Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe

Pavlos E. Masouros, Leiden University
European Company Law (ECL) is published under the aegis of the Centre for European Company Law (CSECL), an academic partnership of the Universities of Leiden, Utrecht and Maastricht, the Netherlands (www.eclc.nl). The purpose of CECL is to further the study of company law by focusing on supranational issues. These include both developments in the EU and on other international levels, as well as comparative law. Leiden University acts as the leading partner in CECL, with Professor Dr. Stef M. Bartman, head of the corporate law department of that University, as coordinating director. ECL aims to be interesting for both practising and academic lawyers in the field of European company law. There are six issues of ECL per year. Two of these (April and October) concentrate on specific topics. The other issues (February, June, August and December) contain articles on various subjects and also include country reports of a general nature, highlighting important developments in a number of EU jurisdictions, as well as columns that offer summaries of recent EU legislation, ECLI case law and of selected articles from various national legal periodicals.

ECL’s Editorial Board encourages all readers to send in (proposals for) contributions and ideas on contributions for publication. Contributions may deal with European company law in a broad sense, including such topics as codetermination law, insolvency law and securities law.

All contributions should follow ECL’s SCIP-principle, which welcomes articles that are scientific, concise, informative and practical. Contributions should have a range of approximately 4,000 to 5,000 words (footnotes excluded), and should be sent to both ECL’s main editor (s.m.bartman@law.leidenuniv.nl) and to its editorial secretary (c.degroot@law.leidenuniv.nl).

At the author’s request, contributions will be peer reviewed by at least two members of ECL’s Editorial Board. Publication in ECL is subject to authors signing a “Consent to Publish & Transfer of Copyright” form on behalf of Kluwer Law International.
Is the EU Taking Shareholder Rights Seriously?: An Essay on the Impotence of Shareholdership in Corporate Europe

PAVLOS E. MASOUROS, LL.M. (HARVARD), PHD FELLOW IN CORPORATE LAW, LEIDEN UNIVERSITY, THE NETHERLANDS AND ATTORNEY AT LAW (ATHENS)

The core problem has been the disappearance of any practical or legal respect for the fiduciary standards that ensure a beneficiary of the loyal competence of the person responsible for managing his property. We have tolerated conflicts of interest throughout the commercial system with the result of enriching service providers and impoverishing beneficiaries.

– Robert A. G. Monks (Corporate governance pioneer and shareholder activist)

1. INTRODUCTION

Right in the beginning of the twenty-first century, two prominent corporate law scholars were writing about ‘the end of history of corporate law’. They postulated that despite the differences in corporate systems around the world there is finally a clear universal tendency towards the dominance of a shareholder-centred ideology in corporate law. Although it is questionable whether there is already such a universal corporate legal culture, it is true that the shareholder primacy norm has gained much attention lately from academics and policy makers alike. I can think of two main factors that have contributed to this end: (i) the influence of the law-and-economics literature; and (ii) the rise of the shareholder activism movement.

Regarding the first factor, the influence of Jensen’s theory of the firm positing that shareholders as residual risk bearers have the optimal incentive to maximize the firm’s value can be detected in the vast majority of scholarly articles discoursing on corporate governance. Contract theory has also done its part in confirming the importance of shareholder authority for corporate functioning by exposing the incompleteness of the contract between the shareholder and the firm; a problem restored by the exclusive enfranchisement of shareholders and by the establishment of the legal obligation of managers to serve primarily the shareholders’ interests.

Regarding the second factor, shareholder activists have rejuvenated the exercise of long-neglected shareholder rights, exposing the benefits of active forms of engagement by shareholders (at least by those shareholders that have committed their funds in the firm for the long term) for corporate governance.

Despite some opposing voices that advocated for shareholder disempowerment arguing that shareholder wealth maximization keeps managers focused on the short term and despite the
prevalence of the stakeholder model in some jurisdictions of continental Europe, the pro-shareholder tendency inspired a policy plan at the EU level in 2003 (‘Modernising Company Law and Enhancing Corporate Governance in the EU: A Plan to Move Forward’), which aspired to ameliorate the shareholders’ position within the firm. Not all the goals that the plan had set for the empowerment of shareholders were finally realized, but the Commission managed at least to produce a Directive on shareholders’ rights (‘SRD’), whose transposition into national laws was – in most Member States – completed by August 2009. At first sight, the SRD appears to invigorate shareholders of European listed corporations by providing them with valuable powers, such as the right to put items on the agenda and to table draft resolutions and also by facilitating the daunting process of proxy voting.

However, many have asserted that the SRD fails to address the main problems of shareholder governance in today’s multinational corporations, while others have already started seeking new legislative initiatives regarding shareholder empowerment in light of the financial crisis. This criticism compels a deeper reflection on the status of European corporate law regarding the issue of shareholder involvement in corporate governance. A series of questions needs to be answered in this respect: Was the SRD sufficient to cure the deficiencies of the past in shareholder governance? Does the SRD interact satisfactorily with the existing legal framework in order to unfetter shareholders from the mechanisms that restricted their active engagement? Or is European corporate law still captive of an ideology that wants other corporate constituencies to be protagonists in corporate affairs?

This article is essentially an attempt to show that the deficit in the European corporate governance model with regard to the status of the shareholders persists even in the post-SRD era and that we still have a long distance to cover in order to truly empower shareholders in the EU. The SRD along with certain other Company Law Directives and the various European national corporate laws form a synthesis that falls short of providing shareholders with the full potential of getting their corporate governance voice through within listed corporations.

2. THE STERILIZATION OF THE VOTING RIGHT

In order to facilitate the clearing and settlement of securities transactions in today’s capital markets, many European jurisdictions have moved away from the paradigm model of shareholding, where the person who is registered as shareholder in the registry (in the case of registered shares) or the person who holds the share (in the case of bearer shares) is also the true investor, who bears the residual risk and to whom the economic benefits from the share accrue. Although some jurisdictions still maintain the traditional direct holding system (e.g., Finland, Greece), in the majority of European capital markets the ultimate beneficial owner of the shares (‘end investor’) holds her entitlement in the firm through a security account established with a financial intermediary, normally a broker or a bank (‘custodian’), who appears vis-à-vis the firm as the formal shareholder. The custodian holding the legal titles to the shares will normally hold as nominee many other shares on behalf of a great number of end investors in a so-called ‘omnibus account’. Especially in cases where the end investor resides in a different country than the one of the stock exchange where the corporation’s shares trade, there can be a complex chain of intermediaries and depositories standing between the corporation and the end investor. This intermediary system of shareholding, although it has not created any problems regarding the distribution of dividends to the end investors, does pose a series of challenges for corporate law and especially for corporate voting.

Under sections 2.1 and 2.2, I examine whether the SRD copes efficiently with the challenges posed by the intermediary system of shareholding.

2.1. The Dysfunctional System of Dissemination of Pre-meeting Information

Member States use a variety of systems to ensure that the custodian appearing as the formal shareholder exercises the voting right in accordance with the end investor’s instructions. For example, under German Law custodians holding registered shares are entered in the registry as ‘shareholders only for legitimation’ (‘Legitimationsakteur’), which means that they are not able to vote without specific

---

14 Since the idea of establishing a regime of proportionality between ownership and control was finally dropped; see Commissioner McCreevy’s Speech (SPEECH/07/592) of the 3 Oct. 2007 at the European Parliament.
16 In March 2010, the Commission sent reasoned opinions to nine Member States (Belgium, Cyprus, Greece, Spain, France, Luxemburg, The Netherlands, Portugal and Sweden) for failure to transpose the Directive.
17 These rights are still sought after as the ‘holy grail’ of shareholder activism on the other side of the Atlantic; for an overview of the shareholder access issue and the conspicuous SEC ‘no-action’ letters in the United States, see Lisa Fairfax, ‘The Future of Shareholder Democracy’, Indiana Law Journal 84: 1259.
20 For the sake of saving space, the following presentation of the weaknesses of the aforementioned synthetic legal framework is meant to be indicative, not exhaustive.
21 Winter, supra n. 18, 372.
23 C.E. Uniken Venema, Effektenverrecht in beweging (Securities Transfer Law in Motion) (2003), 255 ff.
authorization from the end investor. Therefore, since the ultimate decision regarding the voting direction rests – at least theoretically – with the end investor, in order for him to be able to instruct the cast of an informed vote, an efficient system is required that secures the flow of the pre-meeting information through the chain of intermediaries from the issuer down to the end investor. The net position of the end investor regarding his right to be informed should be no worse than it would be in a system of direct holding, where the real investor also appears as the legal holder of the shares vis-à-vis the firm.

There are worldwide two such systems for disseminating pre-meeting information: the ‘push system’, employed in the United States, where after a painful identification process the proxy packet is forwarded either by post or by electronic means to each end investor, and the ‘pull system’, where the convocation of the general meeting (‘GM’) and all necessary information are disseminated through a publication accessible to all end investors, who then take action to have their vote travel up the chain of intermediaries to the issuer. Although the ‘push system’ requires more time between the date of the convocation and the date of the GM, so that everyone can receive the proxy packet, it is more efficient in tackling the conspicuous problem of rational shareholder apathy, as it drives down the costs of voting for the shareholders by eliminating the first layer of costs, that is, information costs.

Therefore, in order to determine how ‘shareholder-friendly’ the dissemination system introduced by the SRD is, we should answer the question of whether it is closer to the push or the pull system. Article 5(2) SRD states that the convocation of the GM is required to be issued ‘in a manner ensuring fast access to it on a non-discriminatory basis’. Exactly the same wording is used in Article 21(2) of the Transparency Directive regarding the dissemination of regulated information; a Directive further clarified by Directive 2007/14/EC. Article 12 of the latter interpretive Directive states that the phrase ‘in a manner ensuring fast access’ means that the pre-meeting information should be communicated to the media. Consequently, if the system established by the SRD is understood in the same way as under the Transparency Directive, then we are essentially dealing with a pull system, incapable of coping with the well-documented challenge of shareholder passivity. Under this system, the real shareholders of a listed corporation, that is, the end investors, are less likely to exercise their voting right, as they remain captive of rational apathy.

However, in my opinion there is an additional and much more serious threat posed to shareholder governance in the EU by the SRD’s pre-meeting information dissemination system. On the one hand, Article 4 mandates the equal treatment of shareholders regarding their participation in the GM. On the other hand, Article 5(2) states that the established pull system is simply a minimum standard, in the sense that it does not displace additional requirements for notification or publication laid down by national corporate laws. This means that Member States can, in principle, keep systems that mandate corporations to ‘push’ the information to a specific category of shareholders (e.g., those that have requested their entry to the shareholders’ registry or those holders of bearer shares that voted in the last GM), while leaving other categories to be informed through the pull system. However, what if a shareholder belonging to the latter category decides to make a case in court that this national rule that allows other shareholders the privilege of the push system runs afoul to the principle of equal treatment provided for in Article 4 of the SRD? Those that have been involved with corporate litigation in the past know that one cannot predict which way the court will go in such cases; consequently, the possibility that a national court will declare the domestic ‘push rule’ as violating the SRD’s principle of equal treatment, thus requiring corporations henceforth to push information to everyone, should not be ruled out. This would mean that corporations – even just for a single annual GM – would have to push information through the chain of intermediaries to the end investors within a time frame designed to be operational when a pull system is applied. One can only imagine how many proxies will not manage to make the trip all the way down to the end investors and all the way up again to the issuer in a period of twenty-one days, when Delaware in the United States has a time frame of sixty days in order to support its fully fledged push system. Even if the corporation voluntarily extends the time frame by issuing the convocation well before the twenty-first day before the GM, the lack of infrastructure in European listed corporations and intermediaries for forwarding material to every single shareholder does not guarantee that materials will be there in time for the GM. Consequently, shareholders will, in essence, be disenfranchised.

24 See s. 135(7) AktG.
26 Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.
29 This rule exists in both Germany and France, see Matteo Gargantini, ‘Shareholder Identification and Voting in Listed Companies: Part 2’, http://ssrn.com/abstract=1469446.
30 This rule exists in Germany, see ibid.
31 Claims regarding the breach of the principle of equal treatment of shareholders in other matters of corporate law are not rare in Europe; see, e.g., UZI BR3523, Hoge Raad, 07/11510 (CW 2516) on how the recent attempt by a Dutch firm to encourage shareholders to register their shares by distributing a loyalty dividend was challenged – although unsuccessfully – before the Dutch Supreme Court on the basis of the principle of equal treatment of shareholders.
32 Section 213 DGCL.
2.2. The Problem of Tight Record Dates and Cut-Off Dates

Corporations that have their shares actively traded in modern capital markets have a shareholder structure constantly in flux.\(^33\) It is, therefore, necessary to set a date, in which those shareholders entitled to vote in the GM will be determined. This date is called the ‘record date’. The record date should be set close to the GM in order to minimize the possibility of having shareholders entitled to vote, who might have sold their shares in the time between the record date and the date of the GM.\(^34\) In other words, the closer the record date is to the GM, the less ‘empty voting’ you get. This is why, for instance, the United Kingdom allows corporations to set a record date that can be as close as forty-eight hours (excluding non-working days) before the GM.\(^35\)

Nevertheless, tight record dates come with a downside; the closer the record date is set to the GM, the less time there is for the proxy packet to travel upwards from the end investor to the issuer (let alone the cases where a push system is applied, so that in the same time frame a downward flow of the materials should take place as well). The SRD does a poor job in facilitating the upwards flow of the material, since it only ensures that issuers allow their shareholders to appoint the proxyholder by electronic means [Article 11(1)]. Still, the digital appointment right is only reserved to the formal shareholder, not the end investor, while voting instructions might still have to be transmitted upwards the old-fashioned way.\(^36\) Forty-eight hours (in the United Kingdom) or three trading days (in Italy)\(^37\) before the GM are simply not enough for custodians, voting agencies, and issuers to process voting entitlements and to reconcile them with voting instructions.

To cope with the tight record date problem, custodians and voting agencies that assist end investors to deal with the voting logistics usually set a deadline well in advance of the record date for the transmission of the proxy and the voting instructions to them; this deadline is called the ‘cut-off date’.\(^38\) The practice of cut-off dates may cause the pathology of overvoting the same position, which if detected by the GM’s tabulator may result in the disqualification of several votes from the GM. Consider the following example: end investor A sends the proxy and the voting instructions to her custodian; the custodian forwards the proxy and the voting instructions to the issuer, who at the same time has set his cut-off date at a point in time later in time; thus, end investor B’s shares are held in custody with a different custodian, who has set his own cut-off date later in time; as a result, the same position will be overvoted, unless the tabulator identifies the share position as inconsistent. In the latter case, the tabulator will most likely disqualify the votes, leaving things to be solved later in litigation, effectively damaging end investor B, who was the only one legitimized to vote at the GM.\(^39\)

All in all, it purports that the SRD and European corporate laws do not deal effectively with the problems of the voting machinery of listed corporations, so that in many cases the shareholders’ voting right is effectively sterilized. The systems established either result in shareholders’ votes not having ample time to arrive properly for the GM (see section 2.1) or in shareholders’ votes not being counted at all (see section 2.2). Consequently, the present status of shareholder voting, ‘the bedrock of governance’,\(^40\) in the EU cannot guarantee an increased role for shareholders in corporate affairs even in the post-SRD era.

3. WHO REALLY VOTES? AN INSIGHT INTO THE ROLE OF PROXY ADVISORS AND CREDITORS IN EUROPEAN CORPORATE GOVERNANCE

We already saw how some shareholders can have their voting right sterilized. However, what happens with the rest, who do not fall victims of the tight deadlines or the overvoting errors of the intermediaries? Are they really casting their vote according to their own risk preferences? Under sections 3.1 and 3.2, I explore the interference of proxy advisors and creditors, who at the same time act as custodians, in corporate voting and the consequences that this has for EU corporate governance.

3.1. An Additional Layer of Agency Costs

The voting research process, that is, the deliberation process resulting in the decision of how to vote, is often outsourced to proxy advisors. The latter recommend to the shareholders how to vote in the GM\(^41\) and often these recommendations are automatically followed by the shareholders, especially by the institutional investors who cannot spend time to check the voting recommendations for the hundreds of corporations in which they hold shares.\(^42\) However, the

---

33 Kahan & Rock, supra n. 25, 1232.
34 Paul Davies et al., ‘Green and Davies’ Principles of Modern Company Law, 8th edn (2008), 465.
35 The Uncertified Securities Regulations 2001, reg. 41(1) and (6).
36 Zetsche, supra n. 28, 51.
37 Article 83 supra n. 28, 29.
38 Gargantini, supra n. 29; Zetsche, supra n. 28, 29.
39 For the pathology of overvoting due to inconsistencies between intermediaries, see Kahan & Rock, supra n. 25, 1255.
41 Usually, the same entities that provide proxy advisory services also provide proxy voting services, but we restrict our analysis here in the former type of services.
involvement of proxy advisors in corporate voting adds a second layer of agency costs in the corporate governance of listed corporations, since the relationship between the shareholder and the proxy advisor gives rise to agency problems of the same kind with those that govern the relationship between the shareholder and the managers.43 Proxy advisors do not bear the weight of their decision and due to their different risk preferences they are likely to recommend a voting policy dissimilar to the one that the residual risk-bearing shareholder would decide, should the latter have had the time to undertake a thorough voting research.

This agency problem is exacerbated by the fact that there seems to be no institutions that can drive these agency costs down,44 as it happens with the various corporate governance institutions that aspire to align the incentives of the managers to those of the shareholders. First of all, there are no market checks in the proxy advisory industry, since the latter is heavily concentrated with Institutional Shareholder Services (ISS) – now acquired by RiskMetrics Group – holding the lion’s share in the European market of proxy advisory services, so that consumer switching costs are abnormally high thus creating a high barrier for entry of a new player in the industry.45 In addition to this, the absence of a regulatory check on the proxy advisory services industry46 increases the non-transparency of the way proxy advisors produce their recommendations, thus hindering their effective monitoring on behalf of the principal/shareholders. The market conditions and the regulatory vacuum, in which proxy advisors function, give them tremendous power in the corporate world47 effectively making management to want to ingratiate themselves more with the proxy advisors rather than with the shareholders.

3.2. Supporting Director Liability Discharge Proposals

Unfortunately, the damaging role of proxy advisors for shareholder governance in the EU does not restrict itself to the adulteration of the genuine expression of the shareholders in a GM but also extends to the impairment of the system of corporate checks and balances. This is because proxy advisors consistently recommend the approval of resolutions proposing the discharge of director liability.48 Given the fact that shareholders often follow proxy advisors’ recommendations automatically, it should not surprise us that such discharge resolutions are frequently endorsed in GMs of European firms. While in some jurisdictions a discharge vote is not binding and cannot shield directors from claims for damages (e.g., Germany, France), in other jurisdictions a discharge vote can effectively block the avenues of corporate litigation (e.g., The Netherlands, Greece),49 by stripping all shareholders – regardless of how they voted – of their right to file a derivative suit for issues not involving willful misconduct or fraud.50 Consequently, proxy advisors contribute to further managerial entrenchment.

3.3. The Voting of ‘Blank Proxies’ by Creditors

The activities of proxy advisors are not the only reason why the shareholder vote in a GM often does not constitute the genuine expression of a residual risk bearer. In several European jurisdictions, the law allows the custodians to vote the share that is deposited with them in case the end investor fails to issue voting instructions. In other words, there is a presumption that the end investor’s inertia constitutes an implicit consent to the exercise of the voting right by the custodian. In these cases, the custodian is not bound by any form of hypothetical voting instructions and is thus free to choose her own voting policy on the end investor’s behalf.51

This practice of ‘blank proxies’ might be useful in order to help corporations meet the quorum requirements for a GM but, at the same time, gives rise to a great deal of conflict of interests within the scope of the process of corporate voting that ultimately weaken the overall position of equity holders within the firm. For instance, a custodian bank may, at the same time, be a creditor of the corporation; this is a conflict of interest that should normally be enough in order to disqualify the custodian bank from voting as proxyholder. However, this case is not included in the indicative list of Article 10(3) SRD, which refers to those conflicts of interest that should lead to the restriction of the exercise of a voting right by the proxyholder. The absence of such a conflict-of-interest rule even from national corporate laws has led to an increase in the influence of major creditors in public corporations52 that undoubtedly damages the shareholders, whose interests conflict with those of the debt-holders. The latter have subscribed for a different income stream that generates to managers a reduced appetite towards risk. This is an incentive structure that does not fit with the shareholders’ risk

---

45 Verdam, supra n. 42, 47; Belinfanti, supra n. 44, 408.
46 Verdam, supra n. 42, 82; Belinfanti, supra n. 44, 422.
51 Gargantini, supra n. 29.
preferences, who by being the residual claimants want managers to take more risks. Therefore, the custodian/creditor vote cannot be a genuine expression of the equity holders’ will, as it is an exercise of ‘perverse ownership’. In light of the above, we need to question ourselves about who really stands behind a corporate ballot and what interests does she serve. The power of a single proxy advisor providing its services to a great range of institutional investors with an ostensibly diverse profile makes as wonder how ‘pluralistic’ our firms’ ownership really is and whether this shareholder homogenization resulting from the fact that everyone follows the same voting advice creates the appropriate environment for the nurture of a true corporate democracy.

4. THE LEGAL BARRIERS TO SHAREHOLDER ACTIVISM

4.1. The Procedural Deadlock of Putting Items on the Agenda

The SRD introduced on an EU-wide basis the right to put items on the agenda of the GM and to table draft resolutions (Article 6). While this may, at first sight, seem as a victory of the shareholder activism movement, the procedural details regarding the exercise of this right reveal that this might be a hasty conclusion.

Given the fact that large blockholdings still prevail in European listed corporations, so that at least big shareholders are, in practice, able to influence the agenda as ‘insiders’ without having to exercise the formal right awarded to them by Article 6, the latter right is established in order to empower minority shareholders. However, several minority shareholders may still be below the 5% threshold required to add items to the agenda or to table a draft resolution53 and thus in order to be eligible to exercise such rights they will have to join forces with other shareholders.54 The first step for a small shareholder to move towards such an alliance is to identify other shareholders and communicate with them. However, between the shareholders and the managers there is an informational asymmetry regarding the identification of shareholders, in the sense that if a shareholder wants to inquire into the shareholder structure, in order to locate allies to put items on the agenda, he will have to contact the issuer for the identification procedure to be effectuated55 and still this right might not be granted just to any shareholder. For instance, in the United Kingdom only shareholders holding at least 10% of the equity capital have the fully fledged right to order the issuer to conduct an enquiry into the beneficial ownership, so that end investors may be identified;56 shareholders holding less than 10% only have the right to inspect the share registry, in order to identify the formal shareholders, so they will have then to bear the costs of piercing through the chain of intermediaries. In other countries, such as Germany, shareholders do not have the right at all to inspect the share registry and thus the identification process for the sake of establishing an alliance becomes practically impossible.57 Finally, there are jurisdictions, such as The Netherlands, where listed shares are – and can only be – bearer shares, so that there is no share registry at all that the shareholder can use a starting point, if he wants to join forces with others. This defective intra-shareholder communication legal infrastructure practically sterilizes the formal right of minority shareholders to put items in the agenda and to draft table resolutions, at least where percentage thresholds stand in the way of the eligibility to exercise this right.

However, even in the case where shareholders are eligible to put autonomously items on the agenda, the deadline set by national corporate laws, in order for them to exercise their right (e.g., in Italy, five days after the publication of the GM),58 does not provide them with ample time to reflect on the agenda and submit additions. This hinders significantly the exercise of the right to put items in the agenda effectively restricting it to when shareholders exert their statutory right to set an agenda themselves by calling for an extraordinary meeting.

4.2. The Legal Risks of Proxy Solicitations

Placing items on the agenda or tabling a draft resolution does not make much sense, if the shareholder does not take any further action to secure support for her proposals from fellow shareholders. Therefore, the insurgent shareholder needs to collect proxies. This is called ‘proxy solicitation’ and what it generates is called a ‘proxy contest’. Contrary to what happens in the United States, proxy contests are extremely rare in Europe59 and have generally proved to be a non-effective tool for shareholders to exert pressure on the management.60 This is largely due to the fact that there are unfortunately legal risks associated with the initiation of a proxy solicitation.

The Takeover Directive61 introduced on an EU-wide basis the so-called mandatory bid rule [Article 5(1)]. The mandatory bid rule requires investors, who by ‘acting in concert’ acquire a significant percentage of the corporation’s voting rights or who coordinate their voting conduct in a way that leads to the formation of a ‘voting block’ that surpasses a specific threshold (defined by national corporate laws

53 In some jurisdictions, the threshold for putting items on the agenda is lower than 5%; for instance in Italy, it is 2.5% (Art. 12bis of the Consolidated Law on Financial Intermediation).
55 Gargantini, supra n. 29.
56 Section 804 of the Companies Act 2006.
57 Section 67(6) AktG; Siems, supra n. 54, 140
usually at 30%), to extend a bid for all the remaining shares. This purports to be absolutely fair, when taking in mind the need for minority shareholder protection. However, paradoxically, the mandatory bid rule asserts its application even in cases of harmless proxy solicitations.

The problem arises by the fact that the term ‘acting in concert’ is vague enough to create the impression that even a group of insurgent shareholders that forms an alliance in response to a single proxy solicitation could be covered by the term’s scope. This would mean that the group could be required to launch a bid for all the shares that did not pick the insurgents’ side within the proxy contest. There have been cases of proxy fights in Europe that were litigated on the basis of a stretched application of the mandatory bid rule and despite the fact that courts so far have refused to acknowledge the existence of an obligation on behalf of the cooperating insurgents to make a bid for all the shares, the mere risk of having minority shareholders or the supervising authorities filing a claim in court and requesting the application of the mandatory bid rule is enough to deter the initiation of proxy contests or other forms of voting cooperation in Europe.

All things considered, it seems that the right of shareholders to put items in the agenda and to table draft resolutions established by the SRD will remain ‘empty letter’ if other parts of European corporate law are not reformed.

5. THE BLOCKED AVENUES OF CORPORATE LITIGATION

One of the most powerful tools that shareholders possess in order to mitigate the agency problem within the firm is the derivative suit. However, available data show that shareholders in most European jurisdictions have made very little use of this tool, as they have to clear several hurdles before bringing an action that stands good chances for being successful.

When it comes to the design of a corporate litigation system, two competing goals must be balanced: on the one hand, the goal of the prevention of managerial abuses and, on the other hand, the goal of the prevention of frivolous suits. Given the disappointingly low number of derivative suits in almost all EU jurisdictions, it seems that European legislators’ scale has tilted more towards the latter goal with the result being that not only frivolous suits but also meaningful suits are prevented.

There are several reasons that could explain the de facto triviality of corporate litigation, as a decisive determinant of European corporate governance. Apart from the well-known problems created by the application of the business judgment rule, which are not unique to European corporate laws, I can identify four European-specific reasons, for which corporate litigation is so under-developed:

(i) shareholders are required to hold a minimum amount of shares in order to be granted standing to file a derivative suit (‘percentage limits’); (ii) the rules regulating litigation costs are unfavourable to the shareholders; (iii) end investors are not provided with standing for filing a derivative suit; and (iv) multiple derivative suits are not allowed to prevent abuses in corporate groups.

5.1. The Consequences of Percentage Limits

In most European jurisdictions – with the exception of the United Kingdom – the right to litigate is not recognized as an individual right of the shareholder but as a stricto sensu minority protection, in the sense that there are percentage limits for filing a derivative suit. It has been claimed that the existence of percentage limits encourages collusive agreements between the managers and those shareholders that hold share blocks that make them eligible for the filing of a derivative suit (e.g., 5% in Spain, 10% in Austria). This is how the argument goes: when the manager identifies a self-dealing opportunity and wants to take advantage of it, the manager has to find a way to fend off against the potential of a future shareholder suit that will require him to pay damages to the corporation. If there are percentage limits, then the manager can make a pre-trial settlement offer to those shareholders exceeding the percentage limits (or just bribe them). If this offer provides the shareholders with more than they would get pro rata if the corporation were awarded damages following a successful derivative suit, then it is in their interest to accept the offer.

62 For example, under German law, see s. 302(2) of the Wertpapierubernahmegesetz.
64 For an account of how the ‘acting in concert’ term proved to be a trap for activist shareholders in The Netherlands, see Strik, supra n. 60, 36.
65 See, e.g., Baums & Scott, supra n. 59, 65.
66 Santella et al., supra n. 63, 25.
70 The problems created by the business judgment rule are the reason why some EU jurisdictions are still reluctant to introduce it into their corporate law. For the skepticism developed in the Dutch legal literature regarding the potential of introduction of some version of the business judgment rule, see Bastian Assink, ‘Naschrift bij “Delaware Revisited, een mini-enquête”’ (“Epilogue for “Delaware Revisited, a Mini-inquiry Proceeding”), Ondernemingsrecht 2008–2009: 356 ff.
71 The entrenchment enjoyed by the application of the business judgment rule in the United States has led to the rule being characterized as ‘abstention doctrine’; see Stephen Bainbridge, ‘The Business Judgment Rule as Abstention Doctrine’, Vanderbilt Law Review 57: 83.
72 See s. 370(5) of the UK Companies Act of 2006.
73 Latella, supra n. 69, 8.
74 Grechenig & Sekyra, supra n. 67, 1.
manager’s offer. Now that the large shareholders, who were eligible to file a derivative suit alone, are not interested in chasing the managers down, the only cure for the tunnelling that took place would be an alliance of those minority shareholders, who fall below the percentage limits, so that they can in aggregate exceed the percentage limit and thus acquire the procedural power to file a derivative suit. Unfortunately though, as we explained in section 4, the dysfunctional system of intra-shareholder communication makes it practically impossible for shareholders to access the contact data of fellow shareholders, so that they can join forces; and no access to the contact data in this case means no derivative suit at all.

5.2. The Unfavourable Regulation of Litigation Costs
The fact that the United States could be characterized as a ‘corporate litigation haven’, compared to Europe, could be attributed to the fact that US law has constructed an incentive system that rewards the attorneys of the shareholders that have prosecuted a meritorious claim; the plaintiffs’ attorneys are paid a percentage of the sum agreed within a settlement or determined by the court’s adjudication. This results in attorneys actively seeking to recruit shareholders to engage in derivative litigation. In essence, the contingent fee system in the United States has expanded the role of lawyers as corporate governance gatekeepers, ensuring a healthier function of the corporate system of checks and balances compared to Europe.

In Europe, it is less likely that the shareholder who brought a successful derivative action before court will be awarded attorney’s fees by the court. The shareholder’s only reward is that the damages are paid to the corporation and thus the value of her shares increases pro rata. However, that could be just pennies on the dollar. Thus, a cost-benefit analysis often leads European shareholders to the decision not to file a derivative suit, since it would be a major cost with a minimal benefit.

5.3. Leaving End Investors Out of the Litigation Game
The custodial ownership system is also another factor that makes derivative litigation costlier for the shareholders. In the majority of European jurisdictions, it is still unclear whether the end investor, as the equitable owner of shares, has the procedural power to file a derivative suit or whether the only person who has standing for such an action is the formal shareholder, that is, the one who holds the shares as custodian or nominee. Thus, where there is no direct holding system, instructions regarding the filing of a derivative suit must travel upwards the chain of intermediaries until the custodian, who is by law granted the formal right to file, can take action. For instance, neither in the United Kingdom nor in Ireland is there case law on the question of whether the beneficial owner of shares is entitled to file a derivative action on behalf of the company. Thus, the person to whom the real benefits from the compensation that might be paid to the firm will accrue cannot move alone towards the direction of filing a derivative suit.

The Netherlands purports to be one of the very few jurisdictions in Europe – if not the only – that has explicitly granted the right to litigate to persons other than the formal shareholders and has specifically done so with respect to holders of non-voting depositary receipts. The latter have the procedural power to initiate an inquiry into aspects of the board’s policy and transactions and to request definitive remedies of non-pecuniary nature if mismanagement is indeed identified within the scope of the inquiry. This may not be a derivative suit, as it is not aimed at holding directors liable, but it has proven to be an important litigation vehicle that Dutch investors may use to influence corporate life. However, The Netherlands’ case is unique in the sense that a good deal of Dutch firms’ equity financing was until recently traditionally effected not through paradigm stock but through non-voting depositary receipts trading in the stock markets; the economic reality of the Dutch capital markets pushed the Dutch Supreme Court to look beyond the share registry in this respect. It remains a question whether the economic reality created by the growing tradition of indirect shareholdings in other EU jurisdictions will lead to the acknowledgment of a similar right to end investors.

The granting of the right to litigate to end investors, so that additional pre-litigation costs may be eliminated, requires a radical re-conception of who the stakeholders of the modern firm really are and a departure from the formalities of property law that govern the
share ownership regime and the concomitant rights that attach to shares. However, unfortunately the legal system usually adjusts slowly to economic reality. In the meantime, management will keep on being in no meaningful way accountable for what it does.

5.4. The Absence of Multiple Derivative Suits
Consider the following case: firm A is a subsidiary of firm B. A self-dealing transaction takes place at the level of firm A. The tunnelling is orchestrated and designed – despite the statutory autonomy of interests of firm A – by firm B’s management, since B has control over the management of A. With the exception of firm B, firm A only has a handful of shareholders, who all fall below the percentage limits required to challenge the tunnelling occurred. The only shareholder eligible for filing a derivative suit on behalf of A is firm B represented through its managers, who however took part in and benefited from the self-dealing. Apart from the shareholders of the subsidiary, the shareholders of firm B are also damaged. As a result of the self-dealing transaction, a business opportunity that would drive the profit of firm A up, thus increasing the dividends distributed to parent B was misappropriated by the managers for their own benefit.

Now smaller dividends paid to B means less profits for B, thus smaller dividends for B’s shareholders. Provided that A’s shareholders do not have the right to litigate, can B’s shareholders bring a derivative suit on behalf of A? This is the question of the so-called ‘double derivative suit’.86

In the aforementioned case, the only thinkable remedy would be the filing of a derivative suit by the shareholders of the parent; otherwise the wrongdoing, albeit damaging, will remain legally irressipable. It goes without saying that multiple derivative actions are necessary in order to expose abuse of powers within corporate groups.87 However, contrary to what happens in the United States,88 in Europe a multiple derivative suit is not allowed. In general, the term ‘multiple derivative suit’ is used for those actions that are raised on behalf of a firm, which constitutes a different legal person from the one in which the litigant holds shares; see Phillip Blumberg et al., *Blumberg on Corporate Groups*, vol. I, 2nd edn, § 44.02.

In the aforementioned case, the only thinkable remedy would be the filing of a derivative suit by the shareholders of the parent; otherwise the wrongdoing, albeit damaging, will remain legally irressipable. It goes without saying that multiple derivative actions are necessary in order to expose abuse of powers within corporate groups.87 However, contrary to what happens in the United States,88 in Europe a multiple derivative suit is not allowed. In general, the term ‘multiple derivative suit’ is used for those actions that are raised on behalf of a firm, which constitutes a different legal person from the one in which the litigant holds shares; see Phillip Blumberg et al., *Blumberg on Corporate Groups*, vol. I, 2nd edn, § 44.02.

6. CONCLUSION
One of the biggest bets of the regulatory frenzy that ensued as a result of the ongoing financial/economic crisis is to restore public confidence in the securities markets. The fragility of the financial instruments has driven investors away from the capital markets in search of safer investments. A way to enhance trust in the stock market is to allow the shareholder to have more control over his investment, which can be realized only by displacing the current regime, where the board and a series of intermediaries control how the shareholders exercise their powers. Ownership is effectively sterilized and cannot even begin to germinate if we do not make a serious effort to regulate all those service providers, such as proxy advisors, credit-rating agencies, share custodians, and voting agents, who without having a stake in the firms affected by their activities, they effectively pull the strings of corporate governance. The gap between ownership and control must close, but in the twenty-first century ‘control’ cannot simply signify the management; it should also mean all these intermediaries, who act in a regulatory vacuum and have all that non-legitimized power over the corporate world. Without allowing the shareholders to monitor and influence what goes on in this ‘black box’ that the firm is and without allowing them to hold those that have damaged them accountable, our capital markets will have to wait for long to see flesh-and-blood investors, who exercise responsible ownership and can resurrect our financial system, back in the game and will thus remain captive of those that treat their shares as betting slips.

86 If the question were whether the parent’s shareholders may bring a derivative suit on behalf of a second-tier subsidiary, then the issue would be whether a ‘triple derivative suit’ is allowed. In general, the term ‘multiple derivative suit’ is used for those actions that are raised on behalf of a firm, which constitutes a different legal person from the one in which the litigant holds shares; see Phillip Blumberg et al., *Blumberg on Corporate Groups*, vol. I, 2nd edn, § 44.02.


88 Blumberg et al., supra n. 86, s. 44.02.


90 Although in Germany such phenomena were partially addressed through the Holtzmueller and Gelatine adjudications (see Marc Löbbe, ‘Corporate Groups: Competences of the Shareholders’ Meeting and Minority Protection: The German Federal Court of Justice’s Recent Gelatine and Macrotron Cases Redefine the Holzmüller Doctrine’, *German Law Journal* 5:1058), other countries do not have similar provisions in their legal system to prevent the oppression of shareholders within group structures; Steef M. Bartman & Adriaan Dorrestijn, *Van het Concern (On the Corporate Group)* (2009), 107.
European Company Law

Submission Guidelines

ECL's Editorial Board encourages all readers to send in (proposals for) contributions and ideas on contributions for publication. Contributions may deal with European company law in a broad sense, including such topics as codetermination law, insolvency law and securities law. All contributions should follow ECL's SCIP-principle, which welcomes articles that are scientific, concise, informative and practical. Contributions should have a range of approximately 4,000 to 5,000 words (footnotes excluded), and should be sent to both ECL's main editor (s.m.bartman@law.leidenuniv.nl) and to its editorial secretary (c.degroot@law.leidenuniv.nl).

At the author's request, contributions will be peer reviewed by at least two members of ECL's Editorial Board. Publication in ECL is subject to authors signing a "Consent to Publish & Transfer of Copyright" form on behalf of Kluwer Law International.