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The European Alternative to Uniformity in Corporation Laws

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THE EUROPEAN ALTERNATIVE TO UNIFORMITY IN CORPORATION LAWS

*Alfred F. Conard**

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PREFACE

Although the European Communities¹ chose many patterns of business law that were parallel to the American, they deliberately rejected the American freedom of each state to frame its corporation law to suit itself. They decided to impose not complete uniformity, but a degree of "coordination" of "equivalent safeguards" that they deemed

1. Although the expression "European Communities" ends with an "s," it refers to a singular governmental entity, as does the equally plural "United States." Unlike the United States today, the Communities are usually juxtaposed with a plural verb ("are," not "is") as were the United States before the Civil War. See 3 S. FOOTE, *THE CIVIL WAR* 1042 (1974).

The plurality in the Communities' designation reflects the fact that before the merger of their institutions by the Single European Act of 1987, 30 O.J. EUR. COMM. (No. L 169) 2 (1987) [hereinafter *Single European Act*], three separate European Communities — the Coal and Steel Community, the Economic Community, and the Atomic Energy Community — acted independently of each other. The only one of these involved with corporation law was the Economic Community, which issued the directives and other proposals on the subject until July 1, 1987. Since that date, the united Communities have been the issuer. Although I will try to designate correctly the issuer of any particular order as the Community or the Communities, I will use the word "Community" as an attributive without distinction between the successive organizations. I will, for instance, refer to the "Community Council" and to "Community directives" to include the instruments of both the European Economic Community and the European Communities.

appropriate to the existence of an economic union.² Leading commentators have described the process as "harmonization."³

The decision to coordinate stimulates reflection on the relative merits of the American system of giving states a free choice of corporation regimes, restricted only marginally by federal securities regulation, and the European system of "minimum standards." The "safeguards" that leaders of other industrial societies have chosen as appropriate means of promoting prosperity in a market economy offer Americans a challenging example of such standards.

I. WHY COORDINATE?

A. *The Silence of the Founders*

The Community founders, for whom the United States was a case study yielding both positive and negative lessons, were surely aware of the competition among American states to attract corporations,⁴ in a

2. The principal authority for enforcing conformity among company laws of the Communities' member states authorizes the Community organs to promote "freedom of establishment" within the Communities by, among other means —

coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms . . . with a view to making such safeguards equivalent throughout the Community

Treaty establishing the European Economic Community, Mar. 25, 1957, art. 54(3)(g), *reprinted in* OFFICE FOR OFFICIAL PUBLICATIONS OF THE EUROPEAN COMMUNITIES, TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 225 (1973) [hereinafter Treaty]. This is the wording in the English text issued by the Communities Office for Official Publications in 1973, and is a translation of original texts in Dutch, French, German, and Italian. An earlier English text, issued by the Communities in 1962, used in place of "safeguards" the word "guarantees," which consequently appears in earlier discussions of the coordination program. *See, e.g.,* E. STEIN, *supra* note *, at 36-41. "Guarantees" was presumably chosen in the earlier translation because of its resemblance to the *garanties* of the original French text. The corresponding word in the original German text was *Schutzbestimmungen*, which might be literally translated as "protection clauses."

Although "safeguard" is not common coin of American corporate literature, Hurst wrote of measures to "safeguard creditors" as an apparent synonym for measures to "protect creditors." J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970*, 52-53 (1970). Other authors have generally written of "protecting" creditors and investors. *See* L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 29 (1983); Douglas, *Protecting the Investor*, 23 *YALE REV.* 521 (1934).

3. The literature on coordination of safeguards employs the caption "harmonization" in order to embrace not only "coordination" of company laws under article 54(3)(g), of treatment of foreigners under article 56(2), of licenses for regulated trades under article 57(2) and (3), of exchange controls under article 70(1) of the Treaty, *supra* note 2, but also "approximation" under article 27 (customs) and miscellaneous laws under article 100(1); "harmonization" of taxes under article 99(1), of export subsidies under article 112(1), and of social policies under article 117(1); and "uniformity" in commercial policies under articles 111(1) and 113(1). *See* E. STEIN, *supra* note *, at 11-12.

4. *See* Romano, *The State Competition Debate in Corporation Law*, in *CORPORATE LAW AND ECONOMIC ANALYSIS* 216 (L. Bechuk ed. 1990); R. WINTER, *GOVERNMENT AND THE CORPORATION* (1978); Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 *J. LEGAL STUD.* 251 (1977). On the evolution of U.S. state corporation laws from regulatory to permissive, *see* J. HURST, *supra* note 2, at 52-53.

rivalry characterized polemically as a "race for the bottom,"⁵ as a "climb to the top,"⁶ and more analytically as a "race of laxity."⁷

Departing at the outset from the example of the U.S. Constitution, which made no mention of corporations, the constitution of the European Economic Community ("the Treaty"⁸) not only mentioned corporations (as "companies"⁹) but expressly authorized the Community to establish what Americans might call "minimum standards."¹⁰ The Treaty called them "safeguards . . . for the protection of the interests of members and others," and authorized the Community legislature to "coordinate" them "to the necessary extent . . . with a view to making such safeguards equivalent throughout the Community."¹¹

By mid-1991, the Community had issued nine directives on company law, requiring "equivalent safeguards" in regard to incorporation, public filing, and financial reporting by domestic and foreign corporations, creation and maintenance of capital, domestic and interstate mergers, split-ups and split-offs, and accounting and auditing.¹² Other directives on governance (including the voice of labor), on

5. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 705 (1974).

6. See Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 920 (1982).

7. This was the term coined by Justice Brandeis in *Liggett v. Lee*, 288 U.S. 517, 559 (1933) (Brandeis, J., dissenting). Although Brandeis condemned the race of laxity, the term itself seems more descriptive than polemic. Under Fischel's analysis, *supra* note 6, laxity is a virtue.

8. Treaty, *supra* note 2.

9. In British English, the variety used in the Treaty, incorporated business enterprises are commonly known as "companies." See, e.g., L. GOWER, *PRINCIPLES OF MODERN COMPANY LAW* (4th ed. 1979); R. PENNINGTON, *COMPANY LAW* (5th ed. 1985).

10. See Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947 (1990); cf. Cary, *supra* note 5, at 696-703.

11. Treaty, *supra* note 2, art. 54(3)(g), at 225.

12. First Directive (on incorporation and registration), No. 68/151/EEC, 11 J.O. COMM. EUR. (No. L 65) 8, 1 Common Mkt. Rep. (CCH) ¶ 1351 (1968); Second Directive (on capital), No. 77/91/EEC, 20 O.J. EUR. COMM. 1 (No. L 26) 11, 1 Common Mkt. Rep. (CCH) ¶ 1355 (1977); Third Directive (on mergers), No. 78/885/EEC of Oct. 9, 1978, 21 O.J. EUR. COMM. (No. L 295) 36, 1 Common Mkt. Rep. (CCH) ¶ 1361 (1978); Fourth Directive (on accounts and their publication), No. 78/660/EEC, 21 O.J. EUR. COMM. (No. L 222) 11, 1 Common Mkt. Rep. ¶ 1371 (1978); Sixth Directive (on "divisions," sometimes known as "split-ups" and "split-offs"), No. 82/891/EEC, 25 O.J. EUR. COMM. (No. L 378) 47, 1 Common Mkt. Rep. (CCH) ¶ 1411 (1982); Seventh Directive (on consolidated accounts of affiliated groups), No. 83/349/EEC, 26 O.J. EUR. COMM. (No. L 193) 1, 1 Common Mkt. Rep. (CCH) ¶ 1421 (1983); Eighth Directive (on auditors), No. 84/253/EEC, 27 O.J. EUR. COMM. (No. L 126) 20, 1 Common Mkt. Rep. (CCH) ¶ 1431 (1984); Eleventh Directive (on filing by branches of foreign companies), No. 89/666/EEC, 32 O.J. EUR. COMM. (No. L 395) 36, 1 Common Mkt. Rep. (CCH) ¶ 1443 (1989); Twelfth Directive (on one-member companies), No. 89/667/EEC, 32 O.J. EUR. COMM. (No. L 395) 40, 1 Common Mkt. Rep. (CCH) ¶ 1447 (1989).

Frank Wooldridge counted 11 company law directives by including two that the Commission had not included in its ordinal enumeration, and that related not to companies in general but to banks and other credit institutions. See F. WOOLDRIDGE, *COMPANY LAW IN THE UNITED KINGDOM AND THE EUROPEAN COMMUNITY* 6-7 (1991).

transnational mergers, and on takeovers were on the horizon.¹³

The desirability of coordinating, rather than permitting the "race of laxity" that was flowering on the American scene, seems to have been taken for granted by the Community founders. Stein's exhaustive analysis of the origins of the coordination program reports rivalry among Eurocrats for administration of the program,¹⁴ but no exposition of reasons for coordinating in the first place.¹⁵ The principal expression of reasons for coordination cited by Wooldridge (writing in 1991) was an internal Community document of 1988.¹⁶ Buxbaum and Hopt (in 1988) discussed economic and political arguments for and against coordination, but did not contend that these considerations were in the minds of Community founders.¹⁷

The Treaty article that authorizes the program deepens the mystery. The power to require "equivalent safeguards" is one of eight powers granted for the purpose of implementing "freedom of establishment," which embraces the freedom of individuals to work, reside, and acquire property in states of which they are not citizens.¹⁸ A related article provides that companies have these rights to the same extent as individuals.¹⁹

But the imposition of equivalent safeguards is not a grant of free-

13. Amended proposal for a Fifth Council Directive on the structure of public limited companies, 26 O.J. EUR. COMM. (No. C 240) 2, 1 Common Mkt. Rep. (CCH) ¶ 1401 (1983) [hereinafter Fifth Directive 1983]; Proposal for a Tenth Council Directive on cross-border mergers of public limited companies, 28 O.J. EUR. COMM. (No. C 23) 11, 1 Common Mkt. Rep. (CCH) ¶ 1439 (1985) [hereinafter Tenth Directive 1985]; Amended Commission proposal for a Thirteenth Council Directive on company law, concerning takeover and other general bids, 33 O.J. EUR. COMM. (No. C 240) 7, 3 Common Mkt. Rep. (CCH) ¶ 60,200 (1990) [hereinafter Thirteenth Directive 1990].

14. E. STEIN, *supra* note *, at 173-87.

15. Stein seemed to assume that harmonization of company laws was an essential element of "a coherent legal order," which was necessary to make a unified economic system work. *Id.* at 6. He reported that coordination became in practice a tool for persuading members to remove restrictions on foreign companies, although he doubted that this was the intention of the authors of the Treaty. *Id.* at 37.

16. F. WOOLDRIDGE, *supra* note 12, at 10 n.46.

17. See R. BUXBAUM & K. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE 8-11 (1988). The authors do not purport to analyze the motives of the Community founders, but only the considerations that seemed relevant to these authors in 1986.

18. Treaty, *supra* note 2, art. 54, at 224. Paragraph 1 of the article directed the Council to abolish restrictions of freedom of establishment. Paragraph 2 directed the Council to issue directives to achieve abolition. Paragraph 3 directed the Council to promote freedom in various particular ways, such as abolishing procedures and practices that form obstacles, ensuring the rights of citizens of one state employed in another to remain in the state, allowing citizens of one state to acquire property in other states, and assuring that freedom of establishment is not distorted by local subsidies. The subparagraph on "safeguards" was the only clause of the article that did not directly further freedom of establishment, but ordered creation of conditions that would make freedom of establishment more acceptable.

19. Treaty, *supra* note 2, art. 58, at 227. See Reindl, *Companies in the European Community: Are the Conflict-of-Law Rules Ready for 1992?*, 11 MICH. J. INTL. L. 1270, 1271-72 (1990).

dom, like the other clauses of the paragraph. The question remains: How was it supposed to contribute to freedom of establishment? The question is particularly puzzling to an American, who witnesses freedom of corporate lawmaking without "safeguards" other than those imposed by federal regulation of securities transactions.

To find plausible answers, one must look beyond promotion of "freedom of establishment." I will offer some hypotheses based largely on speculation.²⁰

B. *Balance and Stability*

Freedom of establishment was not listed among the primary objectives of the Treaty, but as a means²¹ of achieving objectives that were announced in these terms:

The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living, and closer relations between the States belonging to it.²²

While the Community founders may have admired the productivity of the U.S. economy, they surely did not consider it ideal in all respects. In the 1950s, when the Treaty was framed, its architects had not forgotten the American depression of the 1930s, which they sometimes blamed for their own economic troubles of the same era. They knew that reckless corporation finance was widely blamed as a contributing cause of the depression, and that the American Congress had rushed in 1933 and 1934 to supplement lax state corporation laws with rigorous federal securities laws.

When the Community founders articulated their aspiration for "continuous and balanced expansion," and for "an increase in stability," they may well have been contemplating an economy more balanced and more stable than the one they had observed in America. They may have believed that these objectives could be achieved only

20. My speculations are guided partly by conversations with various European company law scholars, including some while I was permitted to sit in 1965 with members of a Community working party on the content of coordination directives. The working party comprised leading experts from each of the six states that were then members of the Economic Community. However, they did not discuss reasons for coordination; their reasons could be inferred only from their preferences among safeguards.

21. Article 3 of the Treaty, *supra* note 2, at 179, lists freedom of establishment, along with the elimination of interstate customs duties and nine other measures as activities to be carried on, "For the purposes set out in Article 2" Article 2 is quoted in the text accompanying note 22, *infra*.

22. Treaty, *supra* note 2, art. 2, at 179.

by forestalling a race of laxity, and ensuring that company laws throughout the Community would require financial disclosure, fiscal prudence, and managements responsible to their constituents.

C. *Gypsies at the Gate*

The demand for safeguards may also have been a response to apprehension in each country that less reliable and less responsible companies of foreign countries would invade, and separate citizens from their wealth or their labor. The article that authorized coordination began by mandating the abolition of all restrictions on doing business by corporations of one Community state in another.²³ When foreign corporations were admitted to a state, investors, customers, suppliers, moneylenders, and employees in the host state would be exposed to the enticements and the risks of corporations over whose organization and finance the host state would have no control.²⁴

This exposure would radically change the preexisting situation. Before the Communities existed, each European state was free to exclude corporations of any other state from transacting business in the state.²⁵ If a host state admitted a foreign corporation, the host could regulate or tax the guest in any way it chose. Many bilateral treaties of friendship and commerce were signed to limit the degree of discrimination, but discrimination remained substantial.²⁶

The position of foreign corporations in pre-Community Europe can be compared to that of out-of-state corporations (also called "foreign") in the United States of the nineteenth century. The U.S. constitutionmakers had sought to assure freedom of commerce by discouraging states from imposing import and export taxes,²⁷ and granting to citizens of each state the rights of citizens in other states

23. *Id.* art. 54(1), at 224.

24. E. STEIN, *supra* note *, at 37; Abeltshauser, *Towards a European Constitution of the Firm: Problems and Perspectives*, 11 MICH. J. INTL. L. 1235, 1246-47 (1990). But see Coleman, *The Fifth Directive and the European Company Statute*, 10 BULL. COMP. LAB. REL. 247 (1979) (suggesting that safeguards were to be coordinated to relieve companies of the burden of complying with differing requirements in each state).

For a recent account of an underregulated Luxembourg bank that precipitated losses in other countries, see Forman, *BCCI Debacle Leaves an African Country All the More Troubled*, Wall St. J., Aug. 6, 1991, at A1, col. 1; Truell, *BCCI Is Fined by the Fed and Faces Fraud Charges*, Wall St. J., July 30, 1991, at A3, cols. 1-2; Truell, *Clifford Resigns Bank Post, Casualty of BCCI Scandal*, Wall St. J., Aug. 14, 1991, at A3, cols. 1-2.

25. E. STEIN, *supra* note *, at 37.

26. *Id.*

27. U.S. CONST. art. I, § 10, cl. 2. To be more specific, the clause excluded export and import taxes unless they were authorized by Congress and their proceeds paid to the U.S. Treasury, thus eliminating most of the incentive for states to levy them.

that they might enter.²⁸ But the founders did not mention corporations, which were too rare in the 1780s to attract their attention.

When the right of corporations of one state to enter another was asserted before the Supreme Court, the Court ruled, in an opinion by Chief Justice Taney, that freedom of movement could not be claimed by citizens operating through corporations.²⁹ Not only did a corporation lack rights outside its home state; it could "have no legal existence outside of the boundaries of the sovereignty by which it was created."³⁰

In order to do business in more than one state during years in which Taney's ontology of corporate nonexistence prevailed, enterprisers commonly formed a separate corporation in each state in which they wanted to operate, or reincorporated in other states so that the enterprises became simultaneously a corporation of more than one state.³¹

The burdens of being "foreign" in a neighboring state were alleviated in 1888, when the Supreme Court decided that out-of-state corporations were entitled as "persons" to due process under the fourteenth amendment of the U.S. Constitution.³² The burdens were further diminished in 1910, when the Court invoked the equal protection clause of the fourteenth amendment to outlaw most forms of discrimination against out-of-state corporations.³³ In the armor of due process and equal protection, enterprises could incorporate in Delaware and do business where they chose.

The incubus of nonexistence survived in rules that denied access to

28. U.S. CONST. art. IV, § 2, cl. 1. The clause was held to invalidate discriminatory taxes on nonresidents, *Austin v. New Hampshire*, 420 U.S. 656 (1975); *Toomer v. Witsell*, 334 U.S. 385 (1948); *Ward v. Maryland*, 79 U.S. (12 Wall.) 418 (1871); and a regulation excluding nonresidents, but not residents, from procuring abortions. *Doe v. Bolton*, 410 U.S. 179 (1973).

29. *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 586 (1839). Taney reasoned that since a corporation is not a citizen, it could not claim the rights of a citizen. The decision reflected a radical difference of approach from that of the Marshall court, which had granted corporations access to federal courts under the "diversity of citizenship" test by viewing the corporation as an instrument of the citizens who constituted it. See *Bank of United States v. Deveaux*, 9 U.S. (5 Cranch) 61 (1809).

30. *Bank of Augusta*, 38 U.S. (13 Pet.) at 588.

31. *Foley, Incorporation, Multiple Incorporation, and the Conflict of Laws*, 42 HARV. L. REV. 516 (1929); Comment, *Multiple Incorporation as a Form of Railroad Organization*, 46 YALE L.J. 1370 (1937).

32. *Santa Clara County v. Southern Pac. R.R. Co.*, 118 U.S. 394 (1888).

33. *Southern Ry. Co. v. Greene*, 216 U.S. 400 (1910). At about the same time, some forms of discrimination against out-of-state corporations were invalidated under the interstate commerce clause. *Pullman Co. v. Kansas*, 216 U.S. 56 (1910); *Western Union Tel. Co. v. Kansas*, 216 U.S. 1 (1910). But the Supreme Court did not repudiate the Taney view on corporations' inability to claim the rights of citizens. See Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C. L. REV. 1 (1968).

justice to an out-of-state corporation that had not been "admitted" to the state.³⁴ But most states now allow out-of-state corporations to sue on preadmittance causes of action, once they have been admitted.³⁵ The rules fuel dilatory and expensive litigation, but do not impose a major obstacle to interstate commerce.

The Community founders, aware of the tortuous struggle of U.S. corporations for freedom of establishment, inserted in their own constitution an explicit guarantee of freedom of establishment for corporations as fully as for individuals. The Treaty declared:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.³⁶

If the doors had been opened to foreign corporations without "safeguards," citizens of states with relatively rigorous laws, such as France and Germany, might have been exposed to the wiles of corporations of other states whose laws were already more permissive, or might be made more permissive in an effort to attract incorporations.³⁷ If corporations were permitted to sell securities and make contracts without adequate requirements of disclosure and of financial strength, economic development might fail to attain the goals of "a continuous and balanced expansion" and "an increase in stability," for which the Communities were formed.³⁸

One may reasonably infer that opening the doors to the corporations of other Community states was politically acceptable only on the assurance that there would be "equivalent safeguards" for the protection of Community residents.³⁹

D. "Interests of Members"

The first-named function of requiring "safeguards" was "protection of the interests of members,"⁴⁰ which would translate in Ameri-

34. See Walker, *Foreign Corporation Laws: A Current Account*, 47 N.C. L. REV. 733 (1969); Walker, *supra* note 33, at 1.

35. See Revised Model Business Corporation Act § 15.02 (1984) [hereinafter MBCA].

36. Treaty, *supra* note 2, art. 58, at 227. Since this article makes no reference to the ownership of companies, companies owned by Americans or Japanese enjoy freedom of establishment if they are incorporated in member states.

37. See Gessler, *Ziele und Methoden der Harmonisierung des Gesellschaftsrechts der GmbH*, in HARMONISIERUNG DES GESELLSCHAFTSRECHTS UND DES STEUERRECHTS DER GMBH IN EUROPA 9, 16-21 (1962).

38. See Treaty, *supra* note 2, art. 2, at 179.

39. E. STEIN, *supra* note *, at 37; Coleman, *supra* note 24, at 248-49.

40. See Treaty, *supra* note 2, art. 54(3)(a), at 224.

can English as protection of the interests of *shareholders*. Protecting shareholder interests was probably viewed as a means of promoting, in the words of the Treaty, "a continuous and balanced expansion, an increase in stability, [and] an accelerated raising of the standard of living,"⁴¹ because the swindling of shareholders and the resultant drying up of capital markets were regarded as contributing causes of the Great Depression.

The Community founders could, imaginably, have attacked the danger of reckless financing as the United States had done, by enacting Community Securities Acts and creating a Community Securities Commission.⁴² But the American securities laws did not fit the Community's legislative pattern, which favored integration of reforms in existing codes, rather than adding uncoordinated regulations. The two largest members of the original Communities, France and Germany, had tackled securities fraud by inserting rigorous provisions for disclosure and auditing of financial statements in their corporation laws.⁴³ None of the Community's member states had adopted laws on the order of the "blue sky laws" that were among the precursors of the U.S. Securities Act of 1933.⁴⁴ Only one Community member, Belgium, had created an agency that was remotely comparable to the U.S. Securities and Exchange Commission.⁴⁵

Besides, the Community founders were not concerned only with "truth in securities," the prime objective of the U.S. securities laws.⁴⁶ They were concerned with many other forms of shareholder protection, including the maintenance of capital,⁴⁷ the equal treatment of shareholders,⁴⁸ and the proportionality of voting rights,⁴⁹ all of which fit better in corporation laws than in securities laws on the American pattern.

If the Community founders thought at all about the U.S. system of

41. See Treaty, *supra* note 2, art. 2, at 224.

42. Cf. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

43. For observations on disclosure requirements in effect when the Economic Community was formed, see Conard, *Organizing for Business*, in 2 AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET: A LEGAL PROFILE 1, 141-45 (1960). For more recent observations, see Buxbaum, *Formation of Marketable Share Companies*, in 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW § 3-31 (1971).

44. For a brief explanation of blue sky laws, see L. LOSS, *supra* note 2, at 8-12, 29-381; 1 L. LOSS & J. SELIGMAN, *SECURITIES REGULATION* 29-157 (3d ed. 1989).

45. See Conard, *supra* note 43, at 145-47.

46. See L. LOSS, *supra* note 2, at 29-37; L. LOSS & J. SELIGMAN, *supra* note 44, at 171-93.

47. See Second Directive, *supra* note 12, art. 15.

48. See Second Directive, *supra* note 12, art. 42.

49. See Fifth Directive 1983, *supra* note 13, art. 33(1).

securities regulation as a model for Europe, they probably dismissed it as an expedient to which Congress had turned because of the constitutional and political impediments to intruding on state sovereignty in the design of corporation laws. By providing at the outset for Community directives on corporation law, they bypassed the constitutional obstacle. Since no member state had yet developed a business of charter mongering, there was no vested interest in a free market in corporate laws.

E. *The Interests of "Others"*

The "others" whom the Community founders envisioned as subjects of protection were presumably customers, suppliers, and money-lenders, including investors in bonds. All of them would be helped by regulations requiring public filing of the addresses and the officers of corporations, by standard accounting practices and disclosures, and by capital requirements designed to maintain firm solvency. Securities regulation on the American model would help only the bond investors.

In what respects employees were contemplated by the Community founders as among the "others" for whom safeguards were to be provided is unclear. They were doubtless intended to benefit in the same way as suppliers and shareholders from provisions designed to assure financial solvency. Whether the Treaty makers intended also to authorize their protection by means of a voice in corporate governance is debatable.

Employee representation in governance was already known in Europe through Germany's codetermination law, introduced in 1952.⁵⁰ But it was not, when the Communities were founded, embedded in the German corporation law, which still declared that the supervisory board should be elected by the shareholders.⁵¹ Employee representation was, however, included in the 1972 proposal of a fifth directive on corporate governance,⁵² and in revised form in the 1983 revision.⁵³ The difficulty in reaching agreement on the terms of employee representation suggests that some Community members do not consider it a

50. See Summers, *Worker Participation in the U.S. and West Germany: A Comparative Perspective*, 28 AM. J. COMP. L. 367, 370 (1980); Conard, *supra* note 43, at 102-05.

51. Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien of Jan. 30, 1937, RGBl. I 107 § 87 (1937) [hereinafter AktG 1937]. In 1976, the law was revised to state that members should be elected by employees to the extent required by the Law on Codetermination. German Stock Corporation Law of Sept. 6, 1965, as amended July 1, 1976 (R. Mueller & E. Galbraith trans. 1976) [hereinafter Ger. SCL.].

52. Proposal for a fifth directive, 15 J.O. COMM. EUR. (No. C 131) 49 (1972) [hereinafter Fifth Directive 1972].

53. Fifth Directive 1983, *supra* note 13, arts. 21a-21j (amended proposals).

safeguard that is essential to attaining the objectives of the Communities.⁵⁴

F. *National Interests*

Beyond the interests of shareholders, customers, suppliers, money-lenders, and employees, a significant source of pressure for conformity in corporation laws was probably the interest of each state in retaining as its "nationals" those corporations whose operations are centered in the state. The founders of the Community had no intention of letting one of the member states become the "Delaware of Europe."

This may have been related to a sense of national loyalty. European states were sensitive to the implications of their giant corporations defecting to other states. A related sensitivity was recognized in the preface to the Commission's 1989 proposal of a Statute for a European Company. In explaining why it proposed a "European" company, rather than merely specifying conditions for a national company, the preface explained: "This Statute based on European law will be a means of overcoming major psychological obstacles, since it will avoid placing the firms concerned in the position of having to choose the structure of a particular Member State"⁵⁵ It was probably a matter of finance, too. Community members would not want a one-member state to siphon off a disproportionate fraction of corporation filing fees and attorneys' fees as Delaware does in the United States.⁵⁶

If there is anything surprising about the decision to standardize European corporation law, it is the absence of any organized effort of European industrialists to create in Europe a free trade in corporation laws like that which flourishes in the United States. When German industrialists found themselves exposed to competition from potentially less regulated Luxembourg rivals, they might conceivably have wanted the right to enjoy Luxembourg laxity by moving their corporate headquarters to Luxembourg. There is no evidence, however, that the captains of European industry perceived a "race of laxity" as advantageous to them. If they contemplated it at all, they probably recognized that a free market in corporation laws could not prevail in the political climate of Europe. They may also have believed that differences in company laws would be eclipsed by differences in laws on taxation, social security, and other matters.

54. See *infra* text accompanying notes 185-87, 230-33.

55. *Statute for a European Company*, BULL. E.C., May 1989, at 7.

56. Cf. Cary, *supra* note 5, at 668.

II. THE INSTRUMENTS OF COORDINATION

A. *The Rejection of American Models*

The Community founders adopted none of the principal methods by which nationwide conformity of laws has sometimes been achieved in the United States — the “uniform act,” the “model act,” and the “federal act.”

The “uniform act” and the “model act,” as known in the United States, were inappropriate because their adoption is voluntary. Although the American Commissioners⁵⁷ have been successful with uniform laws on commercial transactions, and even with laws as close to corporations as the partnership and limited partnership acts, their only attempt to unify corporation laws was abandoned.⁵⁸ There was no prospect of Delaware’s abandoning its program of attracting incorporations by being *nonuniform*. So long as Delaware attracted corporations by laxity, other states were sure to follow along to avoid losing incorporations.⁵⁹ Europeans had no reason to believe that voluntary conformity in corporation laws would succeed in the Communities any more than it had succeeded in the United States.

The Model Business Corporation Act issued by the American Bar Association’s Committee on Corporate Laws was successful in that its provisions were copied or simulated in a majority of states, but it was essentially an “enabling act,” imposing few “safeguards,” and being frequently amended to meet the demands of corporation organizers for greater liberties.⁶⁰ A “model act” was no instrument for assuring “equivalent safeguards” in the European Communities.

Likely reasons for the Communities’ forgoing the enactment of a Community corporation act, which would be comparable to a federal corporation act in the United States, were of a different kind. One reason, which would have been sufficient even if there had been no others, was the enormity of the task of devising a complete corporation act that would be acceptable to the many members of the Community, with their differing languages and traditions. Much more feasible was the gradual coordination of particular elements, starting

57. The National Conference of Commissioners on Uniform State Laws.

58. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS 72 (1943).

59. See Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433 (1968).

60. See Harris, *The Model Business Corporation Act — An Invitation to Irresponsibility?*, 50 NW. U. L. REV. 1 (1955).

with registration and then proceeding to capital maintenance, then to accounting, and so on.

A second plausible reason for forgoing a single Community corporation act may have been a desire to minimize the inconvenience caused, and the disparagement of national traditions implied, by a displacement of existing corporation laws. Compatible with these possible considerations, the Treaty authorized coordinating only "safeguards," and coordinating these only "to the necessary extent."⁶¹

A third reason, one may guess, is avoiding displacement or duplication of the bureaucracies of state officials employed in keeping corporate records. A Community bureaucracy to administer a Community law would have the added complication of dealing with documents in several different languages, which numbered four (French, German, Italian, and Dutch) when the Community was founded. By 1991, there were five more — Danish, English, Greek, Spanish, and Portuguese.

B. *The Directive*

What the Community needed in order to coordinate safeguards without imposing a whole new corporation act in four languages was a means of causing the member states to modify their own acts in selected respects. For this purpose they adopted an instrument that they called a "directive," a term that had been applied previously to various kinds of interagency orders,⁶² but was unencumbered by international or constitutional case law. The Treaty provided: "A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods."⁶³

Although the idea of a federal government ordering member states to legislate seems strange to an American, it is not very different in reality from the practice by which U.S. federal agencies grant highway

61. See *supra* text accompanying note 11.

62. "Directive" in the English version of the Treaty was a translation of the French *directive* and German *Richtlinie*. A pretreaty French dictionary defined *directive* as a "group of instructions, line of conduct to be followed, etc., which the higher military authority in campaign gives to its subordinates, or, by analogy, general instructions given by a religious, political, etc., authority." NOUVEAU PETIT LAROUSSE ILLUSTRÉ DICTIONNAIRE ENCYCLOPÉDIQUE 307 (1956) (author's translation). The original *Oxford English Dictionary* treated the term as obsolete, 2 OXFORD ENGLISH DICTIONARY 391 (1933), but the 1972 Supplement revived it as "a general instruction how to proceed or act," with quotations illustrating its use to describe, among other things, ecclesiastical interferences with the political life of nations, military directions to armies, and the British government's wartime directions to the BBC on handling news. 1 OXFORD ENGLISH DICTIONARY 811 (Supp. 1972).

63. Treaty, *supra* note 2, art. 189, at 305.

money to states on condition of the states adopting and enforcing uniform speed limits.⁶⁴ In form, it resembles the process by which an international treaty requires signatory states to modify their laws to match the treaty.

Unsympathetic parliamentarians, however, could regard the directives as an unconstitutional infringement of parliamentary supremacy — an argument that was forcefully advanced in Great Britain by opponents of British entry into the Common Market.⁶⁵ The imaginable sensitivity of national parliaments to Community dictation was alleviated by long delays between proposal and adoption, during which a directive could be adapted to national differences, and national parliaments could adapt or prepare to adapt their laws to the prospective directive. Even the first directive, which seemed to do little more than to standardize basic disclosure, spent four years in the form of a proposal before it could be enacted without vigorous objection.⁶⁶ The twenty-year gestation of the fifth directive reflects a continuing policy of reciprocal adaptation.

C. *The Community Corporation Act*

Soon after the Economic Community was founded, its leaders became concerned with the need for corporations to operate on a Community-wide scale in order to realize the potential of the Community market. One approach was to authorize companies of different countries to form alliances to work together, which was accomplished by the creation of an entity called a "European Economic Interest Grouping."⁶⁷ But members of a Grouping would still do business under their own names, and be associated with particular member states.

Community leaders concluded that enterprisers should be enabled to form "Community corporations" that would not be viewed as "nationals" of any particular member, nor subject to idiosyncracies of na-

64. See, e.g., *Nevada v. Skinner*, 884 F.2d 445 (9th Cir. 1989), *cert. denied*, 110 S. Ct. 1112 (1990) (discussing constitutional objections to national speed limit).

65. See Brothwood, *Parliamentary Sovereignty and U.K. Entry*, 118 NEW L.J. 415 (1968); Comment, *European Economic Community Law vs. United Kingdom Law: A Doctrinal Dilemma*, 53 TEXAS L. REV. 1032 (1975). For a defense of the compatibility of Community law with Parliamentary sovereignty, see *Legal and Constitutional Implications of United Kingdom Membership of the European Communities*, 1967, CMND. 3301; Simmonds, *Common Law and Community Law*, 111 SOLIC. J. 644 (1967); Note, *Community Law, the Act of Union and the Supremacy of Parliament*, 92 LAW Q. REV. 36 (1976).

66. E. STEIN, *supra* note *, at 237-312.

67. Council Regulation No. 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), 28 J.O. COMM. EUR. (No. L 199) 1 (1985).

tional laws.⁶⁸ To this end, they conceived a company that would be European, rather than French, German, or Luxembourgian. To give it a name that would not identify it with the language of any particular country, they dubbed it in Latin "*Societas europaea*," abbreviated as "SE."⁶⁹

The Treaty, however, did not contain any authorization that plainly contemplated the enactment of a Community corporation act.⁷⁰ The directive power seemed inapplicable to this purpose, because it authorized only orders to member states to modify their national laws.⁷¹ The Treaty granted to the Council and Commission power to "make regulations" in order to "carry out their task,"⁷² but there were early doubts about what "task," if any, would be carried out by authorizing formation of a European company.⁷³

In the 1970s, Community theorists debated the source of authority for the European Company Statute. Some argued that it was a proper regulation under article 100, while others invoked article 235, which authorizes the Community to "take appropriate measures" when the Treaty has not provided the necessary powers to attain one of the objectives of the Community.⁷⁴

The 1970 and 1975 drafts of the SE Statute cited as their authorization the "appropriate measures" clause of article 235.⁷⁵ The 1989 revision divided the proposal into two parts, a regulation authorizing formation of companies, and a directive ordering the member states to require employee representation in European Companies based in member States. The regulation cited the authority under article 100A to adopt "measures" for the establishment and functioning of the in-

68. *Proposition de règlement (CEE) du Conseil portant statut de la société anonyme européenne*, 13 J.O. COMM. EUR. (No. C 124) 1 (1970) (Proposal for a Council Regulation on the Statute for European Companies) [hereinafter SE Stat. 1970]; *Proposal for a Council Regulation on the Statute for European Companies*, BULL. E.C. SUPP., Apr. 1975, at 1 [hereinafter SE Stat. 1975]; *Proposal for a Council Regulation on a Statute for a European Company*, BULL. E.C. SUPP., May 1989, at 37 [hereinafter SE Stat. 1989].

69. SE Stat. 1970, *supra* note 68, art. 1(1), at 3.

70. E. STEIN, *supra* note *, at 427.

71. *Id.*

72. Treaty, *supra* note 2, art. 189, at 305.

73. E. STEIN, *supra* note *, at 445 n.316.

74. The text of article 235 is as follows:

If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, operating unanimously on a proposal from the Commission and after consulting the Assembly, take the appropriate measures.

Treaty, *supra* note 2, art. 235, at 335.

75. SE Stat. 1975, *supra* note 68, preamble, at 11; SE Stat. 1970, *supra* note 68, preamble, at 1.

ternal market,⁷⁶ while the directive cited the authority to prescribe "equivalent . . . safeguards."⁷⁷

Although an SE would owe its existence entirely to Community legislation, the Communities did not propose to set up a Community registry of SEs. Each SE would file its articles of incorporation and its periodic reports in the company registry of a member state, where it would have its headquarters.⁷⁸ If questions of company law should arise that were not answered by the SE statute, they would be decided under the law of the state of incorporation.⁷⁹

At this writing (mid-1991), the SE Statute was reputed to have a good chance of being adopted by the end of 1992.

D. *The Lawmakers*

Of the many original elements of Community structure, none differs more conspicuously from U.S. counterparts than the lawmaking authority. The legislative function is divided between the Council and the Commission, none of whose members are popularly elected to these bodies; they are named by the governments of member states.⁸⁰ Council members must be members of the "governments"⁸¹ (that is, the cabinets) of the states, and as such responsible to their national parliaments. Some of them are members of national parliaments, and subject to popular election in that capacity, but not in their capacities of Community Councillors.

In this respect the Communities followed the tradition of international organizations, whose primary constituents are not citizens, but states.⁸² This conception of the Communities is expressed in the preamble of the Treaty, which speaks as a proclamation not of "We the

76. SE Stat. 1989, *supra* note 68, preamble, at 37 (citing Treaty, *supra* note 2, art. 100A, at 255, added by Single European Act, *supra* note 1, art. 18, at 8).

77. *Proposal for a Council directive complementing the Statute for a European Company with regard to the involvement of employees in the European Company*, BULL. E.C. SUPP., May 1989, preamble, at 69 [hereinafter SE Directive 1989] (citing Treaty, *supra* note 2, art. 54, at 224).

78. SE Stat. 1989, *supra* note 68, arts. 8 & 9, at 40 (incorporating by reference First Directive, *supra* note 12, arts. 2, 3, at 9-10).

79. SE Stat. 1989, *supra* note 68, art. 7(3), at 40.

80. *Traité Instituant un conseil unique et une commission unique des communautés européennes*, J.O. COMM. EUR. (No. 152), arts. 2, 11, 10, at 2, 4, 5-6 (1967); Treaty Establishing a Single Council and a Single Commission of the European Communities in TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 745, 751, 755-56 (1973). On the bureaucratic and undemocratic nature of Community legislation, see Allott, *Memorandum*, in SELECT COMMITTEE ON THE EUROPEAN COMMUNITIES, POLITICAL UNION: LAW-MAKING POWERS AND PROCEDURES, (U.K.) H.L. Session 1990-91, 17th Report, Evidence 35 (1991)..

81. *Traité Instituant un conseil unique et une commission unique des communautés européennes*, *supra* note 80, art. 2, at 4.

82. See B. BEUTLER, R. BIEBER, J. PIPKORN & J. STREIL, *DIE EUROPÄISCHE GEMEINSCHAFT — RECHTSORDNUNG UND POLITIK* 107 (3d ed. 1987), translated in J. WEILER, 1992 -

People,"⁸³ but of a king, a queen, a grand duchess, and three presidents.⁸⁴

The power to legislate, whether by directive, by regulation, or by other "appropriate measures," is vested in the Council on a proposal of the Commission.⁸⁵ In the original Treaty, the Council was directed to "consult" the Assembly and in some cases other agencies.⁸⁶ But the Single European Act of 1987 changed the procedure for coordination of company laws from "consultation" to "cooperation," and defined "cooperation" as submission to a vote of the European Parliament, the Assembly's successor. The vote of the Parliament cannot be overridden except by a *unanimous* vote of the Council.⁸⁷ Since the Council would rarely be unanimous in approving a proposal rejected by a majority of the Parliament, the Parliament has virtually the same power of decision as the U.S. Congress, although it has less authority to initiate. In the exercise of its function of cooperation, the Parliament debates and votes not only on the proposal of the Commission, but also on numerous amendments proposed by Parliamentarians.⁸⁸ By the cooperation procedure, the Parliament has achieved a substantial power over the content of legislation.

III. WHAT KINDS OF CORPORATIONS?

The Community lawmakers decided at the outset to coordinate on two different levels. Some safeguards, like those requiring registration of name, address, and authorized representatives, were to apply to all corporations, large and small. Other directives, like those on maintenance of capital, mergers, and split-ups, would apply only to corporations that were likely to be publicly held.

Defining the enterprises that would fall into the two regimes was complicated, because the laws of member states characterized their

TRADING IN AND WITH EUROPE: INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES unit I, at 37 (teaching materials, University of Michigan Law School, 1990).

83. U.S. CONST. preamble.

84. Treaty, *supra* note 2, preamble, at 173.

85. The various legislative powers were assigned by different articles, scattered throughout the Treaty. For a summary, see Stein, *The New Institutions*, in 2 AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET: A LEGAL PROFILE, *supra* note 43, at 33-43. With respect to directives to coordinate safeguards, the Treaty provided in art. 54(2) as follows: "[T]he Council shall, on a proposal from the Commission and after consulting the Economic and Social Committee and the Assembly, issue directives, acting unanimously until the end of the first stage and by a qualified majority thereafter." Treaty, *supra* note 2, art. 54(2), at 224.

86. See, e.g., Treaty, *supra* note 2, arts. 54(2), 100, 235, at 224, 255, 335.

87. Treaty, *supra* note 2, art. 149, at 295, as amended by Single European Act, *supra* note 1, art. 7, at 5.

88. See, e.g., Statute for a European Company — Cooperative Society, 34 O.J. EUR. COMM. (No. C 48) 72-99 (1991).

various forms of business enterprises in different ways that defied translation. Each directive lists the kinds of companies affected in each country in the language of that country, using (for example) *société anonyme* and *naamloze vennootschap* for Belgium, *aktieselskabet* for Denmark, and so on, including a characterization in the Greek alphabet for Greece.

To simplify the complex classifications used by the directives, I will group the affected kinds of companies in two main classes, which I will call "public" and "private," although the directives do not use these terms, except for British and Irish entities. Public companies in this context embrace companies that are authorized by the laws under which they are formed to issue freely negotiable shares. Private companies are those that are restrained by law from allowing their shares to be freely traded on securities markets.

Although this distinction is reminiscent of the one drawn by American securities laws between companies that do and those that do not make public offerings of securities, it depends on the legal capacity to issue freely tradeable shares, rather than on the actual public issuance of shares.

The companies that I call public are those that are legally so designated in Great Britain and Ireland, and those that are designated in other countries by a sobriquet that includes a derivative of the Latin *actio* or a derivative or translation of the Greek *anonyme*.⁸⁹ They include not only the forms of organization commonly translated as "negotiable share company" or "stock corporation" (Italian *società per azioni*, German *Aktiengesellschaft*, Danish *aktieselskabet*, French *société anonyme*, Spanish and Portuguese *sociedad anónima*, and Netherlands *naamloze vennootschap*), but also some less familiar European forms commonly translated as "limited partnerships with negotiable shares" (Italian *società in accomandita per azioni*, German *Kommanditgesellschaft auf Aktien*, Danish *kommandit-aktieselskab*, French *société en commandite par actions*, Spanish *sociedad comanditaria por acciones*, Portuguese *sociedade em comandita por accoes*, and Netherlands *commanditaire vennootschap op aandelen*).⁹⁰

The companies that I call private include those that are legally so designated in Great Britain and Ireland, and companies of other coun-

89. *Azione* and *Aktie* designate a kind of share that is interchangeable with other shares, and is represented by a transferable certificate, as distinguished from the kind of share that one might own in a house or a partnership that is not interchangeable with other shares, and is not freely negotiable. *Anonyme* and *anónima* refer to the fact that publicly held companies were originally designated by a characterization of their business (like "General Electric Company"), rather than by the names of their owners (like "J.P. Morgan & Co.").

90. These designations are listed in First Directive, *supra* note 12, art. 1.

tries that are designated in foreign languages by equivalents of "limited liability company," as in the French *société à responsabilité limitée*, the Italian *società a responsabilità limitata*, the Spanish *sociedad de responsabilidad limitada*, and the German *Gesellschaft mit beschränkter Haftung* (GmbH).⁹¹ The equivalents of "limited" are not used to distinguish private companies from public companies, in which liability is equally limited, but to distinguish them from partnerships. They resemble partnerships in that the names of their owners frequently appear in their company names, but differ in that the named owners are not normally liable for firm debts.

Three of the directives that had been adopted by the end of 1991 (those dealing with capital, merger, and split-ups) and two that had been proposed (those on governance and on cross-border mergers) applied only to public companies. Five directives in effect — those dealing with identification (domestic and foreign), accounts (simple and consolidated), and auditing — applied to both public and private companies. The directive on one-member companies was limited, naturally, to private companies.

The accounting directives drew a further distinction between the largest companies and those that were smaller. Member states could allow the smaller companies to present simpler financial statements, and to forgo consolidation of subsidiaries.⁹² The line of demarcation, which involved three factors,⁹³ was on the same order of magnitude as the SEC's five-million dollar asset line for reporting under the Securities Exchange Act.⁹⁴

IV. THE CONTENT OF THE SAFEGUARDS

A. Overview

The safeguards that are required or proposed to be required are scattered among several directives in a pattern that reflects the order in which national representatives reached consensus on successive points, rather than any logical progression. Some of them correspond more closely to elements of U.S. securities law than to elements of U.S. corporation acts. To provide a coherent view of the safeguards, I pres-

91. *Id.* Belgium designates its limited liability company as *société de personnes à responsabilité limitée* (in French) and *personenvennootschap met beperkte aansprakelijkheid* (in Dutch). Portugal calls its limited liability company *sociedade por quotas de responsabilidade limitada*.

92. Fourth Directive, *supra* note 12, art. 27; Seventh Directive, *supra* note 12, art. 6.

93. "Smaller companies" for this purpose were companies that fell below two of these three measures: assets of 4 million EVA (about \$5 million), revenues of 8 million EVA (about \$10 million), and employees numbering 250. Fourth Directive, *supra* note 12, art. 27.

94. See Rule 12g-1 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.12g-1 (1990).

ent here a list of the principal subjects of regulation,⁹⁵ followed by designations of the directives in which each subject appears:

Identification: firm name, address, officers, documents.

First and eleventh directives.

Capital: creation and maintenance.

First and second directives.

Financial disclosure: accounting, auditing, publication.

Fourth, seventh, eighth, and eleventh directives.

Mergers and split-ups, domestic and interstate.

Third and sixth (final) and tenth (proposed) directives.

One-member companies.

Twelfth directive.

Governance: powers of shareholders and employees.

Fifth directive (proposed).

Takeovers: conduct and responses.

Thirteenth directive (proposed).

Many of the safeguards, both those proposed and those adopted, reappear in the proposed SE statute.⁹⁶ Although the primary function of this document is to authorize the formation of "European Companies," it may prove to be even more useful as a model of a statute designed from its inception to conform to the directives. Community members that have patched old corporation laws with amendments to satisfy the directives may find in the SE statute a pattern for recodification. American advocates of corporate law reform may find it suggestive of appropriate contents for American "minimum standards."

B. *Identification: Filing and Announcement*

The first concern of the coordinators was to standardize the elements of identity that firms must put on public record.⁹⁷ Most of the requirements in this category look very much like the incorporation procedures of U.S. corporation codes. As in the United States, the duties include filing each firm's formative documents⁹⁸ along with the names of its officers⁹⁹ and its home office address.¹⁰⁰

95. Most of the directives impose, as suggested by the word "safeguard," restrictions on corporations and their managers. But two of them, the merger and the one-member directives, contain also liberations from constraints of prior law. See *infra* text accompanying notes 158-59 and 178-79.

96. SE Stat. 1989, *supra* note 68.

97. First Directive, *supra* note 12, preamble.

98. *Id.* art. 2(1).

99. *Id.* art. 2(1)(d).

100. The first directive does not specifically mention the original address, but specifies filing "any transfer of the seat of the company." *Id.* art. 2(1)(g) (author's translation). The second

Each member state must maintain a central register for all its companies;¹⁰¹ separate registers in different cities or regions (like Bavaria in Germany or Scotland in Great Britain) would not suffice, although the states would be free to maintain them in addition to the national register. Firms formed in other Community states are required, on entering a state, to deposit the same kinds of documents as domestic firms.¹⁰² Like the United States, the Communities refrained from establishing a single register embracing all the member states.

These requirements seem so basic that one might expect to find them in force in all the member countries without any need for coordination. But there are a few interesting features that are unfamiliar to U.S. corporation lawyers. In addition to disclosing its identity in a public filing, a corporation must designate on all its correspondence and order forms the state in which it is registered, the serial number of its registration, the legal form of the company, and the location of its home office.¹⁰³

Another distinctive requirement, also designed to protect suppliers, customers, and employees, is the naming of individuals who "are authorized to represent the company in dealings with third parties and in legal proceedings."¹⁰⁴ The filing of a foreign branch must name not only the officers who can bind the company at its home office, but also those who can act for the foreign branch.¹⁰⁵

This requirement contrasts sharply with U.S. corporation acts, which do not require that officers have *any* power to bind the company. The only assurance of officers' authority that American law gives to outsiders is a *presumption* that a president has authority to bind the corporation in acts of a customary sort;¹⁰⁶ some cases withhold even this presumption.¹⁰⁷ Although a foreign branch must name a resident agent, the agent has no statutory authority beyond the authority to receive service of process.¹⁰⁸

The directive further reinforces the authority of officers by elimi-

directive, which covers only public companies, requires specification of the "registered office." Second Directive, *supra* note 12, art. 3(a).

101. First Directive, *supra* note 12, art. 3(1).

102. Eleventh Directive, *supra* note 12, arts. 1-6.

103. First Directive, *supra* note 12, art. 4.

104. *Id.* art. 2(1)(d)(i) (author's translation).

105. Eleventh Directive, *supra* note 12, art. 8(h).

106. See *Italo-Petroleum Corp. of Am. v. Hannigan*, 40 Del. 534, 14 A.2d 401 (1940).

107. See, e.g., *Kelly v. Citizens Fin. Co. of Lowell*, 306 Mass. 531, 28 N.E.2d 1005 (1940).

108. MBCA, *supra* note 35, § 15.10(a).

nating the defense known to Anglophones as *ultra vires*,¹⁰⁹ and a defense less widely known called "nullity of the company."¹¹⁰ These requirements would be unnecessary in the United States, but were needed in some of the Community states.

C. Capital: Creation and Maintenance

Among the safeguards that the Communities had enacted by 1991, those that present the greatest contrast with American corporation laws are those that regulate capital in "public companies."¹¹¹ They are reminiscent of rules that prevailed in U.S. corporation acts before the 1970s,¹¹² but they are more rigid in detail than those ever were. They require not only *disclosure*, as U.S. securities laws do, but also the *maintenance* of capital at prescribed levels.

Both public and private companies must disclose annually the amount of capital that has been subscribed.¹¹³ Public companies must also disclose the initial amount in the articles of incorporation, and subsequent amounts in annual and occasional reports.¹¹⁴ The directive prescribes no particular amount for private companies, but public companies must have subscriptions in the amount of 25,000 ECU¹¹⁵ (about \$30,000).

It is hard to believe that the requirement of "subscribed" capital serves any useful function today. It is related to financial practices that were apparently fairly common in the United States, and presumably in Europe, in the late nineteenth century. Corporations were organized by individuals who subscribed for shares (that is, promised to buy them) to be paid for progressively as the company's needs for money developed. In the late twentieth century, this practice was certainly rare in the United States, and probably in Europe, too. Since

109. First Directive, *supra* note 12, art. 9. The effect is similar to that of MBCA, *supra* note 35, § 3.04.

110. First Directive, *supra* note 12, arts. 10-12. "Nullity" was the name of a doctrine that when a firm purporting to be a corporation had failed to comply with the essentials of incorporation, its undertakings were binding on no one. The directive requires that the enterprise be bound by the officers' undertakings, although the enterprise may have to be wound up. *Id.* art. 12. Similar fact situations in the United States would usually result either in holding the purported corporation liable as a de facto corporation, or holding the organizers liable as persons who purported to exercise corporate powers without authority to do so, under the MBCA, *supra* note 35, § 2.04.

111. Second Directive, *supra* note 12.

112. For a deconstructive analysis of earlier U.S. capital requirements, see B. MANNING & J. HANKS, *LEGAL CAPITAL* 20-43 (3d ed. 1990).

113. First Directive, *supra* note 12, art. 2(1)(e).

114. Second Directive, *supra* note 12, art. 2, requires reporting in the articles of incorporation and at subsequent times when the amount of *authorized* capital is increased.

115. *Id.* art. 6(1).

the collection of subscriptions is likely to become difficult at the very moment when it is most needed, the directive's requirement of *subscribed* capital seems pointless.

Of greater practical importance than the capital subscribed is the capital paid in. Under the directive, states must require a public company to have paid in capital of a quarter of the subscribed amount, or a minimum of 6250 ECU¹¹⁶ (about \$7500). Although this is larger than the minimum of \$1000 that some U.S. states still required in the 1970s,¹¹⁷ it is too small to offer meaningful protection to creditors of a going concern. Its useful function, if any, is to require company founders to put some real assets at risk before they rent space and hire help.

If the capital safeguards offer any significant protection to creditors, it lies in their application to the capital that is actually paid in and reported in financial statements. In order to obtain credit, companies are likely to collect and report assets in amounts that bear a reasonable relation to the risks of their business.

In order to constitute paid-in capital, the directive requires that payments be made in cash or in other elements "capable of economic assessment," not in future services.¹¹⁸ If the payments are in any medium but cash, they must be appraised by an "expert," unless they amount to less than ten percent of the reported capital and their value is guaranteed in other ways.¹¹⁹ Once the capital is paid in, companies are forbidden to make dividend payments or share repurchases that would reduce it.¹²⁰

Beside these requirements, which seem designed to protect shareholders and creditors by assuring the company's solvency, others are designed to protect shareholders from discriminatory treatment. One article categorically demands equal treatment of shareholders of the same class.¹²¹ Another forbids issuing any share for less than its nominal or accounting-par value.¹²² This prohibition is presumably intended to protect shareholders who have paid par from having their

116. *Id.* art. 9(1).

117. See 2 MODEL BUS. CORP. ACT ANN. 2D 174 (1971) (reporting \$1000 minima in Connecticut, Kansas, Minnesota, New Jersey, and Tennessee, and \$500 minima in Florida, Missouri, and Ohio).

118. Second Directive, *supra* note 12, art. 7.

119. *Id.* art. 10. The value of the consideration must be guaranteed by the recipients of the shares, which must be companies with "reserves" equal to the value ascribed to the consideration. In addition, the waiver of appraisal must be agreed to by all incorporators, and must be published.

120. *Id.* arts. 15, 19.

121. *Id.* art. 42.

122. *Id.* art. 8. The directive's terms are "nominal value" and "accountable par." The com-

equity diluted by issuance to others at lower prices.¹²³

The Communities' requirement of reporting and maintaining *paid-in* capital stands in sharp contrast with the deliberate abandonment of capital protections in most U.S. states, and raises the question whether the United States or the European Community is misguided, or whether there are economic and social differences between the continents that call for different regimes. One function of maintaining net worth is to provide a margin of safety for creditors. A more important function is to give managers and major shareholders an incentive to maintain the company's solvency. When shareholders have no substantial equity, like many shareholders in U.S. savings and loan associations in the 1980s, they have little to lose by making reckless investments.

One of the arguments advanced to support the American abandonment of capital regulation was the ease with which "stated capital" could be reduced, as a consequence of which anyone who relied on a declaration of stated capital at one moment could be disappointed by its speedy reduction and dissipation.¹²⁴ This weakness in the U.S. system of capital protection is dealt with in the Community directive by a provision requiring publication of a decision to reduce capital, whereupon creditors would have the right to demand security, and distributions would be forbidden until creditors were satisfied, or a court determined that they were not entitled to satisfaction.¹²⁵

Another set of arguments for the American position was that creditors can learn from published financial reports and from credit reporting agencies about the solvency of their debtors, and choose the risks that they want to undertake.¹²⁶ This argument is less persuasive in the Communities because of different languages and different sources of financial information in the different countries, and, probably, a lessened availability of financial news and credit reporting within some of the member states.

For both sets of reasons, the Community regime for the protection

pany may receive less than the nominal or accountable par value to the extent of sales commission paid to brokers.

123. The prohibition has a protective effect if shares are normally sold for their nominal or par value, or only slightly more. If, however, their nominal or par values are set at derisory figures like one cent while the shares are sold for prices like ten dollars, as often happens in the United States, the underpar prohibition becomes ineffective. For reasons that are not clear to this author, the practice of setting nominal or par values far under actual issue prices does not appear to have flourished in Europe.

124. See B. MANNING & J. HANKS, *supra* note 112, at 91-94.

125. Fourth Directive, *supra* note 12, art. 32.

126. See B. MANNING & J. HANKS, *supra* note 112, at 98-99.

of paid-in capital seems likely to be more useful than the feeble regime that formerly existed in the United States.

D. Financial Reporting

Perhaps the most radical advance over prior law required by Community directives is the coordination of requirements for financial reporting.¹²⁷ The directives not only require reports, but specify the form and content of financial statements.

The Community reporting requirements appear to be significantly less stringent than those imposed by U.S. securities laws and regulations on firms that fall within their regime, but significantly more stringent than those imposed on other companies by U.S. state corporation acts. Firms that fall within the federal securities acts' regime must report not only annually, but also quarterly and on additional occasions when significant events occur.¹²⁸ Their reports are categorically subject to the SEC's Regulation S-X, and impliedly to the standards promulgated by the Financial Accounting Standards Board (FASB).¹²⁹ These rules and standards are more detailed and stringent than the fourth directive.

Although the directive's rules are less elaborate than those of U.S. securities regulation, they extend to a broader range of companies.¹³⁰ The fourth directive's requirements apply not only to public companies, but also to private companies, which in the United States are subject only to the vague requirements of state corporation acts.¹³¹ Although the directive distinguishes between the requirements for larger and smaller companies,¹³² the two regimes differ only in degrees of detail required.¹³³

Even the abridged statements require detail that is substantial in comparison with reporting requirements of nonpublic companies in

127. Financial statements were initially required in 1968 by First Directive, *supra* note 12, art. 2(f), but the content of the statements was first specified in 1978 for unitary companies by the Fourth Directive, *supra* note 12, and in 1983 for affiliated groups by the Seventh Directive, *supra* note 12.

128. See Rules 13a-1, 13a-11, and 13a-13 under the Exchange Act, 17 C.F.R. §§ 240.13a-1, 240.13a-11, and 240.13a-13 (1990).

129. See 2 L. LOSS & J. SELIGMAN, *supra* note 44, at 697-715; L. LOSS, *supra* note 2, at 159-65.

130. Fourth Directive, *supra* note 12, art. 1; Seventh Directive, *supra* note 12, art. 4.

131. See, for example, MBCA, *supra* note 35, § 16.20(b), requiring only a statement of whether the financial statements were or were not prepared on the basis of generally accepted accounting principles.

132. See *supra* note 93.

133. See Fourth Directive, *supra* note 12, art. 27, allowing the consolidation of particular items, and Seventh Directive, *supra* note 12, art. 6, excusing smaller companies from consolidation of accounts of affiliates.

the United States. An abridged income statement, for example, must report relevant data under seventeen captions, starting with gross profit on sales and running through staff costs (separating social security and pensions), value adjustments (separating current and fixed assets), other operating expenses, income from major investments in other companies (separating affiliated companies), other investment income, interest income, adjustments of value of financial assets, interest expense, income taxes, after-tax profit or loss on ordinary operations, extraordinary income, extraordinary expense, extraordinary profit or loss, taxes on extraordinary profit or loss, other taxes, and total profit or loss.¹³⁴

The same demarcation that separates full-dress from abridged accounting separates companies that must have their annual accounts audited, and those that may be excused.¹³⁵ If the law of a member state excuses some companies from auditing, it must provide "appropriate sanctions" for failure to comply with the directive's accounting standards.¹³⁶

In contrast, the Model Business Corporation Act requires only that a company maintain "appropriate accounting records,"¹³⁷ which include a balance sheet, an income statement, and a statement of changes in equity, which the company must send to its shareholders.¹³⁸ There is no requirement that the reports be audited by anyone, professional or otherwise. If the company prepares more elaborate statements, it must send them to its shareholders,¹³⁹ but there is no requirement that it prepare them.

The practical difference between financial disclosure requirements in the Communities and in the United States is less than this comparison suggests, because large publicly held American corporations commonly fall under the provisions of federal securities acts, which require financial statements conforming to SEC rules.¹⁴⁰ For smaller American companies, which often escape the requirements of the SEC, the financial reporting requirements may be substantially lighter than

134. Fourth Directive, *supra* note 12, art. 23, as modified by art. 27(a). A full-dress income statement would differ only in breaking down "gross profit on sales" into net revenues, increase or decrease inventories of finished and unfinished goods, capitalized expenditures, other operating income, materials consumed, and other external charges. *Id.* art. 23.

135. *Id.* art. 51.

136. *Id.* art. 51(3).

137. MBCA, *supra* note 35, § 16.01(b).

138. *Id.* § 16.20(a).

139. *Id.* § 16.20(a)-(b).

140. *E.g.*, Rule 13a-1 under the Securities Exchange Act, 17 C.F.R. § 240.13a-1 (1990).

those of corresponding European companies.¹⁴¹

The scope of the audit required by the directives is limited to the accuracy of the figures presented.¹⁴² There is no hint of requirements like those of the French corporation law, which requires auditors to ascertain whether shareholders have been treated equally,¹⁴³ and to report to a public prosecutor any infractions of law that come to their attention.¹⁴⁴ These and other requirements of national laws will presumably remain untouched by the directive, which sets minimum, not maximum, standards.¹⁴⁵

A novel peculiarity of the fourth directive is its specification of not only the content of financial statements, but also of the form of presentation or "layout." It offers two alternative layouts of balance sheets¹⁴⁶ and four alternative layouts of income statements,¹⁴⁷ designed to accommodate national differences. The fourth directive also includes a variety of accounting standards, including rules on valuation.¹⁴⁸ It is supplemented by the seventh directive on consolidated accounts of affiliated enterprises,¹⁴⁹ and the eighth directive on the qualifications of auditors,¹⁵⁰ who must audit the required financial

141. American corporations that escape the federal reporting regime may fall under a state securities regime because of the issuance of securities, and may prepare audited financials to satisfy lenders or others. If they prepare such reports for any purpose, they must, under the MBCA, *supra* note 35, § 16.20, file and distribute to shareholders reports on the same basis. But many closely held American companies can escape from the accounting standards and auditing requirements.

142. "The person or persons responsible for auditing the accounts must also verify that the annual report is consistent with the annual accounts for the same fiscal year." Fourth Directive, *supra* note 12, art. 51(1)(b).

143. Law No. 66-537 of July 24, 1966, art. 228, para. 4, *reprinted in FRENCH LAW ON COMMERCIAL COMPANIES* 111 (CCH trans. 1971) [hereinafter *Fr. LLC*].

144. *Id.* art. 233, para. 2, at 113. This is in addition to the duty to report irregularities to the managing and supervisory boards, *id.* art. 230, para. 3, at 112, and to the meeting of shareholders. *Id.* art. 233, para. 1, at 113.

145. *See* Fourth Directive, *supra* note 12, preamble.

146. One of the balance sheet layouts follows the traditional U.S. pattern, in which all assets are shown in one column, and all liabilities plus equities in the other, both columns ending with the same total. *Id.* art. 9. The other layout is a one-column presentation, which starts with assets, then deducts current liabilities to arrive at "assets less current liabilities," then deducts other liabilities to conclude with capital and reserves. *Id.* art. 10.

147. Two of the income statement layouts are essentially similar to the one-column form that is usual in the United States; they start with revenues, deduct expenses, and end with net profit. *Id.* arts. 23, 25, at 19-21. These two layouts differ from each other chiefly in the extent to which they separate labor and material costs from other costs of sales. The other two profit-and-loss layouts are two-column presentations, in which one column contains all expenditures and the other contains all income, and each column ends with net profit or loss. *Id.* arts. 24, 26. Again, the principal difference is in the breakdown of costs of sales.

148. *Id.* arts. 31-40.

149. Seventh Directive, *supra* note 12.

150. Eighth Directive, *supra* note 12.

statements.¹⁵¹

All companies, large or small, must file their financial reports in the national register at least annually,¹⁵² and the register must furnish copies to anyone on payment of the cost of duplication.¹⁵³ Large companies must also publish their financial reports in an official gazette.¹⁵⁴

A comparison of the Community accounting requirements with those of the United States suggests that much more explicit requirements for the preparation and filing of financial statements by the corporations that escape the grip of the Exchange Act would be feasible in the United States. If small European companies can conform, surely small American companies could do likewise.

Market-oriented theorists contend that legal accounting requirements are superfluous because the people who deal with corporations can demand as much information as is useful to them, as banks are said to do. But most suppliers, customers, and employees are confronted with problems of collective action. If they could act together, it would be worth their effort to demand accounting, but the demand is not worth its cost to any one acting separately. Obtaining legislation may be the most efficient means of acting together. Even banks, which are commonly said to have the ability to demand whatever financial statements they need, would find it easier to obtain useful data they need if companies were already required to prepare and file standardized financial reports.

E. *Mergers and Split-ups*

By 1991, a third directive on intrastate mergers¹⁵⁵ and a sixth directive on intrastate split-ups (called "divisions"¹⁵⁶) had been adopted, and a tenth directive on "cross-border" mergers¹⁵⁷ had been proposed. These directives related only to public companies.

The functions of the merger and split-up directives were not only to provide safeguards, but also to assure that member states would authorize simple procedures for combining and dividing enterprises. These procedures were much slower to develop in European countries

151. *Id.* art. 2.

152. First Directive, *supra* note 12, art. 3.

153. *Id.* art. 3(3), at 10; Fourth Directive, *supra* note 12, art. 47(1).

154. First Directive, *supra* note 12, art. 3(4), purports to require publication by all companies, but Fourth Directive, *supra* note 12, art. 47(2), allows states to exempt small companies from publication.

155. Third Directive, *supra* note 12.

156. Sixth Directive, *supra* note 12.

157. Tenth Directive 1985, *supra* note 13.

than they had been in the United States.¹⁵⁸ The directives ordered member states to provide for mergers and split-ups by decisions of corporations' governing boards, confirmed by shareholders' votes or acquiescence.¹⁵⁹

The proposed directive on cross-border mergers would require states to allow their corporations to merge with those of other states, thereby relinquishing their prior nationality. Combined with the liberation of intrastate mergers, the directive would open the door to great freedom in the restructuring of enterprises in the Common Market.

The safeguards imposed on intrastate mergers and proposed for cross-border mergers are milder in some respects than those in American corporation acts. Where shareholders' approval is required, for example, the required majority is measured against the shares *represented* at the meeting,¹⁶⁰ rather than against the shares entitled to vote, as in most U.S. corporations acts.¹⁶¹ The vote of shareholders may be dispensed with if the proposal has been duly announced, and has not been opposed by five percent or more of the shareholders.¹⁶² This is a more generous dispensation than those found in most U.S. corporation acts, which allow bypassing the shareholders only when the economic impact on shareholders is slight.¹⁶³

The disclosures required to accompany a merger are also trivial in comparison with those imposed by federal securities regulations on mergers of companies registered under the Exchange Act.¹⁶⁴ The specific provisions for informing shareholders are also minimal when compared with those of U.S. corporation laws. The merger proposal does not need to be mailed to shareholders — as U.S. acts require even with respect to shareholders who cannot vote on it¹⁶⁵ — but only filed

158. See Conard, *Corporate Fusion in the Common Market*, 14 AM. J. COMP. L. 573 (1966).

159. Third Directive, *supra* note 12, arts. 5, 7, 8; Sixth Directive, *supra* note 12, arts. 3, 5, 6; Tenth Directive 1985, *supra* note 13, arts. 5, 7. The tenth directive omits the authorization of shareholder approval by acquiescence.

160. Third Directive, *supra* note 12, art. 7. The member state's corporation law may require either a majority of two thirds of the shares represented, or a simple majority when half of the outstanding shares are represented. Each class of shares must approve separately.

161. E.g., MBCA, *supra* note 35, § 11.03(e); DEL. CODE ANN. tit. 8, § 251(c) (Supp. 1990).

162. Third Directive, *supra* note 12, art. 8.

163. The MBCA dispenses with shareholder votes when (1) shareholders' rights are unchanged, and the number of shares is increased by no more than 20%, MBCA, *supra* note 35, § 11.03(g), or (2) a merger partner holds 90% of the corporation's shares. *Id.* § 11.04. The Delaware General Corporation Law, DEL. CODE ANN. tit. 8, §§ 251(f), 253 (Supp. 1990) are similar.

164. See Item 14 in Schedule 14A under the Securities Exchange Act of 1934, 17 C.F.R. § 240.14a-101 (1990).

165. MBCA, *supra* note 35, § 11.03(d); DEL. CODE ANN. tit. 8, § 251(c) (Supp. 1990).

and published.¹⁶⁶

The permissiveness of the directives in regard to shareholder information and approval is probably based less on indifference to shareholder interests than on the difficulty of communicating with holders of bearer shares, which are common in European companies. Companies cannot communicate directly with shareholders whose names they do not know. If the Communities were determined to require effective communication with individual shareholders, they would have to change the company laws to require that shares be registered in the names of owners. Although this would facilitate the protection of shareholders as voters, it would collide with the traditional passion of European investors for anonymity. This passion seems to derive partly from a desire to be protected from solicitors, thieves, kidnappers, tax collectors, and from hostile governments in cases of war, revolution, or pogrom.

Notwithstanding the lack of communication with individual shareholders, the interests of shareholders are likely to be well protected in practice. A substantial proportion of shares in European companies are owned or represented by banks, which do not overlook the published notices of proposed corporate actions, and are very ready to vote in defense of their own interests and those of the other shareholders whom they represent.¹⁶⁷ If there is a lesson to be learned from the comparison of European and American shareholder representation, it is not that Europeans should ape the American charade of informing individual shareholders, but that Americans should promote the European practice of active participation by institutional investors.

Besides protecting shareholders, the merger directives provide positive protection to creditors and employees. Creditors who are adversely affected by mergers can demand "adequate safeguards."¹⁶⁸ Bondholding creditors, however, may be bound by a majority vote approving a merger.¹⁶⁹

Employees derive some protection from a separate directive,¹⁷⁰ to

166. Third Directive, *supra* note 12, art. 6, making cross-reference to First Directive, *supra* note 12, art. 3.

167. See R. BUXBAUM & K. HOPT, *supra* note 17, at 192; Grossfeld, *Management and Control of Marketable Share Companies*, in 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, *supra* note 43, §§ 4-241 to -243.

168. Third Directive, *supra* note 12, art. 13. Neither the directive nor its commentary indicates what kinds of safeguards are contemplated. One obvious possibility is to require the merger partner to reduce its debt by exchanging bonds for shares before the merger is completed.

169. *Id.* art. 14.

170. Council Directive 77/187, 20 O.J. EUR. COMM. (No. L 61) 26 (1977). This is one of another series of directives on employee rights issued pursuant to Article 100 of the Treaty au-

which the intrastate merger directive makes cross-reference.¹⁷¹ This order specifies that transferees of business enterprises, or parts of them, are subject to the same employment duties as their transferors.¹⁷² It also requires that transferors notify employees of intended transfers, the reasons for them, and their probable consequences.¹⁷³ The notice must be given "in good time," which is not further defined in the directive. The Community officers presumably expect state lawmakers to add specificity to the "good time" requirement, in accordance with the Treaty's rule that a directive "shall leave to the national authorities the choice of form and methods."¹⁷⁴

The directives on split-ups¹⁷⁵ and on cross-border mergers¹⁷⁶ are essentially similar to the merger directive in regard to rights of shareholders and creditors. They do not deal expressly with rights of employees.

F. *One-Member Companies*

The directive on companies with a sole shareholder¹⁷⁷ is not so much a safeguard as a liberation from the conception of a corporation, derived from Roman law, as an association of two or more individuals.¹⁷⁸ The idea is inherent in the very words by which Europeans designate corporations — *société*, *società*, and *sociedad* (etymologically cognate to "society"), *Gesellschaft* (etymologically parallel to "fellowship"), and even the English "company" (etymologically related to "companionship"). It was formalized in the Code Napoleon, which defined a *société* as a form of contract,¹⁷⁹ which logically requires plurality. It was sometimes invoked to contend that acts of a one-member corporation were null, or that a sole shareholder must be individually liable for all the corporation's obligations.¹⁸⁰

These applications of the theory impeded modern ways of doing

thorizing directives of unspecified content that "affect the establishment or functioning of the common market." Treaty, *supra* note 2, art. 100, at 255.

171. Third Directive, *supra* note 12, art. 12.

172. Council Directive, *supra* note 170, art 3, at 27.

173. *Id.* art. 6, at 27.

174. Treaty, *supra* note 2, art. 189(3), at 305.

175. Sixth Directive, *supra* note 12.

176. Tenth Directive 1985, *supra* note 13.

177. Twelfth Directive, *supra* note 12.

178. See Baugniet, *La société d'une personne*, in *RAPPORTS BELGES AU VIIIE CONGRÈS INTERNATIONAL DE DROIT COMPARÉ* 169 (1966).

179. See Code Civil [C. Civ] art. 1832 (Fr.). It was amended in 1985 to allow formation by a single person. Loi no. 85-697 du 11 juillet 1985, art. 1, 117 J.O. 7862 (1985).

180. Baugniet, *supra* note 178, at 171.

business, especially across state borders, through wholly owned subsidiaries. The directive simply abolishes the theory, by recognizing that a corporation can be formed by a single member¹⁸¹ and may contract with its member,¹⁸² who may perform singlehandedly the statutory functions of a shareholders' meeting.¹⁸³ From an American viewpoint, this directive may be viewed as a sensible, though belated, acceptance of the position that has long prevailed in U.S. law.¹⁸⁴

G. Governance

1. The Fifth Directive

By far the most significant area of coordination, and the most contested, is that of governance. Who makes decisions for the corporation, and who chooses the deciders? These are the same subjects that have engendered a river of literature inspired by Berle and Means' *The Modern Corporation and Private Property*,¹⁸⁵ recapitulated by Herman's *Corporate Control, Corporate Power*,¹⁸⁶ and sustained by prolonged debates in the American Law Institute.

The Commission proposed to deal with this subject in a document issued in 1972 and designated "fifth directive." Although a sixth, a seventh, an eighth, an eleventh, and a twelfth directive were proposed and adopted while the fifth was debated and revised, the governance directive continues to be known as the "fifth." Like the directives on capital and on merger, it is directed only to public companies.

The leitmotif of the directive is the control of corporate managers. In one of its aspects, it seeks to reinforce the same interest that has always motivated corporation laws, the interest of shareholders. In another aspect, it gives new recognition to an interest that was previously unmentioned in most corporation laws, the interest of employees. Notably absent is any effort to recognize the interests of the other corporate constituencies, such as suppliers, customers, communities, and the national economy, which have emerged as desiderata in U.S. corporation law amendments of the 1980s.¹⁸⁷

181. Twelfth Directive, *supra* note 12, art. 2, at 41.

182. *Id.* art. 5, at 41.

183. *Id.* art. 4, at 41.

184. See H. BALLANTINE, BALLANTINE ON CORPORATIONS 295-96 (rev. ed. 1946).

185. A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1933).

186. E. HERMAN, *CORPORATE CONTROL, CORPORATE POWER* (1981).

187. See Symposium, *Corporate Malaise — Stakeholders Statutes: Cause or Cure?* 21 STETSON L. REV. 1 (1991); Symposium, *Defining the Corporate Constituency*, 59 U. CIN. L. REV. 319 (1990); Committee on Corporate Laws, *Other Constituency Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (forthcoming 1990).

The directive seeks to achieve its objectives through four main devices: (1) requiring independent supervision of management, (2) giving employees a voice in the selection of supervisors, (3) reinforcing the powers of shareholders, and (4) requiring an independent audit of corporate reports.

Although the first draft of the fifth directive was published in 1972, and a second in 1983, a final directive had not been issued by mid-1991, and agreement on it did not seem imminent. The liveliest prospect of implementation of its concepts was the likelihood that the Council would adopt an SE ("European Company") statute that would embody most of the same principles. But the choice of any company to bring itself under the SE statute would be entirely voluntary, and was expected to be embraced by no more than a handful of multinational enterprises. When, if ever, the directive's reforms would become binding on member states remained speculative.

2. *Independent Supervision*¹⁸⁸

The first draft of the fifth directive would have imposed a single formula for the independent supervision of management. Every public company would have a supervisory council (called the "supervisory organ" in the English version of the draft) of which managers could not be members, which would hire and fire the managers.¹⁸⁹ Active management would be carried on by a subordinate manager or board of managers (called the "management organ"). This structure was a virtual reproduction of that prescribed for public companies by German law,¹⁹⁰ which had prevailed in its essentials since 1884.¹⁹¹ France had authorized a similar structure as an *option* for public companies in 1967,¹⁹² but it was an innovation that French commentators regarded as a German import.¹⁹³

This assault on national folkways awakened expectable resistance in member states, which intensified when Great Britain became a

188. For a fuller discussion of this subject, see Conard, *The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 MICH. L. REV. 1459 (1984).

189. Fifth Directive 1983, *supra* note 13, arts. 3(1), 13(1), 6.

190. Ger. SCL, *supra* note 51, §§ 84(1), 84(3), 105(1). The supervisory council was known in German as the *Aufsichtsrat* (etymologically "oversight council"), and the manager or management board as the *Vorstand* (etymologically "standing in front").

191. See W. GADOW, E. HEINICHEN, E. SCHMIDT, W. SCHMIDT & O. WEIPPERT, *AKTIENGESETZ KOMMENTAR* ix-xii (1939).

192. Fr. LLC, *supra* note 143, arts. 118-50, at 72-82. The French name for the supervisory council is *conseil de surveillance*, and for the management, *directoire*.

193. 1 J. HÉMAR, F. TERRÉ & P. MABILAT, *SOCIÉTÉS COMMERCIALES* 926-30 (1972).

member state in 1973. In 1983, the second draft of the directive¹⁹⁴ offered states a free choice between a "two-tier system"¹⁹⁵ on the German pattern and a "one-tier system"¹⁹⁶ on the pattern that had prevailed in other states, and which is similar to that of the U.S. "board of directors."

The one-tier option differed from the provisions of U.S. corporation laws in requiring that the nonmanagement members of the board must constitute a majority.¹⁹⁷ But this difference was more formal than real, since a majority of U.S. public corporations have adopted nonmanagement majorities in order to validate transactions involving management compensation and other managerial conflicts of interest.¹⁹⁸ In one respect, U.S. case law seems to be even more productive of directorial independence than the directive, since it tends to disqualify from the "disinterested" category directors with family or financial ties to management.¹⁹⁹ The directive, by contrast, seems to require nothing beyond the directors' not holding executive positions.

In placing reliance on the prevalence of nonexecutives in the governing organs, the Community experts were probably inspired by the German experience, in which banks participate actively as shareholders or as shareholders' custodians in the election of supervisory board members.²⁰⁰ German banks sometimes choose officers of corporate customers or suppliers who would not pass the American test of "disinterest."²⁰¹ But the councillors that the banks select are more likely to act independently of management than councillors chosen by the managers themselves.

In other countries, where banks or other financial institutions do not effectively choose the council or management board members, the directive seems to present no obstacle to managers using proxy power to coopt as board members individuals who are bound to the managers by personal relationship or by economic dependence.

194. Fifth Directive 1983, *supra* note 13.

195. *Id.* arts. 3-21.

196. *Id.* arts. 21a-21u.

197. *Id.* art. 21a(1)(a).

198. See DEL. CODE ANN. tit. 8, § 144 (1990); MBCA, *supra* note 35, § 862.

199. See AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3A.01 (Tent. Draft No. 11, 1991) (defining "significant relationship" to include family connections with executives, recent employment by the corporation, and current business relations with the corporation).

200. See Grossfeld, *supra* note 167, at 98; R. BUXBAUM & K. HOPT, *supra* note 17, at 179.

201. See C. VOGEL, AKTIENRECHT UND AKTIENWIRKLICHKEIT — ORGANISATION UND AUFGABENTEILUNG VON VORSTAND UND AUFSICHTSRAT 120-28 (1980).

3. *The Voice of Employees*

If the fifth directive was radical in its proposal for supervision of management, it was revolutionary in its proposals for the voice of employees in corporate governance. These proposals applied, however, only to companies that employ five hundred or more individuals.

Under the 1972 draft, corporations would have had to give employees a voice in the selection of members of the supervisory council (which every public company, under this draft, was required to have), in one of two ways. One method, patterned after German law,²⁰² required the election of at least one third of the council members by employees.²⁰³ The other method, patterned on Netherlands law, called for cooptation of new supervisory council members by the incumbent members, but gave to employee representatives the right to object to any appointment on the ground that the appointment would cause an "imbalance" in regard to the "interests of the company, the shareholders or the workers."²⁰⁴ These provisions awakened opposition not only from managers and shareholders, but also from labor leaders, especially British labor leaders, who saw the design as a detour around the power of union officers.²⁰⁵

The 1983 draft added two new options to the means of representing employees. Under one of the new options, the employees could be given, instead of the right to appoint or to veto appointments of councillors, the right to have a representative body that would be regularly informed about company affairs, and consulted on major changes, plant closings, and substantial cutbacks.²⁰⁶ Under the other option, employee interests could be protected by any arrangement that was agreed on through collective bargaining and that required informing employee representatives about company affairs, and consulting them on major changes.²⁰⁷ A parallel set of options was offered for compa-

202. See Ger. SCL. *supra* note 51, § 96, which refers to other codetermination statutes relating to different kinds of companies. For most public companies, the relevant law was the Law on Employee Codetermination (*Gesetz über die Mitbestimmung der Arbeitnehmer*) of May 4, 1976, BGBl. I, 1153. For a comparison of German codetermination with U.S. labor relations, see Sharp, *Codetermination: A Postmortem*, 40 LAB. L.J. 323 (1989); Summers, *supra* note 50.

203. Fifth Directive 1972, *supra* note 52, art. 4(2), at 51.

204. Lang, *The Fifth EEC Directive on the Harmonization of Company Law* (pt. 2), 12 COMMON MKT. L. REV. 345, 349-50 (1975); Fifth Directive 1983, *supra* note 13, art. 4c.

205. See Kolvenbach, *EEC Company Law Harmonization and Worker Participation*, 11 U. PA. J. INTL. BUS. L. 709, 725-26 (1990); Clough, *Trying to Make the Fifth Directive Palatable*, 3 COMPANY L. 109, 115 (1982); Conlon, *Industrial Democracy and EEC Company Law: A Review of the Draft Fifth Directive*, 24 INTL. & COMP. L.Q. 348 (1975); Lang, *supra* note 204, at 163-66, 345, 349-50. Cf. Hadden, *Employee Participation — What Future for the German Model?*, 3 COMPANY L. 250, 257 (1982) (suggesting that labor leaders should welcome the German model).

206. Fifth Directive 1983, *supra* note 13, arts. 4, 12.

207. *Id.* arts. 4e, 12.

nies with one-tier systems of governance.²⁰⁸

4. *The Loyalty of Managers and Supervisors*

The proposal to place representatives of both shareholders and employees on the governing council or board gave rise to a conceptual puzzle about the nature of the fiduciary duties that would be owed by these representatives of dissimilar constituencies. Were delegates of each class bound to advance the interests of their own class, and to oppose the interests of the other class when interests clashed? Although German law had provided for employees to elect council members since 1950, it had never addressed the possible conflict of the duties of the two classes of members.²⁰⁹

The United Kingdom adopted in 1980 an express formulation of a directorial obligation to both shareholders and employees in these terms: "The matters to which the directors of a company are to have regard in the performance of their functions shall include the interests of the company's employees in general as well as the interests of its members."²¹⁰ But this provision was directed only to representatives of shareholders, since British law made no provision for representation of employees.

The second draft of the fifth directive proposed answers to the question of conflicting loyalties in these two clauses:

All members of the management and supervisory organs shall have the same rights and duties²¹¹

All the members of the management and supervisory organs shall carry out their functions in the interest of the company, having regard to the interests of the shareholders and employees.²¹²

208. *Id.* art. 21. However, the system of appointment and veto was not extended to one-tier systems, presumably because appointment by a board that included executives would be less likely to lead to choice of independent board members.

209. See Grossmann, *Unternehmensziele im Aktienrecht*, 29 ABHANDLUNGEN ZUM DEUTSCHEN UND EUROPÄISCHEN HANDELS- UND WIRTSCHAFTSRECHT 1 (1980). A clause of the 1937 Stock Corporation Law had called on the managers (not the supervisors) to manage the business as required by the welfare of the enterprise and its personnel, and for the common good of the people and the state (*wie das Wohl des Betriebs und seiner Gefolgschaft und der gemeine Nutzen von Volk und Reich es fordern*). AktG 1937, *supra* note 51, § 70(1). This provision was omitted from the 1965 revision of the Stock Corporation Law, which provided that the management board should manage the business "as a matter of its own responsibility," without specifying for what ends. Ger. SCL, *supra* note 51, § 76(1).

210. Companies Act 1980, § 46(1), reenacted as Companies Act 1985, § 309(1).

211. Fifth Directive 1983, *supra* note 13, art. 10(a)(1). A provision with similar effect, adapted to one-tier structures, appeared in article 21q(1). The elided words allowed the delegation of particular duties to particular members, as an exception to the rule of identical duties.

212. *Id.* art. 10(a)(2). A provision with similar effect for one-tier structure appeared in art. 21q(2), at 22.

5. *The Powers of Shareholders*

The directive's provisions on the powers of shareholders were not very different from those found in U.S. corporations laws. Shareholders must be notified of meetings and of agendas. There were no provisions comparable to those of the U.S. proxy rules requiring the company to inform shareholders about the compensation of officers and directors and the qualifications of directorial candidates. There was no suggestion of a shareholder's right to present proposals at company expense.

One example of a provision that might be regarded as protecting shareholders' voting rights better than U.S. laws do is the prescription that "[t]he shareholder's right to vote shall be proportionate to the fraction of the subscribed capital which the shares represent."²¹³ This command is subject to an exception for "shares which carry special advantages," which in European parlance usually denote shares that Americans would call "preferred." In practice, the prescription means that common shares have voting rights based on their par values, which generally correspond in Europe to their initial public offering prices. Translated to the United States, it would exclude nonvoting common shares in public corporations.

H. *Takeovers*

The latest directive to be proposed — designated the "thirteenth,"²¹⁴ deals with takeovers through share purchase, whether "friendly" or "hostile." The directive would not only regulate takeover procedures, but would also require each state to designate a "supervisory authority" to oversee takeover procedures.²¹⁵

The triggering event for the major incidents of the directive is not the actual acquisition of a specified proportion of the shares of a target company, as under the U.S. Exchange Act,²¹⁶ but *aiming to acquire* a specified proportion.²¹⁷ The percentage of shares that triggers the

213. *Id.* art. 33(1).

214. Thirteenth Directive 1990, *supra* note 13.

215. *Id.* art. 6.

216. Securities Exchange Act of 1934, § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1988).

217. Thirteenth Directive 1990, *supra* note 13, art. 4(1):

Any person aiming to acquire a number or percentage of securities, which, added to any existing holdings, gives him a percentage of the voting rights in a company which may not be fixed at more than 33 1/3% shall be obliged to make a bid to acquire all the securities of that company.

The preamble of the directive and the official explanatory memorandum, BULL. E.C. SUPP., Mar. 1989, at 8, explain the requirement as applying to anyone "wishing to acquire" shares.

duty may be set by each member state at a level as high as 33 1/3,²¹⁸ which is a far cry from the five percent of the U.S. regulation.²¹⁹ When this threshold is reached, the acquirer must not only disclose its identity and purpose,²²⁰ but must make a general tender offer for one hundred percent of the shares of the company.²²¹

The directive contains a number of other features, some of which are reminiscent of U.S. tender offer rules, designed to give shareholders a fair chance to exercise their rights. For example, the tender offer must last four weeks, with an added week for each change in its terms, and if it raises its offer, must make the higher price available to earlier acceptors.²²²

When compared with federal regulation of takeover bids in the United States, the most conspicuous distinction of the proposed directive is its brevity. A more basic distinction, however, seems to be its restriction of defensive activities of takeover targets, subjecting them to governmental supervision. From the moment that it receives notice of the tender offer, the target company must *refrain* from defensive measures unless it receives permission from the state's supervisory authority.²²³ Ultimately, however, the state agencies to which supervision is entrusted may prove to be as protective of target managements as state legislatures have been in the United States.

Although the thirteenth directive seems likely to provoke lively debate, published discussions since issuance of the proposal furnish no substantial bases for evaluating it.

V. THE SUCCESS OF COORDINATION (FROM A EUROPEAN VIEWPOINT)

A. *A Market Economist's View*

If Europeans viewed their coordination program from the viewpoint of an American "market economist," they would probably regard most of its provisions as misguided interventions in state autonomy. If each member state were left free to make its own choice of safeguards, they would think, efficiency-seeking managers would move their enterprises to the states with the most efficient safeguards,

218. Thirteenth Directive 1990, *supra* note 13, art. 4(1).

219. See Securities Exchange Act of 1934, § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1988).

220. Thirteenth Directive 1990, *supra* note 13, art. 10.

221. *Id.* art. 4(1).

222. *Id.* arts. 12 (duration), 15 (raised bid); *cf.* Exchange Act Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1990) (on duration of tender offers); Exchange Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1988) (on raised bids).

223. Thirteenth Directive 1990, *supra* note 13, art. 8.

thereby maximizing the productivity of European business.²²⁴

These economists might see some slight merit in the provisions of the first directive that require enterprises in all member states to identify themselves in a uniform way; bettors can bet better when they know the names and the stables of the horses. But these critics could be expected to regret the adoption of most other provisions on the ground that competition among states would have produced more efficient requirements of financial disclosure and auditing than a Community bureaucracy is likely to produce. The program's greatest success, from this viewpoint, might be the *non*adoption of directives five and thirteen. This appraisal of coordination is, however, uninteresting to most Europeans, who do not share the views of American market economists on the proper role of legislation.

B. *An Institutional Economist's View*

Although "market economists" are prone to assume that their views are the only true economics,²²⁵ another school of economics, with an older pedigree, favors significant degrees of regulation of business,²²⁶ although its advocates in current legal literature are more often called "institutionalists" than "economists." They advocate uniform minimum standards in corporation law, and generally favor some form of federal intervention in order to impose them.²²⁷

The policymakers of the Communities are clearly institutionalists in this sense. Although they favor a free market in goods and services, they do not favor a free market in legislation. Even the British, who are most reluctant to let employees elect members of governing boards, do not seem to oppose rigorous regulation in other matters, such as financial reporting.²²⁸ It is from this perspective that I will

224. See Fischel, *supra* note 6; cf. Lorie, *An Economist's Perception I: A View on the Need to Revise Corporation Statutes*, in COMMENTARIES ON CORPORATE STRUCTURE AND GOVERNANCE 51 (D. Schwartz ed. 1979); Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 929-31, 947-48 (1983).

225. See Fischel, *supra* note 6, at 917-18; Scott, *supra* note 224, at 929-31. For a ringing affirmation of faith in market economics, see Kitch, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-70*, 26 J.L. & ECON. 163 (1983).

226. See Hovenkamp, *The First Great Law & Economics Movement*, 42 STAN. L. REV. 993 (1990).

227. See Cary, *supra* note 5; Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972); Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976).

228. See Clough, *supra* note 205; Coleman, *supra* note 24; Conlon, *supra* note 205; Hadden, *supra* note 205; Lang, *supra* note 204, at 345; Turner, *The Fifth Company Law Directive — A Saga of the Lawyer in the First Elected European Parliament*, 3 BUS. L. REV. 215 (1982); Tyrrell, *Employee Participation in the Decision Making of Public Limited Companies: The 5th Directive Options*, 132 NEW L.J. 35 (1982).

A lonely European voice favoring diversity of company laws on the American model was

examine the success of the Communities' program of coordination.

At this writing, in mid-1991, the process of coordinating company laws is obviously unfinished. Two important directives are hanging fire, and one can imagine demands for additional directives.²²⁹ One must therefore consider separately how successful the coordination is in its present state of incompleteness, and how successful it is likely to be if pending directives are enacted.

The success of coordination has major implications not only for corporations, but also for the progress of the Communities toward economic unity. For example, the agreement of Germany and France to open their markets to other countries was coupled with an assurance that "equivalent safeguards" would be required in the corporation laws of other members.

If markets are opened without safeguards that leaders of member states consider essential, states may have the same kinds of objections to a common market in Europe that laborers in the United States have to a common market in North America. Although member states cannot afford to withdraw now from the market, they can express their frustration by resisting other phases of European integration, like the establishment of fixed exchange rates and of a common currency.

C. Gauges of Success

In order to gauge the success of coordination in either its present or its future stages, one must identify the objectives against which success should be measured. Since the Treaty did not articulate the objectives to be attained by the "equivalent safeguards," I will postulate a

raised by H. KREKELER, *WIRTSCHAFTLICHE INTEGRATION UND GESELLSCHAFTSRECHT: AMERIKANISCHE ERFAHRUNGEN UND EUROPÄISCHE IRRWEGE* 158-63 (1973) (Economic Integration and Company Law: American Experience and European Wrong Turns).

229. For one example, the liability of controlling persons for obligations of subsidiaries has yet to be coordinated. It is addressed in radically different ways by the German Stock Corporation Law, *supra* note 51, §§ 321-323 and by the French Insolvency Law (*Loi no. 67-563 du 13 juillet 1967*, arts. 106, 108, 163 J.O. 7059, 7066 (1967)). See Hofstetter, *Parent Responsibility for Subsidiary Corporations: Evaluating European Trends*, 39 INTL. & COMP. L.Q. 576 (1990).

The proposed SE statute of 1970 would have made a controlling SE liable for the debts of a subsidiary. SE Stat. 1970, *supra* note 68, arts. 6, 239, at 3-4, 46. See Derom, *The EEC Approach to Groups of Companies*, 16 VA. J. INTL. L. 565, 603 (1976). But the 1989 draft left liability of a controlling SE to the national law of the controlled SE's home office. SE Stat. 1989, *supra* note 68, art. 114, at 63-64.

Under the European Economic Interest Grouping, *supra* note 67, art. 24, at 7, members of a grouping are liable for the debts of the grouping, but nothing is said about liability of the grouping for debts of its members.

A proposal to deal with liability of parent companies in a "ninth directive" was aired inside the Commission in 1985, but never emerged as a Commission proposal. Kolvenbach, *supra* note 205, at 733-38.

few that seem likely to have been taken for granted by the Community founders.

1. *Disclosing Identity and Finances*

The most widely shared objective of coordination may have been to assure that denizens of any country who were solicited to buy from, sell to, or work for a company of the same or another country should have a ready way of determining the address of the company, the names of the representatives who are authorized to contract on its behalf, and its financial status. This objective seems to be reasonably well served by the requirements of identification and financial reporting.²³⁰

2. *Representation of Employees*

A second objective, which animates the perennial battle over the fifth directive, is to assure that employees have some voice in decision-making at the highest level of enterprise governance. This objective was probably most strongly cherished by Germans, who had inserted this requirement in their own law. It was probably not viewed as an objective of coordination by most of the states that became Community members later. Great Britain, Ireland, Portugal, Spain, and Greece had nothing in their national laws requiring employee participation in decisionmaking at any level. British opinion was the most vocal in opposing the rigid form of codetermination that appeared in the first draft of the fifth directive.²³¹

To many leaders of labor and of the labor-oriented Social Democratic party, "equivalent safeguards" will seem deficient so long as there is no Community-wide requirement of employee representation in corporate governance. The least happy group will probably be employees in countries like Germany and the Netherlands who now have a voice in their employers' councils. Although the coordination program will not diminish the voice of these employees in their own companies, they may fear that multinational enterprise will shift production from German and Netherlands subsidiaries to Italian and Spanish affiliates in order to diminish the influence of labor representatives.

Even if the fifth directive is adopted in its 1983 form, it will permit some states to make themselves much more attractive to managers than Germany is. If managers can agree with union leaders on a plan

230. See *supra* text accompanying notes 97-110.

231. See authors cited *supra* note 205.

of interaction, they can satisfy the directive without giving employees any chance to vote for representatives, and without giving any labor representative a right to hear and be heard in board meetings. It may be further weakened before it is adopted, thereby intensifying the dissatisfaction of German and Netherlands workers.

On the other hand, employees and their leaders may take comfort from the Community's actions to further employee interests more directly. Pursuant to Treaty articles on promoting "improved working conditions and an improved standard of living for workers," the Council adopted in the 1970s two directives on protection of workers in cases of layoffs and takeovers.²³² In 1990, the Commission proposed a broad "Charter of the Fundamental Social Rights of Workers."²³³

3. *Independent Supervision of Management*

Another major aspiration of the Community coordinators is to require that public corporations have either a supervisory council composed of nonexecutives, or a majority of nonexecutives on an administrative board. This demand is probably based on a European supposition that independent supervision protects investors from the incompetence or opportunism of managers.

Pending adoption of the fifth directive, investors in corporations of most of the member states will have no assurance of independent supervision of managers. If German investors are not wary, they will find themselves tied to foreign corporations that lack the independent supervision to which German investors are accustomed. If German investors *are* wary of investment in corporations of other member states, the free flow of investment will be impeded.

Even when "independent directors" occupy commanding positions, either before or after the fifth directive becomes mandatory, investors may find that the supervision of management under the directive is far from independent. There is nothing in the directive to prevent company executives from soliciting proxies with which they elect themselves or friendly allies, as they ordinarily do in the United States.

Community experts may be relying on the strength of shareholding

232. Council directive 75/129 on the approximation of laws of the Member States relating to collective redundancies, 18 O.J. EUR. COMM. (No. L 48) 29 (1975); Council directive 77/187 on the approximation of the laws of Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses, or parts of businesses, 20 O.J. EUR. COMM. (No. L61) 26 (1977).

233. COMMISSION OF THE EUROPEAN COMMUNITIES, COMMUNITY CHARTER OF THE FUNDAMENTAL SOCIAL RIGHTS OF WORKERS (1990).

banks, as observed in the German experience, to mitigate conflicts of interest.²³⁴ But commentators on corporate practice in other Community members do not mention any similar bank influence. Corporation managers might conceivably reduce their exposure to rigorous supervision by raising their capital chiefly in countries where banks are less powerful than they are in Germany. This phenomenon, if it arose, would distort the conditions of competition for capital in the Communities.

With respect to producing independent supervision of managers where it did not exist before, the fifth directive looks somewhat like a paper tiger.

4. A "Delaware of Europe"?

If the fifth and thirteenth directives continue to gather moss, a gravitation of corporations from stricter to laxer states may become visible, defeating a primary objective of the coordination program. This movement would be facilitated by adoption of the proposed Recognition Treaty,²³⁵ which assures corporations of every Community state that they will be admitted in other Community states, while continuing to be governed (like out-of-state corporations in the United States) by the laws of their states of incorporation. Pending ratification of this treaty,²³⁶ the member states seem likely to recognize out-of-state corporations to a degree not greatly different from that which the Treaty would require.²³⁷

The gravitation would probably not go so far as in the United States, where major corporations are governed by the law of Delaware even though they have nothing there but a file and a mailing address. When European corporations maintain their principal executive offices in another state, they may be subjected to provisions of the host state's laws.²³⁸

This principle invites comparison with the provisions of California and New York law that impose domestic rules on foreign corporations

234. See Grossfeld, *Management and Control of Marketable Share Companies*, in 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, *supra* note 43, at 98; R. BUXBAUM & K. HOPT, *supra* note 17, at 179.

235. Convention on the Mutual Recognition of Companies and Bodies Corporate of Feb. 29, 1968, BULL. E.C. SUPP. Feb. 1969, at 7 [hereinafter Recognition Treaty].

236. Wooldridge considered early ratification unlikely. F. WOOLDRIDGE, *supra* note 12, at 135.

237. See *id.* at 136-37.

238. *Id.* The Recognition Treaty would limit imposition of the host state's rules to those it deems "essential." Recognition Treaty, *supra* note 235, art. 4, at 9; see also Reindl, *supra* note 19, at 1274.

that have a majority of their activities in those states as measured by factors such as sales, assets, and employees.²³⁹ But the European principle is susceptible to easier evasion, since only the executive offices need to be kept out of a host state to escape the impact of legislation.

In pre-Community Europe, the home-office test of subjection to host country law probably offered little temptation for evasion, since the executives of a French company would have felt as strange in Germany as would the executives of a U.S. company in Mexico. But the mobility of executives seems likely to increase as the Market becomes more Common, and the evasion of host country corporation laws becomes more attractive. Luxembourg (where both French and German languages are official) might become a kind of European Delaware for companies that are prepared to set up home offices there.

If the fifth and thirteenth directives are adopted, the force of the impulse to seek a haven of laxity will be diminished, but will not be completely extinguished. The fifth directive offers a variety of forms of employee representation, some of which could degenerate to empty charades.²⁴⁰ If they do, the coordination program may not have exorcised the possibility of a corporate haven's blossoming within the Communities.²⁴¹

VI. LESSONS FOR AMERICANS

What the European experience shows about "minimum standards" in the United States will be viewed quite differently by "market economists" like James Lorie and Daniel Fischel and by "institutionalists" like William L. Cary and Joel Seligman.

A. *A Market Economist's Lesson*

To an American "market economist," the most significant lesson of the Community coordination effort is the extreme difficulty of producing consensus on minimum standards, which may be regarded as an indication that there are no minimum standards that offer gains exceeding their costs.

239. California subjects out-of-state corporations to key provisions of its own corporation law if the average of the California fractions of its property, payroll, and sales is over 50%, and if more than one half of its outstanding voting securities are held of record by persons with California addresses. CAL. CORP. CODE § 2115 (West 1990). New York does likewise when half of the corporation's business income is derived from within the state, and the corporation's shares are not listed on a national stock exchange. N.Y. BUS. CORP. LAW § 1320 (McKinney 1986).

240. See *supra* text accompanying notes 202-08; Abeltshauser, *supra* note 24, at 1255-57.

241. See Note, *Federalism and Company Law: A "Race to the Bottom" in the European Community*, 79 GEO. L.J. 1581, 1597-99 (1991); Reindl, *supra* note 19, at 1287.

B. *An Institutionalists's Lessons*

An American institutionalist may be encouraged by the fact that European leaders have opted for coordination, but dismayed by the obstacles that have arisen even among policymakers who are committed in principle to coordination of safeguards.

1. *Corroboration*

To an American institutionalist, whose views have been denigrated by market economists on one hand and by neofederalists on the other, the decision of European leaders to reject in principle the "race of laxity" brings welcome corroboration even though the progress of coordination is disappointing. Europeans differ on the content of minimum standards, but none of them seem to favor a free market in corporation law. The decision of Communitarians to establish minimum standards in corporation law gains significance from the fact that they could have spared themselves stress and strain by letting each state choose its own regime.

The European choice of coordination not only reinforces the view that corporations in a market economy need some marketwide standards, but also confirms many of the prevailing views of institutionalists on particular features of corporate law. For example, Europeans seem to agree that all common shares should carry voting rights,²⁴² governing boards should have at least a majority of nonexecutive members,²⁴³ and creditors should have a right to block reorganizations that impair the security of their claims.²⁴⁴

2. *Would It Work Here?*

In considering what the European experience shows about the practicability of attaining minimum standards in the United States, institutionalists may start from the objectives set forth by William L. Cary in his seminal article on "Federalism and Corporate Law."²⁴⁵ Substantively, he argued for standards of fiduciary duty and of fairness in conflict-of-interest situations; for more shareholder participation in bylaws, meeting agendas, and major decisions; for abolition of nonvoting common shares; for restrictions on indemnification of directors, and for easier suability of officers and directors.²⁴⁶

242. Fifth Directive 1983, *supra* note 13, art. 33.

243. *Id.* arts. 6, 21A(1).

244. See Third Directive, *supra* note 12, arts. 13, 14.

245. Cary, *supra* note 5.

246. *Id.* at 702.

Above all, Cary wanted to abolish the race of laxity,²⁴⁷ whereby the "public choice"²⁴⁸ of corporation laws is made by people who bear very few of the consequences of the rules they choose. Under these circumstances, the diverse interests of the populations affected by corporate behavior have no chance to participate in the public choice of alternative regulations. When the coordination program is analyzed in terms of these objectives, it falls far short of providing a model for American institutionalists.

a. An end to the race of laxity? The Community coordination program does not exhibit a reliable means of halting the race of laxity. Diverse demands of the Communities' member states led to the directive's offering a variety of governance structures that some states could use to attract corporations from others. Demands of American states might lead to a similar diversity of offerings. Although the Communities' "real registered office" test makes the choice of corporate law a little less free than it is in the United States, it permits corporate havens to allure foreign enterprises at a very moderate degree of inconvenience.

b. Standards of fiduciary duty and of fairness. A major concern of U.S. institutionalists has been the laxity of the standards of fiduciary duty and of fairness in conflict-of-interest transactions applied by some state courts. Delaware decisions have been compared unfavorably with decisions of federal courts.²⁴⁹ Whether the Community directives, effective or proposed, preclude the emergence of a similar problem in the Communities is unclear.

The main basis for enforcing fiduciary duties that has appeared to date is a principle enunciated by the proposed fifth directive, which enjoins the managers and supervisors to act "in the interest of the company, having regard to the interest of the shareholders and employees."²⁵⁰ This principle would be embodied in the laws of particular states, which would be interpreted in the first instance by courts of the state. It might be applied more indulgently in some states than in others, just as similar provisions on directors' and officers' duties are

247. *Id.* at 705.

248. On the theory of public choice, see Tollison, *Public Choice of Legislation*, 74 VA. L. REV. 339 (1988); cf. Folk, *Some Reflections of a Corporate Law Draftsman*, 42 CONN. B. J. 409 (1968); Comment, *Law for Sale: A Study of the Delaware Corporation Law*, 117 U. PA. L. REV. 861 (1969).

249. See Cary, *supra* note 5, at 670-96.

250. Fifth Directive 1983, *supra* note 13, arts. 10a(2), 21q(2).

differently interpreted in the United States.²⁵¹

The question whether a particular action of management serves the interests of a corporation proved debatable in U.S. takeover battles even when the shareholders were the only constituency to be considered. It seems likely to be doubly difficult in Europe, where an action that disserves shareholders could be justified as serving employees, and vice versa. The decision would usually be complicated by economic and social conditions that are peculiar to each country. Under these circumstances, the European Court of Justice would be faced with a formidable task if it undertook to substitute its opinion on the correctness of a disputed corporate action for that of the court of a member state. Thus, the Community program does not seem to offer a reliable formula for establishing uniform standards of fiduciary duty.

c. *The powers of shareholders.* In the area of shareholder rights, Cary called for shareholder participation in bylaws and meeting agendas, more shareholder participation in major decisions, and abolition of nonvoting shares.²⁵²

Pending adoption of the fifth directive, the coordination program will do little for the powers of shareholders that is not done by most American corporation laws. But under the proposed fifth directive, shareholders would be granted some legislative protection that they do not enjoy in the United States. All common shares would have voting rights "proportionate to the fraction of capital subscribed which the share represents."²⁵³ This requirement bars the door against the issuance of nonvoting common shares and of shares with radically different voting rights that awakened the protests of various American commentators.²⁵⁴

The fifth directive also contains requirements for notifying share-

251. The possibility of the European Court's imposing a uniform interpretation on member state courts is suggested by the decision of the European Court of Justice on November 13, 1990, that it could overrule an interpretation of a member state's law that conflicted with a Community directive. *Marleasing S. A. v. La Comercial Internacional de Alimentacion S.A.*, Common Mkt. Rep. (CCH) ¶ 95,900 (1990). The case involved a relatively categorical question, rather than one involving a balancing of complex factors.

252. Cary, *supra* note 5, at 702.

253. Fifth Directive 1983, *supra* note 13, art. 33(1). There are two exceptions. The voting of preferred shares may be denied or restricted, *id.* art. 33(2)(a), and the number of votes cast by any single shareholder may be limited. *Id.* art. 33(2)(b). The latter restriction must apply equally to all shareholders of the same class. *Id.*

254. See Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687 (1986). For a contrary view, see D. FISCHER, *ORGANIZED EXCHANGES AND THE REGULATION OF DUAL CLASS COMMON STOCK* (1986); Dent, *Dual Class Capitalization: A Reply to Professor Seligman*, 54 GEO. WASH. L. REV. 725 (1986).

holders of meetings and of their subject matter.²⁵⁵ These rules are more detailed than those found in American corporation codes,²⁵⁶ although less so than those in the federal proxy rules.²⁵⁷

The major effort of the directive in relation to shareholder rights is to provide the governing boards with *nonexecutives*, who would comprise *all* the members of the supervisory council in a two-tier system, or a *majority* of the administrative board in a one-tier regime.²⁵⁸ In this respect, the proposed directive goes beyond any American corporation code, and even beyond the recommendations of the ALI Principles of Governance, which *recommend* an independent majority,²⁵⁹ but avoid declaring that the law should require it.²⁶⁰

But a majority of nonexecutive directors seems unlikely to do much for shareholders if the nonexecutives are handpicked by the executives. In the United States, where institutional shareholders, unlike the German banks,²⁶¹ are predominantly passive, the executives are likely to control the proxy system and elect reliable allies to be their supervisors. If independent supervision is to be established in the United States, American institutional investors must be liberated and activated to exercise their voting power with the vigor of German banks.²⁶²

d. For whose benefit? The Communities' experience casts new light on a current controversy in the U.S. corporation law: Should corporate directors serve not only shareholders, but also employees, suppliers, consumers, communities, and other corporate "constituencies"?²⁶³

Legislative authorization to manage in the interests of multiple constituencies, which Americans greeted as a new invention in the 1980s, was an old story in Europe. In 1937 the parliament of the Third Reich directed that corporate executives should "manage the

255. Fifth Directive 1983, *supra* note 13, art. 24.

256. See, e.g., MBCA, *supra* note 35, §§ 7.05 (meetings in general), 10.03(d) (amendments), 11.03(d) (merger and share exchange).

257. Securities Exchange Act of 1934, 17 C.F.R. § 240.14a-101 (1990).

258. See *supra* text accompanying notes 188-201.

259. AMERICAN LAW INSTITUTE, *supra* note 199, § 3A.01.

260. *Id.* §§ 3.01-3.05.

261. See *supra* text accompanying note 200.

262. See R. MONKS & N. MINOW, POWER AND ACCOUNTABILITY 181-238 (1991); Gilson, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 865 (1991); Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991); Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990); Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J.L. REF. 117 (1988).

263. See sources cited *supra* note 187.

corporation as the good of the enterprise and its retinue and the common weal of folk and realm demand.”²⁶⁴ What priorities should be assigned among these multifarious objectives was inevitably disputed among German scholars²⁶⁵ until the German parliament mercifully dropped the clause, and left the governors with a terse direction to “manage.”²⁶⁶ In the meantime the German parliament had granted seats on the Supervisory Council to employees without any accompanying indication of whose interests they were bound to serve.²⁶⁷

In 1980, the Conservative British parliament ordered that directors have regard to the interests of employees,²⁶⁸ but gave employees no means, either by representation or by judicial proceedings, to enforce the command.²⁶⁹

With these lessons of history before it, the Commission embedded in its proposed fifth directive at least two interesting conclusions about regarding constituency interests. First, managers can and should regard the interests of employees concurrently with those of investors. Second, a command to regard the interests of employees is effective only if employees have a voice in governance.

What importance Community leaders placed on protecting interests of constituencies other than shareholders and employees is unclear; no proposals for corporate governors to consider other interests have emerged from the Community organs. Communitarians may have thought that additional “regards” would lead to confusion or inaction, or that there was no feasible means of providing representation of other constituencies, or simply that the question should be deferred to another day, consistent with the policy of coordinating by easy stages.

264. AktG 1937, *supra* note 51, § 70(1). “Retinue,” “folk,” and “realm” are translations of similarly old-fashioned German terms (*Gefolgschaft*, *Volk*, and *Reich*), that were embraced by the National Socialists to recapture the aura of past grandeur.

265. See Abeltshauser, *supra* note 24, at 1259-60; Grossmann, *supra* note 209, at 153.

266. Ger. SCL, *supra* note 51, § 76(1).

267. See *supra* note 202. Although § 70 of AktG 1937, *supra* note 51, remained in force until 1965, it applied only to the *managing board*; employee representatives were elected to the *supervisory council*.

268. See *supra* note 210 and accompanying text.

269. The “regard” clause was followed by one that declared that —

the duty imposed . . . above on the directors of a company is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

Companies Act 1980 § 46(2). This means that suit could be brought only by the company itself, or by a shareholder suing derivatively on behalf of the company. It could not be maintained by or on behalf of an employee.

VII. SUMMARY

In a competitive market for goods and services, the European Communities rejected a competitive market for corporation law. They adopted instead a program that might be called, in American terms, "federal minimum standards." It leaves to the member states the registration of corporations and the framing of corporation laws, subject to Community directives on features of the greatest economic import. It also leaves to state courts, at least in the first instance, the application of corporation laws.

The most striking features of the Communities' minimum standards were still, in 1991, under negotiation. These were the requirement that corporations give to nonexecutives the ultimate control of corporations, and that employee representatives participate, or at least be consulted and heard, in the making of major decisions. But some features that differ radically from those of current U.S. corporation law are firmly in place; a notable example is the requirement of creating and maintaining a stated level of capital.

Whether the Community program can prevent a "race of laxity" remains to be seen. In order to reach agreement on nonexecutive control and on employee representation, the Community has had to tolerate a wide variety of options, which some states might use to lure enterprises away from others. If the race is foreclosed, economists will question whether minimum standards have inhibited or promoted efficient allocation of resources. In any event, the Community program of coordination will provide Americans with an opportunity to observe a new and different relationship between uniformity and diversity of corporation laws in a federal system.