions have lineated the differences, commonalities and the problems that this work has identified, compared, and critically assessed in the selected jurisdictions` approaches, with regards to shareholder rights, executive compensation and stakeholder protection. Certainly, the choice of the concrete problems for discussion within the main three aspects, has been conditioned by their centrality to the aspects assessed, but also influenced by the importance attached to them in each specific jurisdiction. Furthermore, while some issues have been of a jurisdiction-specific character, others have been of a broader supra-national interest and this has been reflected in their respective treatment in this work. While other concrete problems of corporate governance, might not have been included for assessment, this does not in any way deny their importance, it is simply as a result of scope and length limitations inherent in a doctoral thesis.

Having said this however, the three aspects chosen for discussion are central to corporate governance, and their critical assessment from a comparative perspective in this work adds to the existing literature, by identifying and comparing the existing gaps, as well as by providing a map of the problematic issues that need to be further addressed with regards to shareholder rights, regulation of executive compensation and stakeholder protection.

BIBLIOGRAPHY

Books, Articles and Commentaries

ABA Committee on Corporate Laws, Corporate Director`s Guidebook, (5th ed.) 2007.

Abowd John M. & Kaplan David S., *Executive Compensation: Six Questions That Need Answering*, 13 Journal of Economic Perspectives 4, [145, 168], 1999.

AFSCME Office of Corporate Governance and Investment Policy, *Say on Pay Facts and Background*, No. 0325, 2010.

Ahdieh, Robert B., *The Dialectical Regulation of Rule 14a-8: Intersystemic Governance in Corporate Law,* Emory Law and Economics Research Paper No. 08-28, 2007.

Albu L.L. & Borman A., *Extended Country Report: Financial Participation of Employees in Romania*, Inter-University Centre Split/Berlin, Institute for Eastern European Studies, Free University of Berlin Paper, 2006.

All Acquitted in Mannesmann Trial, Deutsche Welle World, 22.07.2004.

Allen Claudia, *Study of Majority Voting in Directors Elections,* Neal Gerber & Eisenberg LL.P. Publication, November 2007.

Andenas M. & Wooldridge F., European Comparative Company Law, Cambridge University Press, UK, 2009.

Andersen Bryan, *Gheewalla and Insolvency: Creating Greater Certainty for Directors of Distressed Companies*, 11 University of Pennsylvania Journal of Business Law 4, [1031, 1051], 2009.

Andersen Jenny, *Stock Exchange's Ex-Chief Wins Battle to Keep Pay,* NY Times Article, July 2nd 2008.

Angell J.K. & Ames S., A Treatise on the Law of Private Corporations Aggregate, Boston, 1832.

Anthony B. & Piketty Thomas (*eds*.), Top Incomes Over the Twentieth Century: A Contrast Between European and English Speaking Countries, Oxford University Press, Oxford, 2007.

Ashenfelter O. & Card D. (eds.), Handbook of Labor Economics,1st ed., Vol. 3, 1999.

Bainbridge Stephen M, *Interpreting Nonshareholder Constituency Statutes*, 19 Pepperdine Law Rev. [971, 1025], 1992.

Bainbridge Stephen M, *Much Ado About Little? Directors` Fiduciary Duties in the Vicinity of Insolvency*, 1 Journal of Business and Technology Law 2, [335, 369], 2007.

Bainbridge Stephen M., *Caremark and Enterprise Risk Management*, 34 Journal of Corporation Law 4, [967, 990], June 2009.

Bainbridge Stephen M., *Executive Compensation: Who Decides?*, University of California School of Law, Law and Economics Research Paper Series No. 05/3, 2005.
Bainbridge Stephen M., *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 Washington & Lee Law Review, [1423, 1447], 1993.

Bainbridge Stephen M., *Shareholder Activism and Institutional Investors*, UCLA School of Law, Law and Economics Research Paper No. 05-20, September 2005.

Ball C., Sonnie M., & Triponel, A. F., *Advice for Corporate Directors* in: Mergers and Acquisitions 2010: Trends and Developments, (137, 230), Practicing Law Institute Publication, New York, 2010.

Barnard Jayne W., Corporate Philanthropy, Executives' Pet Charities and the Agency Problem, 41 NYU Law School Law Review, [1147, 1178], 1996-1997.

Bartlett Bruce R., Reaganomics: Supply Side Economics in Action, Arlington House Publishers, New York, 1981.

Barton N., Block D. & Radin S., Business Judgment Rule: Fiduciary Duties Of Corporate Directors, 5th Ed., Aspen Publishers, 1998.

Barzuza Michal, *The State of State Antitakeover Law*, 95 Virginia Law Review, [1973, 2052], 2009.

Baums T. & Scott. K.E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany.* ECGI Law Working Paper No. 17/2003.

Baums T. & Wymeersch E. (eds.), Shareholder Voting Rights and Practices in Europe and the United States, Kluwer Law International, The Hague, Boston, 1999.

Baums Teodor, *Corporate Governance in Germany: System and Current Developments*, University of Osnabrück Paper No. 70, 1998.

Baums Teodor, *Personal Liabilities of Company Directors in German Law*, Speech delivered at the Stratford-upon-Avon Conference of the British-German Jurists' Association, April 21st 1996.

Baums Theodor, *Company Law Reform in Germany*, Paper Presented at the University of Cambridge Conference on Company Law Reform, July, 2002.

Baums Theodor, *General Meetings in Listed Companies – New Challenges and Opportunities,* paper presented at the Conference "Company Law Reform in OECD Countries", Stockholm, 7 - 8 December 2000.

Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 Bus. Law 1, [1, 14], 1985.

Baysinger B. D. & Butler H.N., *Antitakeover Amendments, Managerial Entrenchment, and The Contractual Theory Of The Corporation*, 71 Virginia Law Rev. 8, [1257, 1303], 1985.

Bebchuk L, Coates, J. C. IV & Subramanian G., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy,* .54 Stanford Law Review 5, [887, 951], 2002.

Bebchuk L. A. & Fried J. M., *Pay Without Performance: Overview of the Issues,*17 Journal of Applied Corporate Finance 4, [8, 23], 2005.

Bebchuk L. A. & Fried J., *Executive Compensation as an Agency Problem*, 17 Journal of Economic Perspective 3, [71, 92], September 2003.

Bebchuk L. A., Cohen A. & Spamann H., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008,* Harvard Law and Economics Discussion Paper No. 657; November 2009.

Bebchuk Lucian, *The Case for Increasing Shareholder Power*, 118 Harvard Law Review 3, [833, 914], January 2005.

Bebchuk, L. A., Cohen A, & and Ferrell A., *What Matters in Corporate Governance?*, 22 Review of Financial Studies 2, [783, 827], February 2009.

Becht Marco et al., *Returns to Shareholder Activism*, Evidence from a Clinical Study of the Hermes U.K. Focus Fund, ECGI - Finance Working Paper No. 138/2006.

Becht Marco, *Reciprocity in Takeovers,* ECGI Working Paper Series in Law No. 14, 2003.

Becht, Bolton, & Röell., *Corporate Governance and Control*, ECGI - Finance Working Paper No. 02, October 2002.

Benoit Bertrand, *Germany Gets Tough on Executive Pay*, Financial Times Article, May 29th 2009.

Berger Suzanne (ed.), Organizing Interests in Western Europe, Cambridge University Press, UK 1981.

Berglöf E. & Von Thadden E.L., The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries, in: Proceedings of the Annual Bank Conference on Development Economics, The World Bank, Washington DC, 1993.

Berglöf Eric, Corporate Governance in Transition Economies: The Theory and Its Policy Implications, Corporate Governance in Transitional Economies, World Bank Publication, Washington DC, 1995.

Berglöf, E. & Pajuste, A., Emerging Owners, Eclipsing markets? Corporate Governance in Central and Eastern Europe, in: Cornelius, P.K., & Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, [267, 304], Oxford University Press, UK, 2003.

Berle A. & Means G., The Modern Corporation and Private Property, (rev.ed.) Transaction Publishers, New Brunswick-London, 1968.

Black Bernard S., Shareholder Activism and Corporate Governance in the United States, *in:* Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, [459, 465], Macmillan, New York, 1998.

Blackledge Cath, *Euroland Bonanza*, European, June 1998.

Blair Margaret M., & Stout Lynn A., *A Team Production Theory of Corporate Law*, 85 Virginia Law Review, [247, 303], 1999.

Blair Margaret, Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century, Brookings Institution Press, Washington DC, June 1995.

Blogmanifest, *Countries drag their feet over Shareholder Rights Directive Transposition*, January 14th 2010.

Bobirca A. & Miclaus P. G., *Extensiveness and Effectiveness of Corporate Governance Regulations in South-Eastern Europe,* 1 International Journal of Humanity and Social Sciences, [7, 12], July 2007.

Boodoo Maria & Boodoo Crystal, *Peering Into the Fog: The Emerging Consequences of Sarbanes-Oxley*, 78 Pennsylvania Institute of Certified Public Accountants Journal 1, [1-4], 2007.

Bordonaro Peter D., *Comment, Good Faith: Set In* Stone?, 82 Tulane Law Review [1119, 1135], 2008.

Böttcher L. & Blasche S., *The Limitations of the Management Board's Directive Powers in German Stock Corporations,* 11 German Law Journal 5, [493, 512], 2010.

Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007.
Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007.

Branco M.C. & Rodrigues L.L., *Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility*, 12 Electronic Journal of Business Organizations and Management Studies 1, [5, 15], 2007.
Brandeis Louis D., Other People`s Money and How Bankers Use it, 1914, (Urofsky Melvin I.,(ed.)), Bedford, St Martin`s 1995.

Bröhmer Jürgen *Germany*, *in:* Omar Paul J., Directors` Duties and Liabilities, [51- 56], Ashgate Publications Ltd., New York, 2000.

Brown Lowell H., *The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 Delaware Journal of Corporate Law 1, (1-145), 2001.

Brudney Victor, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 Columbia Law Rev. 7, [1403, 1444], 1985.

Bruner Christopher M., *Shareholder Bylaws and the Delaware Corporation*, 11 Tennessee J. of Bus. Law 1, [66, 75], 2009.

Bryant Morris & White Thomas, *It`s an SEC Option*: *Sarbanes-Oxley Disgorgement Section Creates No Private Claim*, 28 Legal Times 47, November 21, 2005.

Burch Regina F., *Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron*, 6 Wyoming. Law Review 2, [481, 532], 2006.

Campbell Rutheford B. Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era,* 23 Florida State University Law Review, [561, 624], 1996.
Carlin Wayne M., *SEC Claws Back Again*, The Harvard Law School Forum on Corporate Governance and Financial Regulation, April 6 2011.

Carter M.E., Lych L. & Tuna A. I., *The Role of Accounting in the Design of CEO Equity Compensation*, Accounting Review, March 2007.

Cheffins Brian R. & Black Bernard S., *Outside Director Liability Across Countries,* ECGI Law Working Paper No. 71, 2006.

Cheffins Bryan R., *The Metamorphosis of "Germany Inc.": The Case of Executive Pay,* 49 The American Journal of Comparative Law 3, [497, 539], 2001.

Choi, S. J. & Fisch, J. E., *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance,* 61 Vanderbilt Law Review 2, [315, 352], 2008.

Cicero David C.,*The Manipulation of Executive Stock Option Exercise Strategies: Information Timing and Backdating*, 64 Journal of Finance, American Finance Association 6, [2627, 2663], December 2009.

Cioffi John W., *Restructuring "Germany Inc." The Politics of Company and Takeover Law Reform in Germany and the European Union*, Political Economy of International Finance Working Paper No. 1, June 2002.

Claessens S., Djankov S. & Pohl G., *Ownership and Corporate Governance: Evidence from the Czech Republic*, Policy Research Working Paper 1737, World Bank, March 1997.
Clarke Thomas, International Corporate Governance: A Comparative Approach, Routledge, New York. 2007.

Clarkson Max B. E., *A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance,* 20 Academy of Management Review 1, [92, 117], 1995.

Cochran P. L., Wood R.A., & Jones T.B., *The Composition of Boards of Directors and Incidence of Golden Parachutes*, 28 Academy of Management Journal 3, [664, 671], 1985.

Coelho, P. R. P., McLure, J. E. & Spry, J. A., *The Social Responsibility of Corporate Management: A Classical Critique*, 18 Mid-American Journal of Business 1, [15, 24], 2003.

Coffee John C., *Law and the Market: The Impact of Enforcement*, Columbia Law and Economics Working Paper No. 304, 2007.

Coffee John C., *What Caused Enron? : A Capsule Social and Economic History of the 1990's,* Columbia Law and Economics Working Paper No. 214, 2003.

Coffee John J. Jr., *The Uncertain Case for Takeover Reform: An Essay on Stock- holders, Stakeholders, and Bust-Ups,* Wisconsin Law Review, [435, 447], 1988.

Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims,* 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008.

Coffino D.F. & Jeanfreau C.H., *Delaware Hits the Brakes: The Effect of Gheewalla and Trenwick on Creditor Claims,* 17 Norton Journal of Bankruptcy Law and Practice, [63, 91], 2008.

Comments on Corporate Laws, ABA Section of Business Law, *Changes in the Model Business Corporation Act - Proposed Amendments to Chapters 8 and 10 Relating to Voting by Shareholders for the Election of Directors*, 61 Business Law 399, 404, 2006.

Committee on Corporate Laws of the Section of Business Law of the American Bar Association, *Other Constituency Statutes: Potential for Confusion*, 45 Bus Law 2253, 1990.

Conac P. H., Enriques L. & Gelter M., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy,* ECGI - Law Working Paper No. 88/2007, October 2007.

Conard Alfred M., Corporations in Perspective, The Foundation Press, N.Y., 1976.

Conyon M., Fernandes N., Fereira M. Matos P. & Murphy K., *The Executive Compensation Controversy: A Transatlantic Analyses,* Paper presented at the Annual Fondazione Rodolfo De Benedetti, May 2009.

Conyon M. & Schwalbach J., *Executive Compensation: Evidence from the U.K. and Germany*, 33 International Journal of Strategic Management 4, [504-526], 2000.

Core J.E., Guay W. & Larcker D.F., *Executive Equity Compensation and Incentives: A Survey,* 9 Economic Policy Review, [27, 50], 2003.

Core J. E. & Guay W. E., *Is There a Case for Regulating Executive Pay in the Financial Services Industry?,* January 2010.

Cornelius, P.K., & Kogut, B. (eds.), Corporate Governance and Capital Flows in a Global Economy, Oxford University Press, UK, 2003.

Corporate Governance in the Wake of the Financial Crisis, United Nations Conference on Trade and Development Publication, 2010.

Croci E., Gonenc, H.& Ozkan, N., *CEO Compensation, Family Control and Institutional Investors in Continental Europe,* Paper presented at Paris December 2010 Finance Meeting EUROFIDAI – AFFI, 21 December 2010.

Crowley S. & College O., *East European Labor, the Varieties of Capitalism and the Expansion of the EU,* Council for European Studies at Columbia University Paper, 2006.

Czech Republic: A Capital Market Review, World Bank Country Study, Washington, D.C., 1999.

Dammanns Jens C., *The Future of Codetermination After Centros: Will German Corporate Law Move Closer to the U.S. Model?,* 8 Fordham Journal of Corporate & Financial Law, [607, 681], 2003.

Daniels Ronald, *Stakeholders and Takeovers: Can Contractarianism Be Compassionate*?, 43 The University of Toronto Law Journal 3, Special Issue on Corporate Stakeholder Debate: The Classical Theory and Its Critics, [315, 351], 1993.

David Walker`s report, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities, Final Recommendations*, 26 November 2009.
Davies Paul L., Gower's Principles of Modern Company Law (6th ed.), London, 1997.

Davies, P. Schuster, E. & Van de Walle de Ghelcke, E., *The Takeover Directive as a Protectionist Tool?* ECGI Law Working Paper No. 141, 2010.

Dawes P. H. & Johnson M. D., The Disgorgement Mandates of Sarbanes-Oxley Section 304: Do They Reach Innocent CEOs and CFOs?, PLI Corporate Law and Practice Course Handbook Series No. 8805/ 2006.

De Cruz Peter, Comparative Law in a Changing World, Cavendish, London, 1995.

Dell Fabien, *Top Incomes in Germany Throughout the Twentieth Century: 1891-1998*, Chapter 9 *in*: Atkinson Anthony B. & Piketty Thomas (*eds*.), Top Incomes Over the Twentieth Century: A Contrast Between European and English Speaking Countries, [365, 425], Oxford University Press, Oxford, 2007.

Demetriou A. & Olmon J.T., *Stone v. Ritter: The Delaware Supreme Court Affirms the Caremark Standard for Corporate Compliance Programs*, 3 ABA Health Law Section 6, 2007.

Dent George W. Jr., *Stakeholder Governance: A Bad Idea Getting Worse*, 58 Case Western Reserve Law Review 4, [1107, 1144], 2008.

Dew-Becker Ian, *How Much Sunlight Does it Take to Disinfect a Boardroom? A Short History of Executive Compensation Regulation*, CESifo Working Paper 2379, August 2008.

Dittmann I., Maug E. G. & Schneider C., *Bankers on the Boards of German Firms: What They Do, What They are Worth, and Why They are (Still) There*, 14 Review of Finance 1, [35-71], 2009.

Dodd Merrick E., *For Whom are Corporate Managers Trustees?*, 45 Harvard Law Review 1145, 1932.

Doing Business Project, World Bank Group Report, 2008.

Du Plessis J. J. & Sandrock O., *The German System of Supervisory Codetermination by Employees*, in: Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007.

Dunlavy Colleen A, Corporate Governance in Late 19th-Century Europe and the United States: The Case of Shareholder Voting Rights, in*:* Hopt, Kanda, Roe, Wymeersch, & Prigge (eds.), Corporate Governance: The State of the Art of Emerging Research, [5-39], Clarendon Press, Oxford, 1998.

Edwards J. & Fischer K.-H., The German Financial System, Cambridge University Press, Cambridge, 1994.

Eisenberg Melvin A., Corporations and Other Business Organizations Cases and Materials, (9th ed.), West, 2005.

Eisenhardt Kathleen M., *Agency Theory: An Assessment and Review,* 14, The Academy of Management Review 1, [55, 74], January 1989.

Elliot Charles B., The Principles of the Law of Public Corporations, (2d. ed.), (pub.omm.), 1910.

Elson C.M. & Gyves C.J., *In re Caremark*: *Good Intentions*, *Unintended Consequences*, 39 Wake Forest Law Rev., [691, 702], 2004.

Enriques L., Hansmann H. & Kraakman R.**,** The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [33, 70], Oxford University Press, USA, 2004.

Enriques Luca, *The Law on Company Directors' Self-Dealing: A Comparative Analysis,2* International and Comparative Corporate Law Journal 3, [297-333], April 2000.

Eriksson T. Gottvald J. & Mrazek P., *Determinants of Managerial Pay in the Czech Republic,* William Davidson Institute Working Papers Series No. 310, 2000.

Eriksson T. Gottvald J. & Mrazek P., *Determinants of Managerial Pay in the Czech Republic,* William Davidson Institute Working Papers Series No. 310, 2000.

Eriksson Tor, *Managerial Pay and Executive Turnover in the Czech and Slovak Republics*, 13 The Economics of Transition, The European Bank for Reconstruction and Development, 4, [659-677], 2005.

Estrin Saul, *Competition and Corporate Governance in Transition*, 16 Journal of Economic Perspectives 1, [101-124], 2002.

European Commission Press Release 10/ 815, Internal Market: Commission Acts to Ensure that 12 Member States Implement EU Rules on Shareholders' Rights in Listed Companies and Public Procurement Redress, 24 June 2010.

Ewing David W., Who Wants Corporate Democracy?, 49 Harvard Bus. Review 5, [12, 28,], [146, 149], 1971.

Fischel Daniel, *The Business Judgment Rule and the Trans Union Case*, 40 Bus. Law, [1437, 1455], 1985.

Franks J. & Mayer C., *Ownership and Control of German Corporations*, 14 Review of Financial Studies 4, [943, 977], 2001.

Freeman Edward R., A Stakeholder Theory of the Modern Corporation, in: Pincus Laura (ed.), Perspectives in Business Ethics, [171, 181], McGraw-Hill, Singapore, 1998.

Freeman, R. E. & Reed David. L., *Stockholders and Stakeholders: A new perspective on Corporate Governance,* 25 California Management Review 3, [88, 106], 1983.

Friedman Milton, Capitalism and Freedom, University of Chicago Press, Chicago, 1962.

Friedman Milton, *The Social Responsibility of Business is to Increase its Profits, The New York Times Magazine*, September 13, 1970.
Frydman C. & Saks R., *Executive Compensation: A New View from a Long-Run Perspective, 1936-2005,* 23 *Review of Financial Studies 5*, [2099, 2138], 2010.

Frydman C. & Molloy R. S., *Does Tax Policy Affect Executive Compensation? Evidence from Postwar Tax Reforms,* NBER Working Paper No. 16812, February 2011.

Frydman R. & Rapaczynski A., *Markets and Institutions in Large Scale Privatization: An Approach to Economic and Social Transformation in Eastern Europe*, New York University Economic Research Report No. 90-42, September 1990.

Frydman, R., Hessel, M. & Rapaczynski, A., *Why Ownership Matters? Human capital and Incentives in the Restructuring of Enterprises in Central Europe,* Columbia Law School, Law-Econ Working Paper No. 172, 1998.

Gabaix Landier A., *Why Has CEO Pay Increased So Much?,* 123 Quart. J. Econ.1, [49, 100], 2008.

Garfinkle Eugene, *Stock Option Plans for Executives*, 41 California Law Review 3, [535,545], 1953.

Garner C.G.,, Jacqueline L. & Walkling, R. A., *Democracy or Disruption: An Empirical Analysis of Majority Elections for Directors*, October 2009.

Gevurtz Franklin A., *Disney in a Comparative Light*, 26th of February 2007.

Gibson Dun & Crutcher LLP Informational Electronic Publication, *Stricter Rules for Remuneration of Management Board Members in German Stock Corporations - Extended Liability for Members of the Supervisory Board*, 24 August 2009.

Gillan, S. & Starks L.T., *Relationship Investing and Shareholder Activism by Institutional Investors,* 57 Journal of Financial Economics, [275, 305], 2000.

Gillan, S. & Starks L.T., *The Evolution of Shareholder Activism in the United States,* 29 Journal of Applied Corporate finance 1, [55-73], 2007.

Gilson Ronald J., *Corporate Governance and Economic Efficiency: When Do Institutions Matter?,* 74 Washington University Law Quarterly 2, [327, 341], 1996.

Gilson Ronald J., *The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept,* 34 Stanford Law Rev. 4, [775, 836], 1982.

Glass Lewis, *A Market-by-Market Preview of the 2010 Proxy Season Around the World*, 1 World Governance Focus 4, January 2010.

Glodeanu I. & Cocea R., Romania: Company Law Now in Line with EU, International Financial Law Rev., February 2006.

Godfrey Cullen M., *In re The Walt Disney Company Derivative Litigation: A New Standard for Corporate Minutes*, 17 ABA Bus. Law. 6, 2008.

Gordon Jeffrey N., *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 University of Chicago Law Review,[1233, 1241], 2002.

Gorton G. & Schmid F., *Class Struggle inside the Firm: A Study of German Codetermination*, NBER Working Paper Series, No. 7945, 2000.

Gray Cheryl W., et.al, *Evolving Legal Framework for Private Sector Development in Central and Eastern Europe*, World Bank Publication, Washington D.C., July 1993.

Grossman Hugh Alexander, *Refining the Role of the Corporation: The Impact of Corporate Social Responsibility on Shareholder Primacy Theory*, 10 Deakin Law Review 2, [572, 596], 2005.

Grossnickle Faith, *A Disney Tale,* Electronic Journal of Corporate Counsel, January 2006.

Guay, Core & Larcker, *Executive Equity Compensation and Incentives: A Survey,* 9 Economic Policy Review 27, 2003.

Haid A. & Yurtoglu B. B., Ownership Structure and Executive Compensation in Germany, 2006.

Hamermesh Lawrence A., *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?,* 73 Tulane Law Review. 409, 1998.

Hamilton Robert W., Corporations Including Partnerships and Limited Liability Companies, Cases and Materials, (7th ed.), West Group, St. Paul, Minn., 2001.

Hamilton Robert W., *Reliance and Liability Standards for Outside Directors,* 24 Wake Forest Law Rev. 5, [9, 12], 1989.

Hanks James J. Jr., Playing With Fire : Nonshareholder Constituency Statutes in the 1990s, 21 *Stetson Law Review* 97, [97, 119], 1991.

Hansen Charles, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule,* (ABA) 41 Bus. Law, [1237, 1247], 1986.

Hansen Jesper Lau, *When Less Would Be More: The EU Takeover Directive in its Latest Apparition*, 9 Columbia J. Eur. Law, [275, 290], 2003.

Hansmann, H. & Kraakman, R. H., *The End Of History For Corporate Law,* Yale Law School Working Paper No. 235, January 2000.

Harper Ho Virginia E., *'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 Journal of Corporation Law, 1, [59, 112], 2010.

Henn Harry G., Book Review, 49 Cornell L.Q. 14, [574, 576], 1964.

Henry David, *Expensing Options: An Overblown Storm*, Bloomberg BussinessWeek Article, 1 April 2004.

Hernández-López Ernesto, *Bag Wars And Bank Wars, The Gucci And Banque National De Paris Hostile Bids: European Corporate Culture Responds To Active Shareholders*, 9 Fordham Journal of Corporate and Financial Law 1, [127, 190], 2003.

Hertig G. & Kanda H., Creditor Protection, in: Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), [71, 99], Oxford University Press, USA, 2004.

Hertig G. & McCahery J. A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?,* ECGI Law Working Paper No. 12, 2003.

Herzel L. & Katz L, *Smith v. Van Gorkom: The Business of Judging Business Judgments,* 41 Bus. Law., [1187, 1192], 1986.
Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era,* Vanderbilt Law and Economics Research Paper No. 06-15; 2006.

Hill Jennifer G., *Regulating Executive Compensation: International Developments in the Post-Scandal Era*. Vanderbilt Law and Economics Research Paper No. 06-15; 2006.

Hill Jennifer G., *Regulatory Responses to Global Corporate Scandals,* Sydney Law School Research Paper No. 06/35, 2006.

Hirschman Albert O., Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States, Harvard University Press, 1971.

Holmstrom B. & Kaplan S.N., *Corporate Governance and Merger Activity in the United States: Making Sense of* the *1980s and 1990s,* 45 Journal of Economic Perspectives 2, [121, 144], 2001.

Hopt K. J. & Leyeans P. C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy,* ECGI - Law Working Paper No. 18/2004.

Hopt K.J. & Wymeersch E., (eds), European Takeovers - Law and Practice, Butterworths, London, 1992.

Hopt Klaus J., *Comparative Corporate Governance: The State of the Art and International Regulation*, ECGI Law Working Paper No 170/2011, January 2011.

Hopt Klaus J., *Directors' Duties to Shareholders, Employees and Other Creditors: A View from the Continent,* in: McKendrick E (ed.), Commercial Aspects of Trusts and Fiduciary Obligations, [115, 135], Clarendon Press, Oxford, 1992.

Hopt Klaus J., *Shareholder Rights and Remedies: A View from Germany and the Continent*, 2 Company Financial & Insolvency Law Rev., [261, 272], 1997.

Hopt Klaus J., *Takeover Regulation in Europe - The Battle for the 13th Directive on Takeovers*,15 Australian Journal of Corporate Law 1, [1, 18], 2002.

Hopt, K. J. & Leyens, P. C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy*. ECGI, Law Working Paper No. 18, 2004.
Hopt, Kanda, Roe, Wymeersch & Prigge (eds.), Comparative Corporate Governance: The State of the Art and Emerging Research, Oxford University Press, Oxford-New York, 1998.

Hopt, Klaus J., *Modern Company and Capital Market Problems: Improving European Corporate Governance after Enron*, 3 Journal of Corporate Law Studies, [221,268] 2003.

Houston R.E. Jr., *The American Tobacco Company Case: A Study in Profit Sharing* II, (unpublished thesis), Yale Law School, 1933.

Hrisafi I. & Şerban I., *Essential Aspects of the Romanian Insolvency Law*, 14 International Case –Law Alert II, 2007.
Huertas T. F. & Silverman J. L., *Charles E. Mitchell*: *Scapegoat of the Crash*?, 60 The Business History Review 1, [81-103], 1986.

Iancu Monica & Statescu Monica, *Obligations and Civil Liability Incumbent under Romanian Law, Corporate and Commercial Legal Developments*, August 2008.

IFC World Bank, Stakeholder Engagement: A Good practice Handbook for Companies Doing Business in Emerging Markets, May 2007.

Institute of Directors and Croner Reward, Directors Rewards 2005/2006 (25th Anniversary Ed.), November, 2005.

Jackson G. & Höpner M., *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance*, Max Planck Institute for the Study of Societies, Discussion Paper No. 01/4, September 2001.

Jean-Marie Messier v. Vivendi Universal, S.A., AAA Arbitration No. 3-T-199-00205-94 (Am. Arbitration Assoc., June 27, 2003).

Jensen M. C. & Murphy K. J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Review 3, [138, 153] 1990.

Jensen M. C., Murphy K. J. & Wruck, E. G., *Remuneration: Where We've Been, How We Got to Here, What are the Problems, and How to Fix Them,* ECGI - Finance Working Paper No. 44/2004, July 2004.

Jensen Michael C. & Murphy Kevin J., *CEO Incentives – It's Not How Much You Pay, But How,* 68 Harvard Business Review 3, [138, 153] 1990.

Jensen Michael C., *Self Interest, Altruism, Incentives, and Agency Theory*, 7 Journal Of Applied Corporate Finance 2, [40, 45], 1994.

Joerg-Markus Hitz & Werner Joerg R., *Why do Firms Resist Individualized Disclosure of Management Compensation?,* April 2010.

John J. Jr., *The Uncertain Case for Takeover Reform: An Essay on Stock- holders, Stakeholders, and Bust-Ups*, Wisconsin Law Rev., [435, 447], 1988.

John M. Bizjak J.M., Lemmon M.L., & Naveen L., *Has the Use of Peer Groups Contributed to Higher Levels of Executive Compensation?*, Working Paper Series Article, 2007.

Johnson L. & Millon D., *Missing the Point about State Takeover Statutes*, 87 Michigan Law Review, 4, [846, 857], 1989.

Kalisch Ingrid, *Stock Options: Will the Upcoming Amendment of the German Stock Corporation Act Facilitate Their Introduction by German Stock Corporations?,* 9 Int'l. Comp. & Comm. L. Rev., [111, 125], 1998.

Keay Andrew R.,*Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?,* University of Leeds Working Paper No. 4, January 2010.

Keen Michael, *The German Tax Reform of 2000*, 9 International Tax and Public Finance 5, [603, 621], 2002.

Knepper William E & Bailey Dan A., Liability of Corporate Officers and Directors, (8th ed.), New Jersey, 2010.

Köhler Matthias, *Corporate Governance and Current Regulation in the German Banking Sector: An Overview and Assessment*, Center for European Economic Research Discussion Paper No. 10-002, December 2009.

Kolla Peter, *The Mannesmann Trial and the Role of Courts*, 5 German Law Journal 7, [829-847], July 2004.

La Porta, Lopez-de Silanes, Shleifer & Vishny, *Corporate Ownership Around the World*, 54 *Journal of Finance* 2, [471, 517], 1999.

Landler Mark, Scandals Raise Questions Over Volkswagen Governance, NY Times, July 7th 2005.

Lane Christel, Management and Labor in Europe. The Industrial Enterprise in Germany, Britain, and France, Edward Elgar Publishing, London, 1990.

Lang Reinhart (ed.) The End of Transformation?, Hampp. Germany, 2005.

Latella Dario, *Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive,* 6 Eur. Com. & Fin. Law Rev. 2, (307, 323), 2009.

Letter of National Investor Relations Institute to the Securities and Exchange Commission, 16th of March 2009.

Levitt Theodore, *The Dangers of Social Responsibility*, 33 Harvard Business Review 5, [41-50], 1958.

Levy Frank & Temin Peter, *Inequality and Institutions in 20th Century America*, MIT Department of Economics Working Paper 07-17, 2007.

Lieder Jan, *The German Supervisory Board on Its Way to Professionalism*, 11 German Law journal 2, [115, 158], 2010.

Lízal L., Heidenhain S. & Vychodil O., *Extended Country Report: Financial Participation of Employees in Czech Republic,* Inter-University Centre Split/Berlin, Institute for Eastern European Studies, Free University of Berlin Paper, 2006.

Löbbe Marc, *Corporate Groups: Competences of the Shareholders' Meeting and Minority Protection – the BGH's Recent Gelatine and Macrotron Cases Redefine the Holzmüller Doctrine,* 5 German Law Journal 9, [1057,1079], September 2004.

Lublin Joann S. & Thurm Scott, *Money Rules: Behind Soaring Executive Pay, Decades of Failed Restraints*, The Wall Street Journal Online, October 12th 2006.

Maassen Gregory F., An international Comparison of Corporate Governance Models. A Study on the Formal Independence and Convergence of One-tier and Two-tier Corporate Boards of Directors in the United States of America, the United Kingdom and the Netherlands, (2nd ed.), Spencer Stuart Publications, The Netherlands, 2001.

Macey J. R. & Enriques L., *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 Cornell Law Rev., [1166, 1204], 2001.

Macey Jonathon R., *State Anti-Takeover Legislation and the National Economy*, Wisconsin Law Rev., [467, 490], 1988.

Main B.G.M., O'Reilly C. A. III & Wade J., *The CEO, the Board of Directors, and Executive Compensation: Economic and Psychological Perspectives*, 4 Industrial and Corporate Change 2, [292, 332], 1995.

Mallin C. & Jelic R. M., *Developments in Corporate Governance in Central and Eastern Europe*, 8 Corporate Governance: An International Review 1, [18, 43], January 2000.

Mann F.A., *The New German Company Law and Its Background*, 19 *Journal of Comparative Legislation and International Law* (3rd Series) 4, [220, 238}, 1937.

Marens Richard, *Inventing Corporate Governance: The Mid-Century Emergence of Shareholder Activism*, 8 Journal of Business and Management 4, [365, 389], 2002.

Markham Jerry W., A Financial History of Modern U.S. Corporate Scandals From Enron to Reform, M.E. Sharpe, Portland, Oregon, 2006.

Markham, Jerry W., *Regulating Excessive Executive Compensation - Why Bother?*, 2 Journal of Business & Technology Law 2, [277, 348], 2007.

Martin J. & Kensinger J. W., Relationship Investing: What Active Institutional Investors Want from Management, Financial Executives Research Foundation Publication, New Jersey, 1996.

Masouros Pavlos E., *Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe*, 7 European Company Law, [195, 203], 2010.
Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 Eur. Bus. Org. Law Rev., [553, 579], 2005.

Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 Eur. Bus. Org. Law Rev., [553, 579], 2005.

Mattusek Karin, Germany Opens First Criminal Case Linked to Financial Crisis, NY Times, 17 March 2010.
Maxim Mihaela, *Romania: New Insolvency Law*, 7 International Financial Law Review, July 2006.

McCahery J.A., Renneboog L., Ritter P.& Haller S., *The Economics of the Proposed European Takeover Directive*, 32 Research Report in Finance and Banking, January 2003.

McGee, R. W. & Preobragenskaya, G. G., *Corporate Governance in Transition Economies: The Theory and Practice of Corporate Governance in Eastern Europe*, 2004.

McGrane Victoria, *Feinberg Won`t Ask Firms to Turn $ 1.6 Billion in Payouts*, Dow Jones News, 23 July 2010.

McKendrick E (ed.), Commercial Aspects of Trusts and Fiduciary Obligations, Clarendon Press, Oxford, 1992.

Meardi Guglielmo, Trade Union Activists, East and West: Comparisons in Multinational Companies, Gower, UK, 2003.

Meckling W.H. & Jensen M., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.* July 1, 1976, 3 Journal of Financial Economics 4, [305, 360], 1976.

Merkt, Engert, Feldman, Huff, & McKenzie-Skene, *Twilight in the Zone of Insolvency: Fiduciary Duties and Creditors of Troubled Companies*, 1 Journal of Business and Technology Law 2,(Conference Publication), 2007.

Messmann Stefan & Tajti Tibor (eds.), The Case Law of Central and Eastern Europe – Enforcement of Contracts, European University Press, Bochum, Germany, 2009.

Meyer Klaus, Privatisation and Corporate Governance in Eastern Europe: The Emergence of Stakeholder Capitalism, in: Lang Reinhart (ed.) The End of Transformation? [11, 42] Hampp. Germany, 2005.

Millon David, *Frontiers of Legal Thought: Theories of the Corporation* I, Duke Law Journal, [201, 262], 1990.

Mills Daniel Quinn, *Buy, Lie and Sell High: How Investors Lost Out on Enron and the Internet Bubble*, Pearson Education Inc. publishing as Financial Times Prentice Hall, New Jersey, 2002.

Millstein, Gregory, Altschuler & Di Guglielmo, *Fiduciary Duties Under U.S. Law,* ABA Section of Business Law, International Developments in Corporate Governance Subcommittee, March 2011.

Minhat Mariza, *Three Essays on CEO Compensation in the UK,* University of Stirling Online Publication, Accounting and Finance Divisions, June 2009.

Monks, R. A., & Minow N., Corporate Governance, Blackwell Publishers, Cambridge, MA, 2003.

Morck R.,& Steier L., *The Global History of Corporate Governance - An Introduction*, National Bureau of Economic Research Working Paper No. 11062, January 2005.

Mosca Chiara, *The Takeover Bids Directive: An Opportunity for Europe or Simply a Compromise?*, Paolo Baffi Centre Research Paper No. 64, December 2009.

Mülbert Peter O., *Make it or Break It: The Break/Through Rule as a Break-Through for the European Takeovers Directive?*, ECGI Law Working Paper No. 13, 2003.

Murphy Kevin J., *Executive Compensation*, *in*: Ashenfelter O. & Card D. (eds.), Handbook of Labor Economics,1st ed., Vol. 3, [2485, 2563], 1999.

Myerson Allen, *The New Activism at Fidelity*, New York Times, August 1993.

Myslil Stanislav, *Doing Business in Czech Republic*, (Doing Business in Europe Series), Center for International Legal Studies in Salzburg, 2010.

Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, Macmillan, New York, 1998.

Nitescu Delia, *Romania: Enhanced Creditor protection*, International Financial Law Review, February 2009.

O'Connor Marleen, Labor`s Role in the American Corporate Governance Structure, 22 Comparative Labor Law and Policy Journal 1, [97, 134], 2000.

OECD Publication, *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, June 2009.

O'Hair J. & Keans J., Australian Company Law, (4th ed.), Mcgraw-Hill Book Company, Sydney, 1985.

Omar Paul J., Directors` Duties and Liabilities, [51- 56], Ashgate Publications Ltd., New York, 2000.

Orts E.W.& Strudler A., *Putting a Stake in Stakeholder Theory,* 88 Journal of Business Ethics, [605, 615], 2009.

Pajuste Anete, *Corporate Governance and Stock Market Performance in Central and Eastern Europe: A Study of Nine Countries, 1994-2001*, Center for the Study of Economic and Social Change in Europe Working Paper No. 22, January 2002.

Pan Eric J., *A Board's Duty to Monitor*, Cardozo School of Law Working Paper No. 281, 2009.

Papadopoulos Thomas, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 Law and Financial Markets Rev. 6, [525, 533], 2007.

Paris Court Freezes Messier's Severance, Wall Street Journal., July 10, 2006.

Parkinson John, Corporate Power and Responsibility: Issues in the Theory of Company Law, Clarendon Press, UK, 1995.

Patterson Jeanne, *Corporate Law and Economic Development: The Impact of State Constituency Statutes on State Economic Development*, Institute for Development Strategies, Indiana University, IN, 1995.

Paul Carsten A., *Derivative Actions under English and German Corporate Law – Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference,* 7 European Company and Financial Law Review 1, [81, 115], March 2010.

Peltzer M. & Hickinbotham, A.G. *German Stock Corporation Act and Co-Determination Act*, Otto Schmidt, Köln, 1999.

Penington Robert R., Company Law (8th ed.), Butterworths, London, 2001.

Penski Rachel, *The Case of CEO Richard Grasso and the NYSE: Proposals for Controlling Executive Compensation at Public Nonprofit Corporations*, 58 Vanderbilt Law Review 1, [339, 382], 2005.

Piketty Thomas & Saez Emmanuel, *The Evolution of Top Income: A Historical and International Perspective*, 96 American Economic Review 2, [200-205], 2006.

Pincus Laura (ed.), Perspectives in Business Ethics, McGraw-Hill, Singapore, 1998.

Pinto Arthur R., *The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and Observations,* 32 Fordham Int. Law J. 2, [489, 524], September 2008.

Pistor K. & Xu C., *Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the Incomplete Law Theory,* ECGI - Law Working Paper No. 01/2002.

Pistor K., Raiser M., & Gelfer S., *Law and Finance in Transition Economies,* 8 Economics of Transition 2, [325, 368], 2000.

Pistor Katharina & Xu C., *Fiduciary Duty in Transitional Civil Law Jurisdictions Lessons from the Incomplete Law Theory,* ECGI - Law Working Paper No. 01/2002.

Pistor Katharina , Law Meets the Market: Matches and Mismatches in Transition Economies, World Bank Publication, Washington DC, 1995.

Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies,* 1 European Business Organization Law Review 1, [59, 110], 2004.

Pistor Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies,* 1 Eur. Bus. Org. Law Rev. 1, [59, 110], 2004.

Pistor, K., Raiser M., and Gelfer S., *Law and Finance in Transition Economies, 8 Economics of Transition,* [325,368], March 2000.

Poterba James, Tax Policy and the Economy 18, MIT Press, Cambridge, USA, 2004.

Power Sean A., *Sarbanes-Oxley Ends Corporate Lending to Insiders: Some Interpretive Issues for Executive Compensation Surrounding the Section 402 Loan Prohibition,* 71 Univ. of Missouri Kansas City L. Rev., [911, 935] 2003.

Prentig Theodore O., Co-determination: Its Practice and Applicability to the U.S., 57 Society for The Advancement of Management Journal 2, [5, 17], 1992.

Proceedings of the Annual Bank Conference on Development Economics, The World Bank, Washington DC, 1993.

Quinlivan Steve, *SEC Settles Complaint with Beazer Homes CEO,* March 3 2011.

Radin Stephen A., *Smith v. Van Gorkom on its 15th Anniversary,* 24 Directors & Boards 3, [24, 44], 2000.

Recent Developments Regarding Majority Voting in Directors Elections, Transactional and Securities Update, Foley & Lardner Information Bulletin, Electronic Update, December 2005.

Reinier Kraakman et al.,(eds.), The Anatomy of Corporate Law: A Comparative and Functional Approach, (1st ed.), Oxford University Press, USA, 2004.

René D. & Brierly J.E.C.,, Major Legal Systems in the World Today, (3d ed.), Stevens, London, 1985.

Richter Tomas, *The New Czech Insolvency Act - New Insolvency Regime for Czech Corporate Debtors and their Creditors*, 21 Butterworths Journal of International Banking and Financial Law 6, [271, 276] , June 2006.

RiskMetrics Group Report, Implementation of Shareholder Rights Directive, January 2009.
Roderick Martin, *Segmented Employment Relations: Post-Socialist Managerial Capitalism and Employment Relations in Central and Eastern Europe,* 17 International Journal of Human Resource Management 8, [1353, 1365], 2006.

Rolshoven Max Philipp, *The Last Word? - The July 22, 2004 Acquittals in the Mannesmann Trial*, 5 German Law Journal 8, [936, 940], 2004.

Romano Roberta, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 Cincinnati Law Rev., [457, 506], 1988-1989.

Romano Roberta, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, Yale Law & Economics Research Paper No. 297, 2004.

Rosen Carl, *Corporate Governance Still a Matter for Shareholders*, in: Corporate Governance in the Wake of the Financial Crisis, United Nations Conference on Trade and Development Publication, [109, 118], 2010.

Rubin, Meyer, Doru & Trandafir, *New Insolvency Law May Improve Debt Recovery*, 11 The Romanian Digest 7, [28,36] August 2006.

Saez Emmanuel, *Reported Incomes and Marginal Tax Rates, 1960-2000: Evidence and Policy Implications*, in: Poterba James, Tax Policy and the Economy 18, [117-173], MIT Press, Cambridge, USA, 2004.

Sale Hillary A., *Delaware's Good Faith,* 89 Cornell Law Rev., [100, 137], 2004.

Sandrock, Du Plessis, Großfeld, Saenger, Luttermann, German Corporate Governance in International and European Context, [111, 144], Springer, Berlin, Heidelberg, 2007.

Santella, Baffi, Drago, & Lattuca, *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the* US, July 2009.

Sarkar T., Jay S., & Manley G., *An Analysis of the Walker Review of Corporate Governance in U.K. Banks and Other Financial Institutions*, 127 The Banking Law Journal 3, [242, 251], March 2010.

Schmidt Karsten, Gesellschaftsrecht, (Company Law), 4th ed., Carl Heymanns Publishing House, 2002.

Schneeman Angela, Law of Corporations and Other Business Organizations, (5th ed.) Delmar, N.Y., 2010.

Schwartz Rachael E., The *Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean,* 64 Business Law 1, 2, 2008.

SEC Asks That Vivendi Put Ex-Chiefs Money in Escrow, N.Y. Times, Sept. 17, 2003.
SEC Press Release, SEC Adopts New Measures to Facilitate Director Nominations by Shareholders, 155-2010, August 25 2010.

SEC Press Release, SEC Adopts Rules for Say-on-Pay and Golden Parachute Compensation as Required Under Dodd-Frank Act, 2011-25, 25 January 2011.

SEC Press Release, SEC Obtains Emergency Relief Requiring HealthSouth to Place in Escrow All Extraordinary Payments to Officers, Directors and Employees, 2003-38, March 20 2003.

SEC Press Release, SEC Obtains Settlement With CEO to Recover Compensation and Stock Profits He Received During Company's Fraud, 2011-61, March 3 2011.

SEC Press Release, SEC Proposes Rules Requiring Listing Standards for Compensation Committees and Compensation Consultants, 2011-78, 30 March 2011.

SEC Press Release, SEC Settles with Mercury Interactive and Sues Former Mercury Officers for Stock Option Backdating and Other Fraudulent Conduct, 2007-108, May 31 2007.

SEC Press Release, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters, 2006-123, July 26 2006.

Seligman Joel, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance, Aspen Publishing, New York, 3rd ed., 2003.

Siems Mathias M., *Convergence in Corporate Governance: A Leximetric Approach*, Electronic Article, June 07, 2010.

Simensen Ivar, *Trial of Mannesmann Six Set to Finish with Fines of €5.8m*, Financial Times, 25 November 2006.

Sjåfjell Beate, *Political Path Dependency in Practice: The Takeover Directive*, 27 Yearbook of European Law, [387, 404], March 2008.

Sjostrom W.K.Jr., & Kim Y.S, *Majority Voting for the Election of Directors*, 40 Connecticut Law Review 2, December 2007.
Steinhauer Carsten, *La Nuova Legge Tedesca Sulle Offerte Pubbliche di Acquisto*, [The New German Law on Acquisitions]., 29 Giurisprudenza Commerciale I, [391, 443], 2002.

Sternberg Elaine, *The Defects of Stakeholder Theory*, 5 Corporate Governance: An International Review 1, [3, 10], 1997.

Stolleis Michael, *Judicial Review, Administrative Review, and Constitutional Review in the Weimar Republic*, 16 Ratio Juris 2, [266, 280], June 2003.
Story Louise & Labaton Steven, *Overseer of Big Pay Is Seasoned Arbitrator*, New York Times, 11 June 2009.

Strickland, Wiles, & Zenner, *A Requiem for the* USA *(United Shareholders Association): Is Small Shareholder Monitoring Effective?*, 40 Journal of Financial Economics 2, 1996.

Stulz Rene M., *Financial Globalization, Corporate Governance, and Eastern Europe*, The National Bureau for Economic Research (NBER), Working Paper No. 11912, January 2006.

Summers Clyde W., *Codetermination in the United States: A Projection of Problems and Potentials*, 4 Journal of Comparative Corporate Law and Securities Regulation , [155, 191], 1982.

Talner Lauren, The Origins of Shareholder Activism, Investor Responsibility Research Center Inc., Washington D.C, 1983.

The EU Approach to Corporate Governance: Essentials and Recent Developments, International Finance Corporation Publication, February 2008.

Thomas Randall S. & Wells Harwell , *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, 95 Minn. L. Rev., [846, 903], February 2011.

Thomsen L. C. & Norman D., *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 Journal of Bus. & Tech. L., [393, 408], 2008.

Thomsen S., Rose C. & Risager O., (eds.), *Understanding the Financial Crisis: Investment, Risk and Governance*, 1st ed. Palgrave Macmillan, Hampshire, UK, 2010.

Triem Fred, *Judicial Schizophrenia in Corporate Law: Confusing the Standard of Care with the Business Judgment Rule*, 24 Alaska Law Rev., [23, 44], 2007.

Tripon Catalin Razvan, *Foreign Direct Investment in Romania: Challenging the Romanian Legal Framework* Us*ing the Delaware Model of Company Law*, Central European University S.J.D. Thesis, Budapest, 2003.

Tung Frederick, *Gap Filling in* the *Zone of Insolvency*, Emory Public Law Research Paper; Emory Law and Economics Research Paper No. 07-3, 2007.

Ulrich Seibert, *Control and Transparency in B*usiness (KonTraG): *Corporate Governance Reform in Germany*, 10 European Business Law Review, [70, 75], March 1999.

Uniform Terminology for European Private Law, [120, 157], European Commission Improving Human Potential Program Publication, Heidelberg, 2004.

U.S. Department of the Treasury Press Release, Treasury Announces New Restrictions On Executive Compensation, 4th of February 2009.

Uttamchandani Mahesh, *Insolvency Law and Practice in Europe`s Transition Economies*, 10 Butterworths Journal of International Banking and Financial Law, [452, 456], December 2004.

Van Aaken Anne, *Shareholder Suits as a Technique of Internalization and Control of Management: A Functional and Comparative Analysis*, in: Uniform Terminology for European

Private Law, [120, 157], European Commission Improving Human Potential Program Publication, Heidelberg, 2004.

Veasey N.E. & Di Guglielmo C.T., *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments,* 153 Univ. of Pen. Law Rev. 5, [1399, 1512], 2005.

Velasco Julian, *Taking Shareholder Rights Seriously*, 41 UC Davis Law Rev. 2, [605, 682], 2007.

Velasco Julian, *The Fundamental Rights of the Shareholder*, 40 UC Davis Law Review 2, [407, 467], 2006.

Ventoruzzo Marco, *Empowering Shareholders in Directors' Elections: A Revolution in the Making*, ECGI - Law Working Paper No. 147/2010, February 2010.

Ventoruzzo Marco, *The Thirteenth Directive and the Contrasts Between European and U.S.Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?* Bocconi Legal Studies Research Paper No. 06-07, October 2005.

Vilau Dragos, Chapter on Romania in: Cross-border Corporate Governance and Directors' Duties Handbook, [165, 172], Practical Law Company, London, 2007.

Vliegenthartin Arjan, *Corporate Governance in Eastern Central Europe, The State of the Art*, Working Paper Political Science, No. 04, 2005.

Vogel David, Fluctuating Fortunes: The Political Power of Business in America, (rev.ed.) Beard Books, New York, 2003.

Volpin, Paolo F., *Governance with Poor Investor Protection: Evidence from Top Executive Turnover in Italy*, 64 Journal of Financial Economics, [61, 90], 2002.

Vossestein Gert-Jan, Modernization of European Company Law and Corporate Governance: Some Considerations on Its Legal Limits, Kluwer Law International, UK, January 2010.

Walker David I., *Some Observations on the Stock Option Backdating Scandal of 2006,* Boston University School of Law Working Paper No. 06-31, 2006.

Wells Harwell, *"No Man Can be Worth $ 1,000,000 a Year": The Fight Over Executive Compensation in 1930s America*, 44 University of Richmond Law Review, [689,769], 2010.

White Barbara, *Conflicts in the Regulation of Hostile Business Takeovers in the United States and the European Union,* 9 Ius Gentium, [161, 195], 2003.

Wild Robert J., Designing an Effective Securities and Corporate Governance Compliance Program, Thomson West US, 2006.

Wilke, Maack & Partners, *Country Reports on Financial Participation in Europe*, 2007.

Winkler Adam, *Corporate Law or the Law of Business: Stakeholders and Corporate Governance at the End of History*, 67 Journal of Law and Contemporary Problems 4, [109, 133], 2004.

Wirth, Arnold, Greene & Morshäuser, Corporate Law in Germany, 2nd ed., Verlag C.H. Beck, München, 2010.

World Bank Reports on Doing Business Project, 2010.

Wymeersch Eddy, *The Enforcement of Corporate Governance Codes*, 21 Journal of Corporate Studies 1, [113, 138], April 2006.

Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions: England, the US, Germany and China*, Kluwer Publications, Shanghai, 2007.

Yablon Charles M., *Bonus Questions – Executive Compensation in the Era of Pay for Performance,* 75 Notre Dame Law Review, [271, 298] 1999.

Yablon Charles M., *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 Colum. L. Rev., [1867, 1904], 1992.

Yellin David S., *Masters of Their Own Eminent Domain: The Case for a Reliance Interest Associated with Economic Development Takings*, 99 Georgetown Law Journal 2, [651, 676], 2011.

Zetzsche Dirk A., *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, Center for Business and Corporate Law Research Paper Series No. 0031, July 2008.
Zingales Luigi, Corporate Governance, in: Newman Peter, (ed.), The New Palgrave Dictionary of Economics and the Law, [497, 503], Macmillan, New York, 1998.

Zweigert K. & Kötz H., *Einführung in die Rechtsvergleichung, (*An Introduction to Comparative Law), (trans. Weir Tony), (3rd ed.) Klarendon Press, Oxford - New York, 1998.

Laws, Regulations, Legislative Proposals, Voluntary Codes and Observance Reports

Czech Republic

Czech Commercial Code [*Obchodní zákoník*] Act. No. 63/2001 Coll., 1.01. 2001 as most recently amended by Act 409/201 Coll.1.01.2011.

Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002.

Corporate Governance Code based on the OECD Principles, Czech Securities Commission, Prague, June 2004

Act on Business Activities in the Capital Market [*Zákon o Podnikání na Kapitálovém Trhu*] Act No.256/2004 Coll., 14.04.2004, as most recently amended by Act 409/201 Coll.1.01.2011.

Labor Code [*Zákoník Práce*] Act No. 262/2006 Coll. of 21.04.2006.

Report on Observance of Standards and Codes, Czech Republic, Compliance with Basel Core Principles for Banking Supervision, IMF Publication, July 2000.

Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Czech Republic, World Bank-IMF, July 2002.

Act of Bankruptcy and Compensation [*O Úpadku a Způsobech Jeho Rešení*] Act No. 182/2006 Coll. of 9 May 2006.

EBRD Insolvency Law Assessment project – 2009: Czech Republic.

Germany

Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], 15.06.2005, published in the Lower House of the Parliament of the Federal Republic of Germany [*Bundestag*] Official Printed Bulletin [BT – Drs.)]. 15/5693.

AktG as amended by Act Regarding Integrity of Companies and Modernization of Stock Corporation Law [*Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes*], of 15.06.2005 published in *Bundestagsdrucksache (BT-Drs.)* 15/5693.

Appropriateness of Executive Compensation Act, [*Gesetz zur Angemessenheit der Vorstandsvergütung],* of 5 August 2009, published in Federal Law Gazette BGBl. I, 50, S. 2509.

Berlin initiative Group, German Corporate Governance Code, 6 June 2000.

Co-Determination Act [*Gesetz uber die Mitbestimmung der Arbeitnehmer*] of 4 May 1976, published in Federal Law Gazette BGB1 I 1153.

Corporate Control and Transparency Act [*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich]* of 27 April 1998 published in Federal Law Gazette BGBI I, S. 786.

German Commercial Code [*Handelsgesetzbuch*] of 10 May 1897, published in Imperial Law Gazette [*Reichsgesetzblatt* (RGBI)]I S. 219, as amended most recently by the Act of 1.03.2011 BGBl. I S. 288.

German Commission on Corporate Governance, Amendment to the German Corporate Governance Code, 12 June 2006.

German Commission on Corporate Governance, Amendment to the German Corporate Governance Code, 21 May 2003.

German Corporate Governance Code, German Commission on Corporate Governance, 26 May 2010.

German Criminal Code [*Strafgesetzbuch*] As promulgated on 13 November 1998, [BGBI I, 945, 33220].

German Financial Markets Stabilization Act [Gesetz zur Umsetzung eines Maßnahmenpakets zur Stabilisierung des Finanzmarktes *Finanzmarktstabilisierungsgezetz (FMStG)*] of 17.10.2008 published in BGBl. I S. 1982, 46.

German General Commercial Code, [*Allgemeines Deutsches Handelsgesetzbuch*, *(*ADHGB)] of 31 May 1861.

German Panel of Corporate Governance, Code of Best Practice for German Corporate Governance, Berlin, July 2000.

Government Commission, German Corporate Governance, Code as amended on 26 May 2010.

Isolvency Statute [*Insolvenzordnung*], of 5 October, 1994, BGBl. I 2866.

Law on Board Member Monetary Compensation Disclosure [*Vorstandsvergütungs-Offenlegungsgesetz*] of 29.06.2005, published in the Lower House of the Parliament of the Federal Republic of Germany, [*Bundestag*] Official Printed Bulletin [*Bundestagsdrucksache (BT – Drs.)*] 15/5860.

Law On Control and Transparency [*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*] 27.07.1998, published in the Federal Law Gazette BGBl I S.786.

Law On Transparency and Disclosure *[Transparenz und Publizitätsgesetz*], 19.06. 2002, BGBl I. S.2681.

One Third Participation Act [*Drittelbeteiligungsgesetzes (DrittelbG*)] of 18 May 2004, published in the Federal Law Gazette BGBI IS. 974.

Securities Acquisition and Takeover Act [*Wertpapiererwerbs und Übernahmegesetz (WpÜG*)] of 20 December 2001, published in Federal Law Gazette BGBI IS. 3822.
OECD Principles of Corporate Governance, 1999.

Stock Corporation Act [*Aktiengesetz (AktG*)], of 06.09.1965, published in Federal Law Gazette **[***Bundesgesetzblatt BGBT]* I 1089.

The Act for stabilization of Financial Markets [*Gesetz zur Umsetzung eines Maßnahmenpakets zur Stabilisierung des Finanzmarktes (Finanzmarktstabilisierungsgesetz,* (FMStG), of 17 October 2008, BGBl I, No. 46, 1982.

The Mining, Iron and Steel industry Codetermination Act, [*Gesetz über die Mitbestimmung der Arbeitenhemer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie*, *Montan-MitbestG*)], of 21 May 1951, published in the Federal Law Gazette BGBI I S. 347.

Works Council Constitution Act, [*Betriebsverfassungsgesetz, (BetrVG*)], of 11 October 1952, published in the Federal law Gazette BGBl I 43 S.681.

Romania

Corporate Governance Code Romania, Bucharest Stock Exchange, Bucharest, January 2009.

Labor Code [*Codul Muncii*] Law No. 53 of 5 February 2003, published in OG No. 72/1 of 5 February 2003.

Law No. 297 of 28.06.2004, On Capital Markets [Legea Privind Piata de Capital] OG No. 571, 29.06.2004)

Law No. 297 On Capital Markets *[Legea Privind Piata de Capital, nr. 297, 28.06.2004]* published in OG 571, 29.06.2004.

Law No. 467 of 12.12.2006 On Establishing the General Framework for Informing and Consulting Company Employees, [*Privind Stabilirea Cadrului General de Consultare a Angajatilor]* published in OG No. 1006 of 18.12.2006.

Law No. 85 of 20 April 2006 On Insolvency, *[Legea Insolventei],* published in the OG No. 359 of 20 April 2006.

Regulation No.31/2006 Amending CNVM (Romanian National Securities Commission) Regulations by Implementing Certain Provisions of European Directives, approved by Order No. 106/14.12.2006, (effective as of January 2007).

Report On The Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Romania, World Bank-IMF, January 2004.

Romanian Company Law, Law No. 441, of 31.10.2006, On Amending and Supplementing the Provisions of Law No. 31/1990 On Commercial Companies and of Law No. 26/1990 On the Register of Commerce Registration Procedures *[Lege pentru Modificarea Legii nr. 31/1990 Privind Societãtile Comerciale, Republicata, si a Legii nr. 26/1990 Privind Registrul comertului, Republicata, Nr. 441, 31.10. 2006,]*, published in OG No. 955, 31.10.2006.

Romanian Strategic Alliance of Business Associations, Code of Corporate Governance, 24 March 2000.

Voluntary Code of Corporate Governance, Romania, Strategic Alliance of Business Associations, Bucharest, 2002.

United Kingdom

Financial Reporting Council 2009 Review of the Combined Code*:* Final Report, December 2009.

Financial Reporting Council, The UK Approach to Corporate Governance, November 2006.

Financial Reporting Council, The UK Corporate Governance Code, June 2010.

The Finance Act of 1965, 13 & 14 Eliz. 2, c. 25.

The Study Group on Directors' Compensation, Directors' Compensation: Report of a Study Group Chaired by Sir Richard Greenbury, Gee, London, 1995.

UK Companies Act of 2006, An Act to Reform Company Law and Restate the Greater Part of the Enactments Relating to Companies; to Make Other Provision Relating to Companies and Other Forms of Business Organisation; to Make Provision about Directors' Disqualification, Business Names, Auditors and Actuaries; to Amend Part 9 of the Enterprise Act 2002; and for Connected Purposes", passed on 8th November 2006, printed by Queen's Printer of Acts of Parliament, No. 352246.

United States

A Bill to Promote the Financial Stability of the United States by Improving Accountability and Transparency in the Financial System, To End "Too Big to Fail", To Protect the American Taxpayer by Ending Bailouts, to Protect Consumers from Abusive Financial Services Practices, and for Other Purposes of 2010, Pub. L. 111-203, 124 Stat. 1376, July 21 2010. (Dodd-Frank Wall Street Reform and Consumer Protection Act).

ABA Committee on Corporate Laws Model Business Corporation Act (2005, rev. 2006, 2009, 2010).

ALI Principles of Corporate Governance: Analysis & Recommendations, West Thompson, (1994 & supp. 2008).

American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115, February 17 2009.

An Act To Protect Investors by Improving the Accuracy and Reliability of Corporate Disclosures Made Pursuant to the Securities Laws, and for Other Purposes, of 2002, Pub. L. 107-204, 116 Stat. 745, July 30 2002. (Sarbanes-Oxley Act).

An Act To Amend the Securities Exchange Act of 1934 to Provide Shareholders with an Advisory Vote on Executive Compensation and to Prevent Perverse Incentives in the Compensation Practices of Financial Institutions, (Corporate and Financial Institution Compensation Fairness Act of 2009 incorporated now in Dodd-Frank Wall Street Reform and Consumer Protection Act), H.R. 3269, July 31 2009.

Arizona, Ariz. Rev. Stat s.10-1202 (2002).

Banking Act of 1933 Pub. L. 73-66, 48 Stat. 162, June 16 1933.

Commission On Banking, Housing, & Urban Affairs, U.S. Senate, Report to the Ranking Minority Member, Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Activities, GAO-06-678, July 24 2006.

Conn. Gen. Stat s.33-313 (2003).

Consumer Credit Protection Act, Pub. L. 90-321, 82 Stat.146, June 29, 1968.

Fair Packaging and Labeling Act, Pub. L. 89-755, 80 Stat. 1296, July 1 1967, 15 U.S.C.§§ 1451–1461.

Delaware Code Annotated (2004 rev. 2006, 2009), tit. 8 Corporations.

Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat. 3765, October 3 2008.

Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 88 Stat. 829 September 2, 1974.

FASB Generally Accepted Accounting Principles (GAAP), 2004.

FASB Statement of Financial Accounting Standards 123 (Revised 2004), Share-Based Payment, December 2004.

Idaho Code s.30-1602 (2002).

Ind. Code, s.23-1-35-1(d) (2008).

Internal Revenue Code of 1986, Pub. L. 99-514, 100 Stat. 2085, October 22 1986.

National Labor Relations Act of 1935, Pub. L. 74-198, 49 Stat. 449, July 5 1935, (29 U.S.C. §§ 151-66 (2004)).

National Environment Policy Act, Pub. L. 91-190, 83 Stat. 852, January 1 1970, 42 U.S.C. § 4321 et. seq.,

Report of the NYSE Corporate Accountability and Listing Standards Committee, 2002.

Resource Conservation and Recovery Act, Pub. L. 94-580, 90 Stat. 2795, 42 U.S.C.§ 6901 et.seq.

NYSE, Listed Company Manual (2004).

Ohio Rev. Code Ann, s.1701.59 (E) (Supp 1989).

SEC Release No. 33-6003, Uniform and Integrated Reporting Requirements: Management Compensation, [43 FR 58151], December 4 1978.

SEC Release No. 33-6962, Executive Compensation Disclosure, [57 FR 48126], October 16 1992.

SEC Release No. 33-8655, Executive Compensation and Related Party Disclosure, [71 FR 6542], January 27 2006.

SEC Release No. 34-1823, 1938 WL 33169, August 13 1938.

SEC Release No. 34-48745, Order Approving Proposed Rule Changes and Amendments on Listed Company Manuals of NASD and NYSE, [68 FR 64154], November 4 2003.

SEC Release No. 34-60215, Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, July 1 2009.

SEC Release Nos. 33-9136; 34-62764, Proposed Rule on Facilitating Shareholder Director Nominations, August 25 2010.

SEC Release Nos. 33-9178; 34-63768, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, [FR vol. / issue info om.] January 21 2011.

SEC Release Nos. 33-9199; 34-64149, Proposed Rule on Listing Standards for Compensation Committees, March 30, 2011.

Securities Act of 1933, Pub. L. 22, 48 Stat. 74, 15 U.S.C. §§ 77a– 77aa (2006).

Securities Exchange Act of 1934, Pub. L. 291, 48 Stat. 881, 15 U.S.C. §§ 78a–78nn (2006).

The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, 115 Stat. 38 June 7, 2001.

The Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. 108-27, 117 Stat. 752, May 23 2003.

A Bill to Provide Shareholders with Enhanced Authority over the Nomination, Election and Compensation of Public Company Executives, 111 S. 1074, 2009.

Supra-national

Commission Recommendation 2005/162/EC, of 15 February 2005 On the Role of Non-Executive or Supervisory Directors of Listed Companies and On the Committees of the (Supervisory) Board, OJL 52/51, 29.02.2005.

Commission Report on the Implementation of the Takeover Bid Directive, SEC (2007) 268, Brussels, 21 February 2007.

Communication from the Commission to the Council and the European Parliament - Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, COM (2003) 284, 21. 05.2003.

Directive 2004/25/EC of the European Parliament and of the Council of 21 January 2004 on Takeover Bids, OJL 142/12, 30/04/2004.

Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies, OJL 184/17, 14.07.2007.

EU Commission Green Paper COM (2001)366, Promoting a European framework for Corporate Social Responsibility, 18 July 2001.

EU Commission Green Paper COM (2011) 164 on the EU Corporate Governance Framework, 5 April 2011.

Final Act to the Treaty for Accession to the European Union, 46 OJL 236/ 2003, 23.09.2003.

Final Act to the Treaty for Accession to the European Union, 48 OJL 157/ 2005, 21.06.2005.

High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels, 10 January 2002.

Initial Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover bids, OJ C 64, (8) 14 March 1989, (with explanatory memorandum Supp. 3/89 - Bull. EC.),

OECD Guidelines for Multinational Enterprises 2008.

OECD Principles of Corporate Governance, 2004.

Second Council Directive 77/91/EEC of the Council of European Communities of 13 December 1976 on Coordination of Safeguards which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, in Respect of the Formation of Public Limited Liability Companies and tie Maintenance and Alteration of Their Capital, with a View to Making Such Safeguards Equivalent, 1977 OJL 26/1 and 1992 OJL 347/64 13.12.1976.

Second Proposal for a Thirteenth Directive on Company Law Concerning Takeover Bids, OJ C 162, COM(95)655 final (5), 8 February 1996 (6 June 1996, with explanatory memorandum COM(95)655 final).

The Insolvency Legal Indicator Survey, EBRD Report, 2004.

Cases and Litigation Releases

A.P. Smith Manufacturing Co. v. Barlow, 98 A.2d 581 (N.J. 1953).

Arag/Garmenbeck Entscheidung des BGH, 21.04.1997, ZIP 1997, 833, BGHZ 135, 244 (253), NJW 1997.

Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

Beam v. Stewart, 845 A.2d 1040, (Del. 2004).

Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

CA v. AFSCME, 953 A. 2d. 227, (Del Sup. Ct 2008).

Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

Charter Township of Ypsilanti v. General Motors Corp., 506 N.W.2d 556, 201 Mich. App. 128 (Mich. App. Ct. 1993).

Chesapeake Corp. and Sheffield, Inc., v. Marc P. Shore and co-joined defendants, Civ. A. No. 17626., (Del. Ct. of Chancery, 2000).

Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, (Del. Ch. 1994).

Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995).

Cohen v. Viray, 2010 WL 3785243 (2d Cir. Sept. 30, 2010).

Corporate Aviation Concepts, Inc. v. Multi-Service Aviation Corp., 2004 WL 1900001 (E.D. Pa. 2004).

Cramer v. General Telephone & Electronics Corp., 582 F.2d. 259 (3d Cir. 1978).

Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp, 1991 WL 277613 (Del. Ch. 1991).

Crowell v. Jackson, 53 N.J.L. 656, 23 Atl. 426 (1891).

CTS Corp. v. Dynamics Corp. of Am., 481U.S.69 (1987).

Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. S. Ct.1919).

Envirokare Tech, Inc. v. Pappas, No. 05 Civ. 5515 (S.D.N.Y. March 10, 2006).

Farris v. Glen Alden Corp., 143 A.2d 25, 28-31 (Pa. 1958).

Gallin v. Nat'l City Bank, 273 N.Y.S. 87, 113 (N.Y. Sup. Ct. 1934).

Gantler v. Stephens, 965 A.2d 695, (Del. 2009).

Gelatine Case, BGH 26.4.2004, II ZR 155/02, BGHZ 159, 30.

Georgia-Pacific Corp v Great N. Nekoosa Corp 727 F. Supp. 31 (Me. 1989).

Geyer v. Ingersoll Publications Co., 621 A.2d 784, 787 (Del. Ch. 1992).

Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 664 (Del. 1952).

Gow v. Consol. Coppermine Corporation, 165 A. 136, 140 (Del. Ch. 1933).

Guth v. Loft, 5 A.2d 503, (Del. 1939).

Hannover Corp. of America v. Beckner, 211 B.R. 849, 854 (M.D. La. 1997).

Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963).

Heller v. Boylan, 29 N.Y.S.2d 653, 680 (N.Y. Sup. Ct. 1941).

Helverling v. Mitchell, 303 U.S. 391, 396 (1938).

Hollinger Int'l Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004).

Holzmüller BGH 25.2.1982, II ZR 174/80, BGHZ 83, 122.

In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009).

In re Enron Corporation Securities, Derivative & ERISA Litig., 235 F. Supp.2d. 549, US Dist., 2002.

In re Exide Technologies, Inc., 299 B.R. 732 (Bankr. D. Del. 2003).

In re Hechinger Investment Co. of Delaware, 274 B.R. 71, 89 (D. Del. 2002).

In re LTV Steel Co., Inc., 333 B.R. 397, 421-23 (Bankr. N.D. Ohio 2005).

In re the Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del. Ch. 1998).

In re the Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).

In re the Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005).

In re The Walt Disney Company Derivative Litig., 825 A.2d 275 (Del. Ch. 2003).

In re Toys "R" Us, Inc., Shareholder Litig., 877 A.2d 975, (Del. Ch. 2005).

In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, (Del. 2006).

In re Whitehall Jewellers, Inc. Shareholder Derivative Litig., 2006 WL 468012.
Jean-Marie Messier v. Vivendi Universal S.A., C. No. 50-T-116-00585-02 (N.Y. App. Div. Sept. 16, 2003).

Kahn v. Sullivan, 594 A.2d 48 (Del. 1991).

Katz v. Oak Indus. Inc., 508 A.2d 873 (Del. Ch. 1986).

Kerbs v. Cal. E. Airways, Inc., 90 A.2d 652, 656–58 (Del. 1952).

Kidde Industries, Inc. v. Weaver Corp., 1994 WL 89013 (Del. Ch. 1994).

Landergericht Stuttgart DB 1999, 2462 ASS AG/OLG Stuttgart OLGR Stuttgart 2003, 55.

Lewis v. Vogelstein, 699 A.2d 327, 338 (Del. Ch.1997).

LG Düsseldorf, 14.07.2010, 14 KLs 6/09.

Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009).

Mannesmann AG BGH 21.12.2005, 3 StR 470/04, NJW 522/2006.

Mannesmann AG 22.07.2004, Landgericht Düsseldorf, XIV 5/03, NJW 3275/2004.

McPadden v. Sidhu, 964 A.2d 1262 (Del. Ch. 2008).

McQuillen v. National Cash Register Co., 112 F.2d 877 (4th Cir. 1940).

Michelson v. Duncan, 407 A.2d 211, 223 (Del. 1979).

Neer v. Pelino, 389 F. Supp. 2d (E.D. Pa. 2005).

North American Catholic Education Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007).

Northeast Harbor Golf Club, Inc. v. Harris, 661 A2d 1146 (Maine Sup. J. C. 1995).

O'Reilly v. Transworld Healthcare Inc., 745 A.2d 902 (Del. Ch.1999).

Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 38 Bankr. Ct. Dec. (CRR) 147 (3d Cir. 2001).

Paramount Communications Inc. v. Time Inc., 571 A.2d 1140, (Del.1989).

Production Resources Group L.L.C. v. NCT Group, Inc., 863 A.2d 772 (Del. Ch. 2004).

Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

Rogers v. Hill, 289 U.S. 582 (1933).

Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007).

Ryan v. Lyondell Chem. Co., 907 A.2d 235 (Del. 2009).

SEC Litigation Release No. 18352 , SEC Files Sarbanes-Oxley Act Application for Temporary Order Compelling Vivendi Universal S.A. to Escrow Extraordinary Payments to its Former CEO Jean-Marie Messier, September 16 2003.

SEC Litigation Release No. 18523, SEC Files Settled Civil Fraud Action Against Vivendi Universal S.A., Its Former CEO, Jean-Marie Messier, and Its Former CEO, Guillaume, December 24 2003.

SEC Litigation Release No. 52865, In the Matter of Peter Goodfellow and Stamatis Molaris, December 1 2005.

SEC v. HealthSouth, 261 F. Supp. 2d 1298 (N.D. Ala. 2003).

SEC v. Gemstar-TV Guide Int'l Inc. 401 F.3d 1031, 1036 (9^{th} Cir. 2005).

SEC v. Gemstar-TV Guide Int'l Inc., 367 F.3d 1087 (9th Cir. 2004), 384 F.3d 1090 (9th Cir. 2004)

SEC v. Jenkins, CV 09-1510-PHX-JWS (D. Ariz. July 23 2009).

SEC v. McCarthy, No. 1:11-CV-667-CAP (N.D. Ga. March 3, 2011).

SEC v. Medical Committee for Human Rights, 404U.S.App. D.C. 403 (1972).

SEC v. Vivendi Universal, S.A., C. No. Mll-03 (S.D.N.Y. 2003).

Shlenksy v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968).

Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

Spitzer v. Grasso No. 04-CIV-4565, (N.Y. Sup. Ct. May 24, 2004).

Stegemeier v. Magness, 728 A.2d 557 (Del. 1999).

Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

Trenwick America Litigation Trust v. Ernst & Young, LLP, et al, 906 A.2d 168, (Del Ch.2006).

United States v. Andrew Fastow, Ben F. Glisan Jr. and Dan Boyle, Cr. No. H-02-0665329, (US Dist. Ct. South. Dist. of Tex. April 30 2003).

United States v. Ebbers, 458 F. 3d, 110, 130, (2^{nd} Circ. 2006).

United States v. Quattrone, 441 F. 3d, 153, 160, (2^{nd} Circ. 2006).

Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995).

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

Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

Wheelabrator Techs. Inc. Shareholder Litig., 663 A.2d 1194 (Del. Ch. 1995).

Electronic Sources

ftp://ftp.zew.de (last visited June 16th 2011).

http://www.abanet.org (last visited August 5th 2011).

http://www.advfn.com (last visited July 15th 2011).

http://www.americanbar.org (last visited August 5th 2011).

http://www.arccgor.nl (last visited June 13th 2011).

http://www.blog.manifest.co.uk (last visited June 16th 2011).

http://www.businessweek.com (last visited August 5th 2011).

http://www.caselaw.lp.findlaw.com (last visited August 5th 2011).

http://www.cdep.ro (last visited June 13th 2011).

http://www.ces.columbia.edu (last visited August 5th 2011).

http://www.cgscenter.org (last visited August 5th 2011).

http://www.cnvmr.ro (last visited May 10th 2011).

http://www.codulmuncii.ro (last visited May 10th 2011).

http://www.corp-gov.gpw.pl (last visited May 10th 2011).

http://www.corporatecounsel.com (last visited May 23rd 2011).

http://www.dealbook.nytimes.com (last visited February 12th 2011).

http://www.delcode.delaware.gov (last visited February 13th 2011).

http://www.dodd-frank.com (last visited August 5th 2011).

http://www.doingbusiness.org (last visited August 5th 2011).

http://www.dw-world.de (last visited January 22nd 2011).

http://www.ebrd.com (last visited August 5th 2011).

http://www.ecgi.org (last visited August 5th 2011).

http://www.eir-database.com (last visited May 24th 2011).

http://www.ejbo.jyu.fi (last visited May 24th 2011).

http://www.elsa.berkeley.edu (last visited August 5th 2011).

http://www.eprints.ucl.ac.uk (last visited June 22nd 2011).

http://www.eur-lex.europa.eu (last visited August 5th 2011).

http://www.eur-lex.europa.eu (last visited August 5th 2011).

http://www.europa.eu/ (last visited August 5th 2011).

http://www.faculty.london.edu (last visited August 5th 2011).

http://www.foley.com (last visited July 12th 30th 2011).

http://www.frc.org.uk (last visited July 12th 30th 2011).

http://www.frdb.org (last visited July 12th 2011).

http://www.fsb.muohio.edu (last visited July12th 2011).

http://www.ft.com (last visited June 11th 2011).

http://www.georgetownlawjournal.org (last visited July 13th 2011).

http://www.germanlawjournal.com (last visited July 13th 2011).

http://www.gibsondunn.com (last visited January 30th 2011).

http://www.govtrack.us (last visited August 1st 2011).

http://www.hha.dk (last visited January 30th 2011).

http://www.hm-treasury.gov.uk (last visited May 4th 2011).

http://www.hr.ro (last visited July 30th 2011).

http://www.ifc.org (last visited July 30th 2011).

http://www.iflr.com (last visited January 30th 2011).

http://www.ifo.de/portal (last visited June 4th 2011).

http://www.ilf-frankfurt.de (last visited July 24th 2011).

http://www.imf.org (last visited July 24th 2011).

http://www.intercentar.de (last visited July 24th 2011).

http://www.irrcinstitute.org (last visited July 10th 2011).

http://www.iuscomp.org (last visited July 24th 2011).

http://www.jura.uni-frankfurt.de (last visited July 24th 2011).

http://www.law.fsu.edu (last visited July 24th 2011).

http://www.law.harvard.edu (last visited July 24th 2011).

http://www.law.illinois.edu (last visited July 24th 2011).

http://www.law.umaryland.edu (last visited July 24th 2011).

http://www.law2.fordham.edu (last visited July 24th 2011).

http://www.lawreview.richmond.edu (last visited August 5th 2011).

http://www.mit.edu (last visited June 16th 2011).

http://www.mmc.edu.cn (last visited August 5th 2011).

http://www.mpifg.de (last visited April 18th 2011).

http://www.mpsv.cz (last visited April 18th 2011).

http://www.nber.org (last visited June 14th 2011).

http://www.ngelaw.com (last visited April 18th 2011).

http://www.nyse.com (last visited August 5th 2011).

http://www.nytimes.com (last visited August 5th 2011).

http://www.oecd.org (last visited August 5th 2011).

http://www.old.nhh.no (last visited April 18th 2011).

http://www.riskmetrics.com (last visited August 4th 2011).

http://www.sec.cz (last visited July 24th 2011).

http://www.sec.gov (last visited August 5th 2011).

http://www.sfu.ca (last visited January 15th 2011).

http://www.sfu.ca (last visited July 24th 2011).

http://www.shareholderforum.com (last visited June 21st 2011).

http://www.sova.ro (last visited July 22nd 2011).

http://www.springerlink.com (last visited July 24th 2011).

http://www.ssrn.com (last visited August 6th 2011)

http://www.taglaw.com (last visited February 23rd 2011).

http://www.thomas.loc.gov (last visited July 22nd 2011).

http://www.umich.edu (last visited June 16th 2011).

http://www.umich.edu (last visited July 22nd 2011).

http://www.unctad-docs.org (last visited February 23rd 2011).

http://www.uniformterminology.unito.it (last visited June 24th 2011).

http://www.upenn.edu (last visited March 12th 2011).

http://www.whitehouse.gov (last visited March 12th 2011).

http://www.worker-participation.eu/ (last visited March 12th 2011).

http://www.works.bepress.com (last visited August 5th 2011).

http://www.worldbank.com (last visited March 12th 2011).

http://www.worldservicesgroup.com (last visited March 12th 2011).

http://www.worldservicesgroup.com (last visited March 12th 2011).

https://dspace.stir.ac.uk (last visited March 12th 2011).