

Antoine REBÉRIOUX
FORUM
Université de Paris X-Nanterre
200, avenue de la République,
92001 Nanterre CEDEX
e-mail: antoine.reberieux@u-paris10.fr
tel: 00.33.(1)40.97.71.83

The end of history in corporate governance ? A critical appraisal ¹

*Amsterdam Research Centre for
Corporate Governance Regulation*

Inaugural Workshop

17-18 December 2004

Despite the apparent divergence in institutions of governance, share ownership, capital markets, and business culture across developed economies, the basic law of the corporate form has already achieved a high degree of uniformity, and continued convergence is likely. A principal reason for convergence is a widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders. [...] Since the dominant corporate ideology of shareholder primacy is unlikely to be undone, its success represents the 'end of history' for corporate law (Hansmann and Kraakman, 2001, p.89).

This quotation, written by two of the foremost representatives² of US Law and economics, shows the extent to which shareholder value has become a resonating theme in academic debates on corporate governance. Today, the large majority of theoretical publications uphold this form of governance, more or less explicitly. What, however, are the foundations of this position? One possible answer is that the theorists are simply

¹ This text is partly based on Aglietta, M. and Reberieux, A., *Corporate Governance Adrift. A Critique of Shareholder Value*, Edward Elgar Publishing, may 2005.

² Hansmann is professor of law at the Yale School of Management and Kraakman at Harvard Law School.

repeating the legal order, the very function of which is to pronounce what the community recognizes as being legal or just. The question which immediately arises, then, is the following: is it true that the legal order, if assumed to express the norm, is favourable to shareholder value? The answer, just as immediate, is no, not in all countries. Neither Germany nor France grant much credit to this conception of power within quoted companies. For the United States, the answer is not so clear. After British law, US is, out of all the developed countries, without a doubt the most favourable to shareholders.

In this respect, the thesis of Hansmann and Kraakman has the merit of defending a clear-cut point of view: both US law and practises tend to support shareholder value. Moreover, these two authors predict that the other models of governance (French, German, Japanese, etc.) will converge relatively quickly to US standards. This widely accepted prediction is based on the belief that the dynamic of institutions is driven by a logic of efficiency due to the growing intensity of competition on world markets. The confrontation between different models (German, Japanese, American, etc.) that was characteristic of the 1980s is now a thing of the past, heralding the 'end of history' as regards governance.

This thesis appears to us profoundly erroneous, in both its normative and positive (empirical) foundations: shareholder value is not a good principle of governance, nor is it establishing itself throughout the world. We shall first examine this thesis from an *empirical* perspective. We shall limit our analysis to the German and French cases, as they are characteristic of the continental European model. The period studied is the 1990s, during which the rise of financial markets, supposedly at the origin of transformations in forms of governance, has been most prominent. In the first part of this paper, we shall present the US, German and French models and underline their principal differences.³ We aim to highlight the elements that make up these models, as brought out by the comparative literature on this subject. In the second part of the paper, we shall appraise the way in which current transformations in the financial sphere are reshaping these elements. We shall also focus our attention on movements outside the financial sphere that may either reinforce or weaken the continental European model. It is on this basis that we shall be able to pass an overall judgement on the thesis of convergence. In a third part, we will offer a critical assessment of shareholder value from a *normative* point of view, through an analysis of the Enron-era financial scandals.

1. The empirical diversity of the models of corporate governance

The essential factor of distinction between the US model and the continental European model lies in the distribution of share ownership, both from the quantitative (degree of concentration) and the qualitative (identity of shareholders) point of view. Roughly⁴, the US model is characterized by wide dispersion of ownership and by liquid capital markets, dominated by investment funds (mostly pension funds and mutual funds). The essential properties of the continental European model, on the contrary, are relatively narrow capital markets, the presence of large blockholdings and cross-shareholdings between firms.

The importance of the legal framework

The origins of this dispersion of ownership in the United States are currently the subject of a rich and lively controversy. Box 1 retraces the arguments of the main authors in this debate: Roe (1994) on one side, and La Porta, Lopez de Silanes, Shleifer and Vishny (1998) on the other. Over and above the differences which oppose the two sides, this debate is marked by a common approach, today unavoidable in comparative studies: to understand the most significant facts in terms of corporate governance requires detailed analysis of the legal environment.

Box 1

Distribution of ownership and the legal framework: the Roe versus La Porta et al. debate

In 1994, Mark Roe presented an innovative approach to the structure of North American ownership in his book entitled, *Strong Managers, Weak Owners; The Political Roots of American Corporate Finance*. He developed the following thesis: far from being the result of a process of selection through efficiency, the 'Berle and Means' type firm, characterized by a wide dispersion of ownership, is the product of a legal framework which has fragmented financial institutions. This framework, largely introduced before the Second World War due to the pressure of public opinion and certain lobbies, discourages or prevents institutional investors

³ The British model does display certain differences from the US model, but it also has a certain number of characteristics in common with the latter. As we are primarily interested in the evolution of France and Germany, we have chosen not to deal with the British model in detail.

⁴ For a more detailed account, see Lannoo (1999) and Rebérioux (2002).

from amassing large blocks of ownership (see, for example, the Glass-Steagall Act of 1933 for banks, or the Investment Company Act of 1940 for mutual funds). A presumption of inefficiency therefore weighs on the US model: in the absence of this over-regulation, large blockholdings could have developed, as they did in Europe, making it easier to monitor and control management.

In 1998, La Porta, Lopez de Silanes, Shleifer and Vishny (see also La Porta, Lopez de Silanes, Shleifer, 1999) challenged this thesis, observing that the United Kingdom also has a widely dispersed ownership structure, but with no question of laying the responsibility for this at the door of a severe legal framework vis-à-vis financial institutions. They suggest another explanation for the existence of the two main governance models, an explanation which has been widely taken up today. According to these authors, the level of dispersion of ownership increases in direct proportion to the level of legal protection accorded to minority shareholders. Now, the quality of this protection is a direct function of the legal tradition of each country. Thus, common law countries (the United States, the United Kingdom, etc.) provide much stronger guarantees to small owners than civil law countries, which make up for this shortcoming by a concentrated structure of ownership. This thesis, backed up by a very large body of data, takes a view diametrically opposed to that of Roe: it is not the US model that errs through an *excess* of regulation, but the continental European model that errs through a *lack* of regulation.

Following this comparative method, the legal environment and legal foundations of these models will be given a position of foremost importance in our analysis. In other words, we shall connect the constituent elements and the most significant changes of each model as closely as possible with the legal order and its transformations. There is no question of affirming that legal rules are the sole determinants, at any given time, of the way in which the large listed companies are governed. Indeed, many practices without any legal foundation also play a part in shaping the exercise of power (the reproduction of an elite in France through the *grandes écoles* system, for example). In addition, a distinction must be made between the pronouncement of a legal rule and its practical application. We can, however, consider that the legal order sticks closely to the practices and conceptions of the players, whether preceding or following them. Thus, for instance, the existence of blockholdings is widely associated with legal measures that authorize their constitution. The dispersion of ownership, on the other hand, is often connected with the prohibition of certain mechanisms that would facilitate the formation of large blocks. We shall, however, as far as possible, attempt to evaluate the influence of the legal order, by supplying indications of the degree of application of certain rules.

We shall therefore start our analysis by picking out a set of legal mediations which help to distinguish relatively clearly between the exercise and aims of managerial power in each of the two models, US on the one hand, and continental European on the other. At this stage, it is important to identify the legal fields which play a part in shaping the exercise of power. The rejection of shareholder value as an efficient form of governance argued in favour of a re-integration of workers into governance debates. Labour relations should be on a par with the financial sphere as a prime subject of study in the matter of governance. There are therefore three legal fields which should be taken into account.⁵

- Financial market regulation: this *corpus* comprises all regulations covering share issues (primary capital market), and subsequent transactions involving these shares (secondary capital market). The aim of these regulations is both to reduce informational asymmetries between investors and players inside the company, the ‘insiders’, and to prevent misappropriation of value by these insiders (Black, 2001). In the first case, the regulations aim to increase the financial transparency of companies, by obliging them to disclose standardized information. In the second case, the principal targets are insider trading and internal transactions.

- Corporate law: these are the legal rules defining the relations between the different constituents of the company, that is the shareholders, directors, managers and employees. Typically, these rules deal with the nature of voting rights granted to shareholders, the power of the general meeting of shareholders, the composition and functioning of corporate boards, the accountability of managers and directors, and so on.

- Labour law: this field can affect corporate governance directly when it favours the involvement of workers in decision-making processes. Following Turner (1993), we use the term ‘negotiated participation’ to describe this intervention by employees.⁶ Negotiated involvement marks the recognition of workers as a constituent element of the firm, over and above their supply of service (working force). As a constituent element, they have the right to be informed and consulted about the main points involving the functioning of the firm (weak involvement). Possibly, they may be granted a power of co-determination on a more or less wide range of subjects, through elected representatives (strong involvement). This concept of negotiated involvement may create confusion: there is obviously no question of managers being absolutely controlled by the very people they are supposed to manage. Rather, the concept refers to

⁵ For a similar approach, see Cioffi and Cohen (2000).

⁶ This form of involvement contrasts with financial participation, which introduces a variable element in the payment of salaries, and ‘managerial-type involvement’, which covers a group of organizational innovations aiming to increase the autonomy of employees (see Rebérioux, 2003).

a body of positive rights which induce (or force) managers to take the interests of employees into account when making their decisions (Streeck, 2001). Corporate governance is thus directly affected: these rights to information, consultation and co-determination contribute, when they exist, to the definition of a specific aim for the exercise of power within companies, in which the maximization of the well-being of shareholders is not taken to be the required norm (Rebérioux, 2002).

The classification proposed here clearly tends to over-simplify. It is sometimes difficult to determine whether a particular rule lies within the domain of financial market law or corporate law (for example, shareholders' obligation to inform the market authorities when they possess a certain amount of voting rights). In France, financial market and corporate law are brought together within the *Code de commerce*. Likewise, the participation of employees in corporate boards may fall within the scope of either corporate law or labour law. Lastly, it should be noted that the regulation of public offers (takeover bids or exchange offers) touches simultaneously on all three legal fields. Nevertheless, it is useful to adopt this representation to appreciate the main differences between national models of corporate governance.

The US model: shareholder value and market liquidity

The United States is characterized by highly developed financial market law. This law, of federal origin, imposes a set of procedures on managers to guarantee the disclosure of relatively standardized information to the capital markets. It also regulates share operations carried out by insiders, whose position within the firm provides them with private information. Lastly, financial market law also encroaches on internal relations within the company, as it regulates the use of proxies in general meetings. The Securities and Exchange Commission (SEC), the capital markets' regulating authority instituted by the Securities Exchange Act of 1934, plays a key role in this area: it supervises the whole informational chain, from the harmonization of accounting standards (the principal sources of financial information) to auditing and financial analysis.

Compared with financial market law, corporate law is relatively little developed; these laws are mainly produced by individual states, which compete with each other to attract companies.⁷ The legislation of the United States therefore provides firms with a great

⁷ The state of Delaware is the runaway winner in this competition, as more than half of the biggest US companies are registered there.

amount of flexibility in the internal organization of their governance, in the name of contractual freedom. Only a few measures, such as the establishment of a board of directors, are of a constraining nature. Corporate law also introduces certain measures to guarantee the protection of minority shareholders, of an intensity which varies from state to state. The fiduciary duties of the managers and directors constitute the keystone of corporate law in the United States. The fulfilment of these duties is controlled *ex post*, with a high risk of litigation that is specific to the US system. Jurisprudence thus plays a decisive role, in that it specifies the responsibilities of managers. The nature of the fiduciary duties of directors and managers is the subject of a great deal of controversy; but many commentators agree that these duties should be exercised in the name of the shareholders *and* of the company.

Consequently, shareholders are protected more by financial market law than by corporate law.⁸ Nevertheless, the legal framework still offers managers potential room for manoeuvre, all the more so since intense pressure from management circles led to the reinforcing of anti-takeover devices at the beginning of the 1990s. The freedom of managers is further strengthened by the absence of internal, non-shareholder counterbalancing powers: the employees in particular have no rights in terms of governance.

The US model of governance is therefore characterized by the importance it accords to the liquidity of financial markets. Neither corporate nor labour law really affect the discretionary power of managers; control of these managers therefore relies decisively on the regulatory force of the capital markets. From this point of view, two types of actors play a crucial role: first, the SEC, responsible for the good functioning of these markets; second, the institutional investors who, because of their weight in the capital of companies, today exert considerable influence on strategies. Therefore, if shareholder value is winning ground in the United States, it is thanks to the rise to power of these investors and a legal environment that is globally favourable to their wishes.

The German model: a compromise in management

In first analysis, the German model of governance appears to be diametrically opposed to the US model, at least until the middle of the 1990s. The most recent changes will be examined at the end of this paper.

⁸ This conclusion thus counters the thesis of La Porta *et al.* (see Box 1), who appraise the protection of minority shareholders solely through corporate law (see Coffee, 2001, note 7).

Financial market law is traditionally little developed, and specific to each State. Capital markets are not very active and ownership is concentrated. The quality of financial transparency is distinctly lower than the standards prevalent in the United States. The logic of intermediation far outweighs market finance. Banks play a major role: at one and the same time, they are suppliers of liquidities, owners, proxies for the voting rights of their customers and active members of supervisory boards.

Corporate law, on the other hand, regulates strictly the internal organization of companies. This law is of federal origin. Contrary to the monistic structure that prevails in the United States (the board of directors), German companies have a dualistic structure with a board of directors (*Vorstand*) in charge of management, and a supervisory board (*Aufsichtsrat*), responsible for monitoring the managers. The functioning of shareholders' general meetings is also the subject of a large number of legal measures.

Without a doubt, the most characteristic trait of the German model is the position reserved for workers in the matter of corporate governance, through the co-determination system, the *Mitbestimmung*. This co-determination, guaranteed both by corporate and by labour law at a federal level, is based on two pillars. The first pillar is integrated into the dualistic structure of German companies. In companies employing more than 500 workers, workers representatives sit on the supervisory board, alongside shareholder representatives elected during the general meeting⁹. The works council (*Betriebsrat*) constitutes the second pillar of German co-determination. This council possesses a right to co-determination concerning the consequences, both social (principles of payment and working hours) and personal (systems of promotion, recruitment and individual lay-offs), of the economic and financial orientations of the company. For these orientations, the *Betriebsrat* only has the right to information and consultation.

⁹ This form of co-determination has three faces. In the iron and steel and mining industries, the co-determination law of 1951, provides for parity between the shareholder and employee representatives (i.e. an equal number of seats on the supervisory board). The co-determination law of 1976, imposes 'sub-parity' for all firms employing more than 2000 workers. Although the number of seats reserved for the representatives of each party is equal, the president of the supervisory board, whose vote counts double in the event of a deadlock, is elected by the shareholders. Finally, the constitutional law of 1952, extends the principle of co-determination to all companies with a work force of between 500 and 2000 employees. This structure does not have equal representation of both sides, as only one-third of seats are occupied by worker representatives.

Taken as a whole, the German system produces a compromise in management between shareholders, workers and creditors, through the medium of a considerable *corpus* of corporate and labour law. Transparency and capital market liquidity, on the other hand, are weak, and the regulatory bodies for these markets are very fragmented. Shareholder value enjoys neither practical nor legal legitimacy. German law tends to conceptualize the company as an autonomous entity, the running of which is subject to strong procedural constraints obliging the stakeholders to negotiate.

The French model: an intermediate system

The French model occupies the middle ground between the US and German systems. Corporate governance is regulated more by corporate law than by financial market law, but this latter is richer than in Germany. Capital markets are also more developed. Created on the model of the SEC in 1967, the *Commission des Opérations de Bourse* (COB – the stock market regulatory body) has played an important role in the development of these markets. The State's disengagement from productive capital (privatizations) carried out in the 1980s and 1990s, followed by the explosion, from 1996 on, of the 'hard cores' (Morin, 1998), have dramatically altered the landscape of French governance, which had been characterized by the importance of the public sector and cross-shareholdings.

The great majority of companies have a monistic structure (board of directors), but corporate law provides for the possibility of adopting a dualistic structure, which is being chosen by a growing number of big companies.

As in Germany, employees intervene in matters of governance, but to a lesser extent. They possess rights to information and consultation through the intermediary of the works council. However, this council does not enjoy any right to co-determination, and the directing board (board of directors or supervisory board) are reserved for shareholder representatives.¹⁰ Nevertheless, the powers of the works council, inscribed in the Labour Code, are considerable. Article L.431 of the Labour Code, for example, requires the employer to provide the works council with the information it may wish to obtain on the general functioning of the company. This information also plays an important role in the *ex post* control, conducted by judges, of the legal validity of economic lay-offs. Another important right is the possibility for the works council to call in an expert accountant, in order to obtain a counter-valuation of the information

communicated by the employer. This right challenges the “*employer’s monopoly on legitimate expertise*” (Grumbach, 1995; our translation). This is particular to France. Grumbach (1995) thus perceives in France the outlines of a veritable ‘*system of co-supervision*’, rather than co-determination, conducted jointly by the judge and the works councils.

Lastly, French law reproduces an holistic vision of the company as an autonomous entity. In this, it is much closer to the German model than to the US one. Managers must act in the name of ‘*corporate interest*’, which, according to certain authors (see in particular Paillusseau, 1984; 1999), is synonymous with the interests of the firm. This is also the position adopted in the Viénot I report on corporate governance. Commissioned by the MEDEF (Movement of French Businesses) and the AFEP (French Association of Private Businesses) and published in 1995, the section devoted to ‘The objectives of the mission of the board of directors’ notes:

In Anglo-Saxon countries, the emphasis is primarily placed on the objective of fast maximization of share value, whereas, on the European continent in general and in France in particular, it is placed rather on the corporate interest of the company. [...] The corporate interest can be defined as the greater interest of the body itself, in other words the company considered as an autonomous economic agent pursuing its own ends, distinct notably from those of its shareholders, employees, creditors (including the tax authorities), suppliers and customers, but which correspond to their common general interest, which is to ensure the prosperity and continuity of the company (p. 8).

The French system therefore presents the characteristics of an intermediate model, as regards both the financial transparency of companies and the degree of worker involvement in the decision-making processes. It is customary to present French managers as enjoying very wide discretionary powers, although this vision sometimes verges on caricature.¹¹

This discussion has enabled us to bring out the diversity of corporate governance models, rooted in distinct conceptions of the firm and its inscription in the capitalist system. Heuristically, it is useful to distinguish between two main types of model:

- The US model is characterized by an orientation resolutely favourable to shareholders through strong regulation of capital markets. Disclosure requirements are high and

¹⁰ Worker representatives may sit on these boards, but with no more than a consultative role.

¹¹ Fanto (1998) writes, in an article of reference in the Anglo-American world on the French corporate governance system: ‘*chief executives in large French companies have almost dictatorial power*’ (p.53).

interventionism on the part of the authorities (principally the SEC) is considerable. The direct regulation of intra-firm relations through corporate law, is, on the contrary, weak. The integration of employees into decision-making processes is non-existent. This particular configuration of power within the firm, where control is ultimately intended to be exerted from the outside by minority shareholders, is often described as the 'outsider' model;

- The continental European model favours internal regulation of the firm: corporate and labour law thus organize the deliberative structures between the main players in the firm. Controlling interests protect management from capital market fluctuations. An holistic vision of the firm prevails, finding expression in the concepts of corporate interest and/or worker involvement. Financial market law is less ambitious. This situation can be referred to as the 'insider' model.

2. Convergence or divergence? the outlines of an answer

The thesis of convergence, with its underlying apologetic vision of shareholder value, sees in current developments a gradual abandon of continental specificities in favour of an alignment with US standards. We shall now present an overall appraisal of this thesis, concentrating on the transformations that affect the structures of ownership and the legal environment. The current movement appears to us to be much more complex than that announced by the 'end of history' thesis.¹²

Financial market law as a factor of convergence

Parallel to the very favourable development of capital markets, financial market law is the domain which has undoubtedly drawn closest to US standards.

First, obligations in terms of the disclosure of information and financial transparency have greatly increased. The European Union has been a driving force behind this increase. The 1988 directive on financial transparency, aiming to develop information about the identity of shareholders, gave impetus to this movement, even though its transposition into national law took time: Germany only became compliant in 1994. The 2001/34/CE directive, which strengthens publicity norms and standardizes information connected with share issues with the creation of a unique prospectus, also constitutes an

¹² For a similar conclusion in relation to the British case, see Armour, Deakin and Konzelmann (2003).

important step in the transformation of European capital markets. In this field, France has appeared as a model, with two major texts: the 1989 law relating to the security and transparency of the capital market, and the 1996 financial activity modernization law.

Second, there is a tendency towards the centralization of market authorities, along the lines of the SEC. The German case is particularly striking: in 1994, the second law for the promotion of capital markets instituted a federal market authority, the *Bundesaufsichtsamt für den Wertpapierhandel* (BAWe), thus breaking with the fragmentation of German stock market authorities. Centralization was further strengthened in April 2002 with the FinDAG law, which replaced the BAWe by the BAFin (*Bundesanstalt für Finanzdienstleistungsaufsicht*), a body of which the prerogatives exceed even those of the SEC. In France, the law on ‘new economic regulations’ (NRE), passed in May 2001, gave more powers to the COB, while the Financial Security Act, passed in July 2003, took a further step forward with the creation of the Financial Markets Authority (AMF), a merger of the COB and the Financial Markets Council (CMF, created in 1996). In the field of financial market law, the signs of convergence are therefore evident: the transparency of information given to shareholders as a whole has progressed greatly, while the role of market authorities continues to grow.

Corporate law and controlling interests: overall stability

In corporate law, on the contrary, it is impossible to draw such a clear conclusion. Certain signs of convergence can be observed. Most notably, the risk of litigation, characteristic of the US model, is tending to increase as the accountability of managers and directors and the possibility of bringing legal actions against them grow: the NRE law in France (Frison-Roche, 2002) and, to a lesser extent, the KonTrag law in Germany, passed in 1998, both move in this direction. As for the protection of minority shareholders and the stability of blockholdings, it is difficult to make a final judgement. Certain measures favouring these blocks are losing ground: in Germany, the KonTrag law has forbidden multiple voting rights and voting caps and has restricted the banks’ use of their voting rights. However, the most recent studies (Barca and Becht, 2002; Becht and Mayer, 2002; Faccio and Lang, 2000; Boutillier, Labye, Lagoutte, Levy and Oheix, 2002) show that these devices, which are constituent of the continental European model at the same time as they reveal national specificities, remain widespread. For example, it appears that voting caps are on the increase in France (Magnier, 2002). The existence of blockholdings remains the situation of reference in various continental

European countries, despite the increase in market liquidity. The massive presence of US and UK institutional investors in the capital of European companies does not call this observation into question: essentially, these investors have taken their place in the 'float' of company equity, in other words outside the structures and controlling interests (Boutillier *et al.*, 2002). Furthermore, given the size of the blocks they possess individually (rarely exceeding two or three per cent), the ability and desire of these investors to impose their views in a foreign context is doubtful.

Worker involvement: affirming the European model

The existence of forms of 'negotiated involvement' in Germany and France has already been mentioned. This participation, which can be found in various forms throughout continental Europe, constitutes an original, specifically European model of corporate governance. It is possible, at the present time, to observe a movement of consolidation of the rights of employees to participate in the affairs of their company, not only on a national level¹³ but also, and above all, on the level of the European Union. This movement is putting a brake on the process of convergence of the European model towards the US model.

The adoption, in September 1994, of the directive 94/45/CE on European works councils can be interpreted as the first step in this process. Since it came into force in 1996, companies of 1000 employees or more, with a minimum of 150 workers in at least two member States, must have established a 'European' works council, representative of the international composition of the workforce of the firm and endowed with information and consultation rights. While there were only about 30 such structures in the European Union in 1994, and about 400 in 1999, today there are nearly 800, out of a total of a little more than 1800 companies concerned. The directive appears to have succeeded in developing what used to be a minority practice, by imposing employee representatives as legitimate partners. Its success can also be appreciated in terms of the spreading effects it has provoked. Thus, even before Great Britain signed the Maastricht social protocol, within the framework of which the directive had been adopted, a large number of British multinational companies had established European works councils through voluntary agreements (more than 150 in 1999), exceeding even the most optimistic predictions (Jobert, 2000, p. 161). This phenomenon also seems to have influenced non-transnational companies, which have

¹³ Germany, for example, strengthened the co-determination powers of the works council (*Betriebsrat*) in a law passed in 2001.

adopted information and consultation bodies after observing these practices within firms subject to directive 94/45 (Streeck, 2001, p. 199).

This movement of consolidation of a European model of governance through legislative action, based on the 'negotiated involvement' of employees, accelerated significantly with two EU legislative advances, following the Nice summit (December 2000).

(1) The adoption, in October 2001, of regulation 2157/2001 relating to the status of European Company Statutes and of the directive 2001/86/CE, which completed this statute in terms of worker involvement, constituted the first step forward. A European Company (EC) is a moral person possessing an original, specifically EU status. It must be registered in one of the member States of the European Union, with the obligation of establishing its central administration in that State.

The diversity of European practices with regard to employee participation (information, consultation and co-determination) has represented an obstacle to the adoption of a European structure for more than 30 years. In particular, the question of board-level participation (supervisory boards or boards of directors) has crystallized these conflicts, with certain countries fearing the import of this practice (Spain, the United Kingdom and Ireland), and others seeing in this statute the means to avoid strong national requirements in this domain (Germany). The *tour de force* of this directive was to overcome these disputes, thanks to an original legal technique, but which also added to the complexity of the text.

This text, while preserving national differences, clearly moves towards a strengthening of employees' rights in terms of governance (Rebérioux 2002 ; Bordogna and Guarriello, 2003): not only do the rights accorded in the field of information/consultation go further than those provided for by the directive 94/45 on European works councils, but the preservation of the rights of employees previously covered by board-level participation has, essentially, been acquired. This latter requirement is to guard against the use of the directive to weaken labour rights. Moreover, spread or contamination effects, depending on how one judges them, are to be expected from the installation of companies with a strong participative structure in countries where this form of governance does not exist. We have already remarked on the occurrence of such effects concerning the directive on European works councils. These processes of diffusion are hard to contain in the present case, as an EC cannot be registered in one country and transfer its central administration to another. It is precisely

to avoid this ‘shock wave’ that Spain obtained the right not to transpose the fall-back provision for board-level participation in the case of a merger (Moreau, 2001; p. 975); consequently, no company that falls under this measure can register in Spain. We can therefore expect this text to lead to a certain generalization of worker participation on boards throughout Europe.

(2) The adoption of directive 2002/14/CE, establishing a general framework relating to information and consultation of employees throughout the Union, in March 2002, represented another step in the consolidation of employees’ rights in Europe. This directive is to be applied, depending on the choice of the member States, to all companies with more than 20 or more than 50 employees. Three types of subjects must be covered: economic and strategic questions (solely in the form of information), employment evolution within the company and the organization of work. The changes are particularly significant for Ireland and the United Kingdom which, apart from directives 98/59 and 77/187 (see above), had no regulations in this field. The directive does not specify particular conditions within this general framework, but defines a protocol for negotiation of these measures. Here again, fall-back provisions are set out in case negotiations fail. This text completes Union legislation on information/consultation, composed, at the national level, of directives 98/59 (collective lay-offs) and 77/187 (establishment transfers), and, on a supranational level, of directive 94/45 on European works councils.

Labour law therefore represents an even greater thorn in the side of the convergence thesis than corporate law.

The regulation of takeovers: chaotic development

The question of exchange offers and takeover bids¹⁴ – at the intersection of financial market law, corporate law and labour law – crystallizes the oppositions running not only through Europe, but also through each country, concerning the way in which companies should be considered. The questions of managerial accountability and the nature of the firm arise forcefully at the time of takeover offers (Deakin and Slinger, 1997). For agency theorists, these operations represent the ultimate weapon of small shareholders against management. Yet in the United States, most States adopted anti-takeover measures at the beginning of the 1990s. The repeal of these measures, alleged to reduce

¹⁴ These operations can be carried out either using liquidities (takeover bids) or shares (exchange offers).

the stock market valuation of companies, is one of the traditional demands in the activism of institutional investors.

In Europe, the history of the thirteenth directive, concerning takeovers, does not correspond to the predictions of the convergence thesis (see Box 2). This history is a good illustration of the two opposing conceptions of the nature of the firm present within the Union. According to the liberal economic conception, the firm ‘belongs’ to the shareholders. This is the conception underlying the proposition of the directive in its initial version. The continental conception, on the contrary, seeks to implement the idea of the company as a community. There are two ways to do that. First, management could be authorized to act in the name of a greater interest (the corporate interest). Second, the employees could be integrated into decision-making processes. That would mean partially merging the corporation, as a moral person, and the firm, as a productive entity. In fact, the text voted by the European Parliament on 16 December 2003, leaves considerable freedom to member States in their choice of the rules that are to apply to companies within their jurisdiction. In this respect, the text constitutes a certain setback for the advocates of the creation of an active and integrated takeover market into the European Union.

Box 2

The eventful history of the 13th takeover bid directive

On 4 July 2001, the European Parliament rejected the proposition of a corporate law directive on takeover offers, with 273 votes for and 273 votes against. Formulated by the Commission as early as 1985, this directive has had an eventful history. The objective of this text was to facilitate the restructuring of companies in Europe, the idea being to harmonize the takeover market within the Union. After a series of closely argued negotiations between the Commission, the Parliament and the Council, the text was structured around three articles.

- Article 5 provided for the obligation to make a takeover bid once a certain level of voting rights had been acquired (with each Member State free to choose this threshold). This measure aimed to prevent takeovers without the agreement of minority shareholders, in other words by the gradual and discreet purchase of shares in a company. The price of the bid (referred to as an ‘equitable price’) was not defined in the directive.

- Article 6 obliged the company targeted by the takeover bid to inform employee representatives of the conditions of the operation, once this had been made public by the bidder.

- Article 9 prevented, according to the principle of ‘neutrality’, the managers and the board of the targeted company from interfering with the free choice of the shareholders. For example, it should be impossible for the board of directors to take defensive measures once a takeover operation has been started, without submitting them to the general meeting for approval.

The last two articles were the subject of debates which led to rejection of the text. With regard to article 6, many members of Parliament considered that the measures proposed in favour of employees were highly insufficient and should go beyond a simple procedure of information. It was article 9 that proved to cause the biggest problems: the principle of neutrality – the heart of the directive – derives straight from the doctrine of shareholder sovereignty. According to this article, only the shareholders have the right to decide the fate of the company in the event of a takeover bid, despite the fact that such an operation has major consequences for the future of the firm: the restructuring that generally follows such operations bears witness to this. According to article 9, management cannot use corporate interests or the interests of the firm as grounds to oppose a takeover, a measure which goes against the holistic (partenerial) vision of the firm.

In response to this failure, the Commission nominated a group of experts in corporate law, chaired by law professor Jaap Winter. This group was entrusted with the task of producing a report on the drafting of a new directive to harmonize the law concerning takeovers. This report, delivered in January 2002, shaped the drafting of a second directive project; the most controversial elements of the first text were kept. Notably, article 9, setting forth the principle of neutrality, was not changed. It was in fact reinforced by article 11, forbidding the use, during general meetings convened to decide on the adoption of defensive measures, of devices to restrict voting rights, as well as the use of double and multiple voting rights: this article prevents management from taking advantage of mechanisms that could be used to adopt anti-takeover measures antidemocratically, thus bypassing the principle of neutrality. Moreover, although one article (article 13) was added concerning the information of employees, it only refers back to labour law directives already in existence. This is a way of leaving workers out of the debate, all the more so since managers cannot intervene to take worker interests into account (in accordance with article 9). This raises the question of the usefulness of consultation of the employees by the managers, if these latter subsequently have no power to intervene.

After many negotiations, the second directive project was finally adopted on 16 December 2003, by the European Parliament (321 votes for, 219 against and 9 abstentions), accompanied by numerous amendments which considerably reduce the impact of the text. Among these amendments, three are particularly important:

Article 9 is optional: each member of the Union can decide, when the directive is transposed into national law, to keep this article or to drop it. In addition, each State can authorize a company within its national jurisdiction not to respect article 9, if this company is targeted for a takeover by a company that is not subject to this article ('reciprocity' clause).

Article 11 is also optional: nothing obliges a member State to restrict the use of double and multiple voting rights during hostile takeover operations.

Lastly, obligations in the field of information/consultation have been strengthened. The worker representatives of the targeted company and of the assailing company must be consulted for the procedure to be considered legitimate.

These optional clauses are shifting the focus of debates to national borders. Although it is still too early to appreciate fully the impact of this text, the fact that articles 9 and 11 are not

obligatory clearly deprives this directive of some of its substance. The perspective of a unified takeover market in Europe – a factor of competitiveness and modernity according to the champions of shareholder value – has been, if not definitively dismissed, then at least postponed. On the other hand, the fact that article 9 has been conserved (its abandon being optional) is a relative failure for the advocates of an holistic or partnerial vision of the firm.

Within national jurisdictions, the construction of legal frameworks to regulate takeover bids has revealed similar tensions – to such an extent that it is difficult to observe any alignment with the standards of the outsider model. Thus, France, since the end of the 1980s, has adopted a series of measures that have considerably improved the functioning of the takeover market. The year 2001 was marked by particularly effervescent legal activity, with no less than four successive reforms, the most important of which was part of the law on the ‘new economic regulations’ (NRE). Current developments do not all go in the same direction. The NRE law established the obligation for the company making the takeover offer to inform and consult the works council of the targeted firm about its industrial projects; if it does not, the voting rights acquired during the operation will be cancelled. This text, which increases the number of measures, does not come out clearly in favour of either a pro-shareholder vision or a more institutional vision of the firm. It can also be observed that the recent generalization of voting caps and multiple voting rights is tending to seize up the takeover market. For Becht and Mayer (2002), the growth in anti-takeover devices is a specifically European phenomenon.

In Germany, we can observe a strengthening in anti-takeover devices. One week after the rejection of the 13th European directive in July 2001 – partly ascribable to German MEPs – the *Bundestag* adopted a law on takeover bids. The text, initially very close to the proposition of the directive, was heavily modified, to such an extent that its final contents appear to combine opposites. As in article 5 of the European directive, a takeover offer becomes obligatory when a shareholder exceeds a threshold of 30 per cent of voting rights. In addition, the principle of neutrality is validated, preventing the directors (*Vorstand*) from taking defensive measures once the takeover bid has been launched. At the same time, however, the law increases the possibility for managers to adopt anti-takeover measures *in advance*. This point is decisive, certainly more so than the acceptance of the principle of neutrality¹⁵: hostile takeovers can thus be effectively slowed down. The position of employees has been improved considerably. First, the role of the supervisory board, on which worker representatives sit in accordance with

¹⁵ I would like to thank Jean-Philippe Touffut for this remark.

co-determination laws, is increased during these operations. Second, both the assailing firm and the target firm are required to inform and consult the works council (*Betriebsrat*) of the latter.

Taken as a whole, recent developments in the legal framework covering hostile takeovers, and in particular the failure to introduce a specifically European takeover market, are incompatible with the thesis of convergence. The continental European treatment of this issue is certainly changing. However, rather than strictly imitating US standards, the changes taking place in Europe are the result of the confrontation between European specificities and capital market requirements.

The rejection of the convergence thesis

We are now in a position to present an overall appraisal of the thesis of convergence. Table 1, below, summarizes the main points of convergence, resistance or divergence of the continental European model of corporate governance. The developments related in this table illustrate a movement of considerable complexity. The diagnosis of a one-dimensional movement, such as that put forward by the thesis of convergence, is proved to be erroneous. It is possible to break down recent developments in the following manner.

- Financial market law constitutes a strong factor of convergence, both in content and form. In terms of content, the strengthening of the transparency of European capital markets is a movement towards the affirmation of shareholder power. In terms of form, the centralization of capital market regulatory authorities, with the creation of the AMF in France and the BAFin in Germany, tends to reproduce the US model, embodied in the SEC. Equally, from an institutional point of view, even if we stray somewhat from financial market law towards corporate law, the growth in the risk of litigation in Germany and France brings them closer to the US system.
- Corporate law, at least the branch dealing with measures of control, displays a certain inertia. Germany, where the KonTrag law abolished double voting rights and voting caps, represents an exception in this respect.
- Lastly, labour law is a factor of resistance, even of divergence. Directives on European works councils, the information and consultation of workers on a national level, and worker involvement in the European Company all strengthen the European model of governance, founded on 'negotiated involvement'. The symbolic dimension of these directives, particularly the directive on employee involvement within Companies of European law, should not be underestimated. By reminding European players, notably

managers, of the foundations of the conception of the firm which prevails in Europe, this directive is capable of favouring European integration and social cohesion.

Table 1: Principal transformations of the continental European model of governance

Domains	Main changes	Degree of convergence
<i>Financial market law</i>	Improvement of financial transparency: ++ <ul style="list-style-type: none"> • EU: directives of 1988 and 2001 • France: 1996 law on the modernization of financial activities 	++
	Centralization of market authorities: ++ <ul style="list-style-type: none"> • Germany: BAWe (1998) followed by BAFin (FinDAG law, 2002) • France: AMF (financial security law, 2003) 	
<i>Corporate law</i>	Rise in risk of litigation: + <ul style="list-style-type: none"> • France: NRE law (2001) • Germany: KonTrag law (1998) 	0 / +
	Blockholdings: 0 <ul style="list-style-type: none"> • France and Europe: stability and blockholdings • Germany: KonTrag law forbidding multiple voting rights and voting caps 	
<i>Takeovers</i>	<ul style="list-style-type: none"> • XIIIth European directive: 0 • France: NRE law: 0 • Germany: law of 2001: – 	0
<i>Labour law</i>	<ul style="list-style-type: none"> • Directive on European works councils (1994) • Directive on information/ consultation of employees (2002) • Directive on employee participation in European Companies (2002) 	--

Note: The '+' sign signifies that this field (domain) of governance contributes significantly to the convergence of the European model towards US standards. The '0' sign indicates stability. The '-' sign represents a divergence of the European model from the US model.

It therefore appears that convergence becomes ever stronger as we draw closer to the financial sphere, the spearhead of globalization. On the contrary, the institutions connected with labour relations, in other words the way in which internal company relations are conceived and codified, act as a brake on convergence towards the US

model or, alternatively, are no longer a factor of inertia, but a factor of divergence. Corporate law, which occupies a position in between these two spheres (financial and labour) is globally the most stable (Cioffi and Cohen, 2000). Lastly, the regulation of takeover bids, at the intersection of financial market law, corporate law and labour law, is marked by the contradictory evolutions specific to each of these fields. It is therefore very difficult to pass a definitive judgement on the direction taken.

3. Critical assessment of the shareholder sovereignty : the Enron-era scandals

On 2 December 2001, Enron was placed under bankruptcy protection according to Chapter 11 of the Bankruptcy Code – one month and a half after the personal enrichment of its Chief Financial Officer, to the sound of \$30 million, was made public by the *Wall Street Journal*. At \$63 billion in assets, this has been the largest bankruptcy in US history. In terms of stock market capital gone up in smoke, the loss inflicted upon shareholders was considerable: at the end of November, the stock traded at 26 cents. For Enron's 27 000 employees, the damage was just as heavy. They lost their jobs, and their retirement fund evaporated. The in-house pension fund, based on a 401(k) Plan and thus exempted from the ERISA law imposing diversification, had been 60 % invested in Enron shares (Bratton, 2002). Besides, heavyweights of the US financial industry numbered among the actors compromised by this bankruptcy: the audit company Arthur Andersen, which would pay for its part in the scandal by its disappearance; the investment banks J.P. Morgan Chase & Co. and Citigroup, sentenced by the SEC to pay \$255 million in an out-of-court settlement; or even the California pension fund Calpers. The various investigations will show that accounting frauds and manipulations were systematic¹⁶: heavy recourse to off-balance-sheet accounting, hi-jacking of fair value and creative accounting on the income statement all contributed to the misuse of value for the benefit of few executives.

Astonishing as it sounds, it was not an isolated case. In the months that followed Enron's collapse, massive scandals of listed companies in the United States followed one after the other. The telecommunications sector was hit especially hard by the bankruptcies of Qwest, Global Crossing, and WorldCom, all three audited by Arthur

¹⁶ The Powers Report (2002) remains the authoritative reference. See also the US Senate Report (Permanent Subcommittee on Investigations of the Committee of the Governmental Affairs United States Senate, 2002).

Andersen. WorldCom's June 2002 bankruptcy even surpassed Enron's in scale (\$104 billion in assets, \$41 billion in liabilities). But all sectors were involved. In 1998, 158 listed companies were the objects of earnings restatements; in 2000, this number rose to 223, a 43 % increase at the height of the New Economy. According to a report published by the General Accounting Office in October 2002, between January 1997 and June 2002, nearly 10 % of listed companies in the United States restated their earnings at least once due to accounting irregularities.

The gatekeeper failure thesis

Very few experts attribute scandals like Enron solely to the dishonesty of few executives. One would be hard-pressed to explain the recrudescence of dishonesty in the second half of the 1990s on the basis of psychological factors alone. The standard explanation rather points to the responsibility of the "gatekeepers". Coffee (2002) provides the most convincing sketch of this thesis. The (external) auditors, who verify and certify companies' accounts, and the financial analysts, who compile information in order to make buy-and-sell recommendations on securities, are those whose responsibility has been the most emphasised. How then is the failure of auditors and analysts explained?

Mostly, by the conflicts of interest in these professions, that were taking on growing significance. Concerning auditors, the conflicts arose as firms began to provide consulting services to their clients (beyond auditing). Not wanting to lose this lucrative consulting activity, audit firms tended to be more indulgent toward the accounts presented. These conflicts of interest were nothing new, but it seems they became particularly widespread over the course of the 1990s: according to the Panel on Audit Effectiveness, from 1990 to 1999, earnings from consulting rose from 17 %, to 67 % of total fee income. Coffee (2002) also underlines the fact that, in the 1990s, a series of legal decisions made legislation on auditors' responsibilities more flexible. Thus the cost of "error" was relatively weak. Conflicts of interest are also presented as the main driver of analysts' adrift: securities analysts most often worked for investment banks offering advisory services to the corporations they analyse. Under these conditions, it can prove to be a costly move (both for the bank and the analyst's career) to issue a recommendation to sell. The mounting force of conflicts of interest may be properly appreciated by looking at the ratio of buy recommendations *versus* sell recommendations, issued by all of the analysts in the USA: whereas in 1991 the ratio was 6 to 1, by 2000, it had risen to 100 to 1.

Beside the gatekeepers' dysfunctional, Enron-era scandals revealed the weaknesses of the board of directors, as some commentators judiciously noted (see for example Gordon 2002). In the Enron case, independence did not prevent misbehaviour: Enron's board, composed of 12 "independent" directors of a total of 14, saw nothing, and made themselves richer in the process. Such (mis)behaviour might be observed in most of the other scandals.

The Sarbanes-Oxley Act (SAO), promulgated on July 2002, is the explicit response to the loss of confidence in US security markets. This text addresses two main issues :

- First, the SAO strengthens the gatekeepers' regulation in order to limit conflicts of interests. From now on, audit firms are forbidden from providing certain services to the firms they are auditing (appraisal or consulting services, creation and operation of financial data processing systems, etc.)¹⁷. Note that despite their ineffectiveness as gatekeepers from 1997 to 2001, securities analysts are the objects of fairly inconsequential clauses aimed principally at preventing conflicts of interest. The Act does not deal with ratings agencies.
- Second, the SAO reaffirms the disciplinary role of the board of directors. The most significant rule concerns the audit committee. The Securities Exchange Commission is authorized to strike a company off the exchange if its audit committee, "*directly responsible for appointing, paying and supervising*" the external auditor, is not entirely composed of independent members¹⁸. This last point marks a noticeable departure from US regulation in the sense that company law, which regulates the purely internal relations of a company, had been a matter solely for state law. This clause of the Sarbanes-Oxley Act therefore implies for the first time an interference of federal law in the internal organization of companies, much like in Germany (cf. Donald, 2003).

Despite increasingly virulent criticism, the subject of stock options is not even broached¹⁹. In short, the SAO can be summed up as follows: shareholder sovereignty is

¹⁷ In addition, the Public Company Accounting Oversight Board – a new supervisory body created by the SAO, in charge of implementing the peer review system in the profession – has the authority to extend this list of forbidden activities in order to guaranty the stability of these "Chinese walls".

¹⁸ Note that even if the text does not specifically anticipate the obligation to put an audit committee into place, it does specify that in the absence of such a committee, all clauses dealing with this committee (notably the independence of its members) must be applied to the board of directors as a whole. The constrictive character of this clause leads one to conclude that the majority of listed companies will create an audit committee.

¹⁹ In the different scandals, the stock options look more like the means of personal enrichment, encouraging every manipulation that might give a favourable short-term financial market valuation, than

good, but its monitoring system failed. As a consequence, controlling devices accountable to the shareholders must be strengthened. For example, rather than concluding from the Enron case that independency of directors is problematic, it is called for a reinforcement of independency. This account appears to be both *weak* in its explicative power and *paradoxical*.

Even if the United States were particularly affected by scandals related to the management of listed companies, European countries did not escape unscathed. Various affairs can be cited, though none having the magnitude of the US crisis: Vivendi and France Télécom in France, Ahold in the Netherlands, and Parmalat in Italy all contributed to varying degrees in undermining confidence in financial markets. Yet gatekeepers are, by their very nature, national. They consist of actors and procedures defined by national regulations. To explain the crisis in the United States by gatekeeper failure alone, attributing the failure to local (national) factors (increasing conflicts of interest, more flexible jurisprudence on auditing, etc.), is either to ignore the difficulties outside of the United States or to render the gatekeeper thesis so general as to dilute its message. Monitoring would thus be untrustworthy in every respect, everywhere. However, given such a level of gatekeeper incompetence, would it not be better (more logical) to turn attention to the intrinsic motivations of agents, to the conduct of firms themselves? To use a metaphor, the gatekeeper thesis would attribute violence in society to the incompetence of the forces of law and order without questioning the root cause of that violence.

Moreover, it is paradoxical that the governance model in the USA, focused entirely on stacking up mechanisms of control for the last twenty years, failed so spectacularly in controlling corporate actors. Put differently, never have managers been as powerful, or at least well-remunerated²⁰, as they have been since the return in force of the shareholder. In fact, Berle and Means (1932) had already given us the keys to interpreting this phenomenon.

the lever of a well-thought-out strategy. Again, Enron's case is striking: in 2001, the year of bankruptcy, the CEO made \$9.6 million from stock options; the CFO made \$3 million.

²⁰ The *Business week* pay executive survey, regularly carried out, gives an idea: in 1980, the average income of the Chief Executive Officers of the largest firms in the United States was 40 times the average salary of a worker. In 1990, it was 85 times greater, and in 2003, it jumped to 400 times greater.

Beyond gatekeeper failure: shareholder sovereignty at the root of the crisis

Few books have caused as much stir as *The Modern Corporation and Private Property*, written in 1932 by Berle (a legal specialist) and Means (an economist). The “*separation of ownership and control*” still is a key concept in corporate governance debates. Yet it might be argued that the crux of their thesis is today misunderstood, both in its positive and normative levels.

Berle and Means examined the way in which the rise to power of the stock company, the equity capital of which could be freely traded in financial markets, had affected private property, the main driving force of US economic dynamics in the nineteenth century. From a survey of the 200 largest, non-financial corporations in the United States (presented in Book I), the two authors noted the following empirical fact: 44 % of firms were under managerial control. For these firms, the equity capital was so dispersed that shareholders had little opportunity or incentive to get involved in the internal affairs of the company. Because of the development of the stock markets, the US economy had arrived at a new stage in its development, one characterized by a “*separation of ownership and control*”. The “liberal conception of ownership” (see Honoré, 1961) – where the owner is both the beneficiary of the wealth created by the object owned and the sole person capable of transforming (controlling) its substance – no longer applied to the real situation of shareholders. According to Berle and Means, shareholders of public corporations were just owners of an equity stake in a company. This ownership gave them certain rights: for example, the right to vote in general assemblies on the nomination of members of the board of directors. Nevertheless, these rights were no longer sufficient to provide shareholders with control of the company. In practical terms, therefore, the shareholders were no longer owners of firms.

Book II is devoted to an analysis of the jurisprudence of the time, conducted by Berle. This analysis demonstrates that US jurisprudence did not apprehend the full measure of the transformations presented in Book I. Thus, the US judicial system continued to cling to the “liberal”, classical, concept of ownership, as if shareholders were still the owners of companies. The legal order therefore reaffirmed shareholder sovereignty, in other words the primacy of equity owners over the company. This revealed a certain lag in the legal order in relation to the social and economic reality, as well as it underscored the failure of the legal order to discipline corporate managers. Indeed, detailed analysis of the jurisprudence demonstrated that the stacking of legal measures, with the aim of

ensuring shareholder control despite the dispersion of ownership, was totally insufficient for restoring shareholder power:

“As the power of the corporate management has increased, and as the control of the individual has sunk into the background, the tendency of the law has been to stiffen its assertion of the rights of security holder. The thing that it has not been able to stiffen has been its regulation of the conduct of the business by the corporate management. And this omission has resulted, not from lack of logical justification, but from lack of ability to handle the problems involved. The management of an enterprise is, by nature, a task which courts can not assume; and the various devices by which management and control have absorbed a portion of the profit-stream have been so intimately related to the business conduct of an enterprise, that the courts seem to have felt not only reluctant to interfere, but positively afraid to do so” (p. 296).

This quotation clarifies the reasons behind the legal system’s incapacity to control effectively the misappropriation of corporate wealth by managers: courts are *exterior* to the firm as much as the shareholders concerned with preserving the liquidity of their shares. Ultimately, cases of pure embezzlement, objectively perceptible by the law (insider trading, for example, or misuse of corporate property), are relatively rare.

This analysis of the courts’ structural inability to discipline managers did not retain much attention by subsequent commentators, as compared to the free riding problem stemming from the dispersion of ownership. However, as we read it, it has profound insights for current debates on corporate governance: this analysis highlights the intrinsic limits of shareholder sovereignty. Legal mechanisms cannot not re-establish the link between the subject of property (the shareholder) and the object of property (the firm). The same is true for gatekeepers: just as courts, these actors are *exterior* to the firm. Outside the firms, they have little to say in managerial decisions. They can only monitor a firm’s behaviour *ex post*, the limits of which were evident in the Enron-era financial scandals. Shareholder sovereignty is therefore fundamentally unstable; it cannot be realized. The loss of control was and still is a congenital defect of shareholder sovereignty. The fundamental reason is the innate contradiction at the heart of this doctrine, i.e. the will to combine liquidity and control. Liquidity, however, *specifically* pre-supposes complete separation between the person and the property. Put differently, the main principle of this doctrine implies maintaining a distance and is synonymous with exteriority. Berle (1963) expresses this idea most clearly:

“To accomplish this liquidity, it is necessary that the property [...] have no relation whatever to its owner except that relation arising from the owner’s capacity to transfer it. Nothing can be liquid if any value assigned to it depends upon the capacity or effort or will of the owner. Marble would stop being readily salable if its value depended on having the sculptor transferred along with it” (p.25).

The question of the board of directors perfectly illustrates this contradiction (the desire to combine liquidity, i.e. exteriority, and control): in order to prevent collusion between the controllers (board members) and the controlled (managers), the independence of the former becomes a cardinal virtue. There is no longer one code of “good governance” that does not strive to offer an operational definition of what “independency” could be. In the end, this independency can be expressed by one word: exteriority. It is the rationale of shareholder value: how can an internal power be controlled from the outside? As much as possible, board members should have no links to management. In concentrated sectors, this most often means having no links with either the sector or the profession. The assessment of the board of directors offered by the doctrine of shareholder value is paradoxical in that it advocates an increasing *exteriority* for this *internal* mode of control. This exteriority obviously has a price: incompetence – remember that for Enron 12 directors on a total of 14 were “independent”.

The reading of Berle and Means enables to conclude that the gatekeepers’ failure is not the definite explanation of the current crisis. It is just a manifestation of a deeper contradiction, inherent to shareholder value. This contradiction might be expressed as a paradox: the more the interests of shareholders are privileged, the more the firm must be managed in the name of an exterior party (financial markets). This contributes to making managerial power *less* responsible. Shareholder value reinforces the discretionary power of managers rather than limiting it. As a consequence, in its espousal of shareholder value doctrine, the Sarbanes-Oxley Act, far from attacking the root of evil, fertilizes it.

In the same way, the reaction of European authorities might be critically assessed. Faced with an ever increasing number of scandals across the Atlantic, in April 2002, the European Commission decided to entrust the drafting of a report on desirable reforms in EU law to the hands of a ‘high level group’ of experts in business law, chaired by Jaap Winter. The general orientation of the report, favourable to shareholder primacy, is clearest in the following lines:

“In a proper system of corporate governance, shareholders should have effective means to actively exercise influence over the company. As we emphasised in our Consultative Document, shareholders are the residual claimholders (they only receive payment once all creditors have been satisfied) and they are entitled to reap the benefits if the company prospers and are the first to suffer if it does not. Shareholders need to be able to ensure that management pursues - and remains accountable to - their interests. Shareholders focus on wealth creation and are therefore, in the Group’s view, very suited to act as “watchdog” not only on their own behalf, but also, in normal circumstances, on behalf of other stakeholders.” (p.47)

Inspired in large part by the Sarbanes-Oxley Act, but having to take European specificities into account, the report’s conclusions are fairly modest. For example, conscious of the US model of governance, the report insists on the advantages of the independency of board members who head *ad hoc* committees. The report immediately notes, however, that this arrangement would be difficult to adapt to Europe. It would automatically exclude majority shareholders and employee representatives, because their involvement in the firm would be incompatible with the notion of independence. Yet majority shareholders are present all over Europe, and board-level participation of employee representatives is characteristic of many member countries. Thus the report adopts a moderate position, one of fairly limited scope: *ad hoc* committees should constitute a majority (not a totality) of independent members. The most daring clause in the report, which clearly differentiates itself from the Sarbanes-Oxley Act, is that it proposes stronger regulations on stock options.

The Winter Report illustrates the reaction of European regulatory authorities. They did not use the US crisis to reaffirm the specificities of the continental European model. Instead, they were content to copy measures taken in the United States, exploiting the relative quiet of the European landscape to justify less ambitious clauses.

Conclusion

The ‘end of history’ thesis of corporate governance, besides the fact that it adheres blindly to the doctrine of shareholder value, is the product of a faulty interpretation of globalization, according to which the model that appears to have dominated during a given period (the US model of the second half of the 1990s) is imposing itself on an international scale. On the contrary, we have demonstrated that globalization involves a

process of confrontation of supra-national phenomena (in this case the integration of financial markets) with more local, continental, national or regional regulations. In this respect, the convergence of the European model of governance is far from established: although certain elements are indeed moving closer to the US model, factors of resistance, or even of divergence, are equally identifiable – particularly in the field of labour relations.

Bibliography

- Armour, J., Deakin, S. and Konzelmann, S., 2003, « Shareholder Primacy and the Trajectory of UK Corporate Governance », University of Cambridge, ESRC Centre for Business Research, Working Paper n°266.
- Barca, F. and Becht, M. (eds.), 2002, *The Control of Corporate Europe*, Oxford University Press.
- Becht, M. and Mayer, C., 2002, « Introduction », in Barca, F. and Becht, M. (eds.), *The Control of Corporate Europe*, Oxford University Press, pp. 1-45.
- Berle A., 1963, *The American Economic Republic*, New York, Harcourt, Brace and World.
- Berle A. and Means G., 1932, *The Modern Corporation and Private Property*, New York, Harcourt, Brace and World, new ed. 1967.
- Black, B., 2001, « The Legal and Institutional Preconditions for Strong Securities Markets », *UCLA Law Review*, vol. 48, pp. 881-855.
- Bordogna, L. and Guarriello, F. (eds.), 2003, *Aver voce in capitolo. Società europea e partecipazione dei lavoro nell'impresa*, Edizioni Lavoro.
- Boutillier, M., Labye, A., Lagoutte, C., Lévy, N. and Oheix, V., 2002, « Financement et gouvernement des entreprises : exceptions et convergences européennes », *Revue d'économie politique*, vol. 112, pp. 499-544.
- Bratton W., 2002, “Enron and the Dark Side of Shareholder Value”, *Tulane Law Review*, vol. 76, pp. 1275-1362.
- Cioffi, J. and Cohen, S., 2000, « The State, Law and Corporate Governance : the Advantage of Forwardness », in Cohen, S. and Gavin, B. (eds.), *Corporate Governance and Globalization. Long Range Planning Issues*, Cheltenham and Northampton, Edward Elgar, pp. 307-349.
- Coffee, J., 2001, « The Rise of Dispersed Ownership : the Role of the Law in the Separation of Ownership and Control », The Center for Law and Economic Studies, Columbia Law School, Working Paper n°182.
- Coffee J., 2002, “Understanding Enron : It’s About the Gatekeepers, Stupid”, *Columbia Law School Working Paper*, n°207, July.

- Deakin, S. and Slinger, G., 1997, « Hostile Takeover, Corporate Law, and the Theory of the Firm », *Journal of Law and Society*, vol. 24, pp. 124-151.
- Donald D., 2003, “Some Observations on the Use of Structural and Remedial Measures in American and German Law after Sarbanes-Oxley”, *German Law Journal*, vol. 4(2), February.
- Faccio, M. and Lang, L., 2000, « The Separation of Ownership from Control ; An Analysis of Ultimate Ownership in Western European Corporations », mimeo, Università Cattolica del Sacro Cuore, Milan.
- Fanto, J., 1998, « The role of Corporate Law in French Corporate Governance », *Cornell International Law Journal*, vol. 31, pp. 31-91.
- Frison-Roche, M.-A., 2002, « Le droit français des sociétés entre corporate governance et culture de marché », in Plihon, D. and Ponsard, J.-P. (eds.), *La montée en puissance des fonds d’investissement ; quels enjeux pour les entreprises ?*, Les études de la documentation Française, pp. 77-91.
- Grumbach, T., 1995, « Citoyenneté, Entreprise et Contrat Social », *Droit ouvrier*, juin, pp. 235-257.
- Hansmann, H and Kraakman, R, 2001, « The End of History for Corporate Law », *Georgetown Law Journal*, Vol. 89, pp. 439-68.
- Honoré A. M., 1961, “Ownership”, in Guest A. G. (ed.), *Oxford Essays in Jurisprudence*, London, Oxford University Press.
- Jobert, A., 2000, *Les espaces de la négociation collective, branches et territoires*, Toulouse, Octares.
- Lannoo, K., 1999, « A European Perspective on Corporate Governance », *Journal of Common Market Studies*, vol. 37, pp. 269-294.
- La Porta, R., Lopez-de-Silanes, F. and Shleifer, A., 1999, « Corporate Ownership Around the World », *The Journal of Finance*, vol. 54, pp. 471-517.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R., 1998, « Law and Finance », *Journal of Political Economy*, vol. 106, pp. 1113-1155.
- Magnier, V., 2002, « L’évolution du gouvernement d’entreprise en France », in Plihon, D. and Ponsard, J.-P. (eds.), *La montée en puissance des fonds d’investissement ; quels enjeux pour les entreprises ?*, Les études de la documentation Française, pp. 67-75.
- Moreau, M., 2001, « L’implication des travailleurs dans la société européenne », *Droit social*, novembre, pp. 967-976.
- Morin, F., 1998, « Le modèle français de détention et de gestion du capital. Analyse, prospective et comparaisons internationales », *Rapport pour le Conseil d’Analyse Economique*, Les Editions de Bercy, coll. Etudes.
- Paillusseau, J., 1984, *Les fondements du droit moderne des sociétés*, JCPE.
- Paillusseau, J., 1999, « Entreprise, société, actionnaires, salariés, quels rapports ? », *Chronique*, Recueil Dalloz, pp. 157-166.

- Permanent Subcommittee on Investigations of the Committee of the Governmental Affairs United States Senate, 2002, *The Role of the Board of Directors in Enron's Collapse*, Report 107-70, July.
- Powers W. (dir.), 2002, *Report of Investigation by the Special Investigate Committee of the Board of Directors of Enron Corp*, February.
- Rebérioux, A., 2002, « European Style of Corporate Governance at the Crossroads : the Role of Worker Involvement », *Journal of Common Market Studies*, vol. 40, pp. 111-134.
- Rebérioux, A., 2003, « Les marchés financiers et la participation des salariés aux décisions », *Travail et emploi*, n°93, janvier, pp. 23-41.
- Roe, M., 1994, *Strong Managers, Weak Owners ; The Political Roots of American Corporate Finance*, Princeton University Press.
- Streeck, W., 2001, « La transformation de l'organisation de l'entreprise en Europe : une vue d'ensemble », in *Institutions et croissance ; les chances d'un modèle économique européen*, Colloque du Centre Saint-Gobain pour la recherche en économie, Albin Michel, pp. 175-230.
- Turner, L., 1993, « Prospects for Worker Participation in Management in the Single Market », in Ulman, L., Eichengreen, B. and Dickens, W. (eds.), *Labor in an Integrated Europe*, Washington D.C., The Brookings Institution.
- Viénot, M., 1995, *Le conseil d'administration des sociétés cotées*, rapport du comité conjoint CNPF et Afep, Paris.