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European Perspectives: A Foreword

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Our authors perform a valuable service for American corporation lawyers by presenting us a picture of the corporate responsibility question as seen from European perspectives. It is a significant addition to the limited number of writings that shed real light on the ways in which the different legal traditions of the industrialized nonsocialist powers have tried to organize and channel large-scale private economic activity. To each of those systems of law the modern corporation poses a puzzling set of challenges: How can one obtain economic efficiency from large productive units? How can one, at the same time, prevent those entitities from spinning off negative externalities as their impact on their surroundings grows? Finally, how can we accomplish those ends without setting up such an elaborate system of signals, checks, balances, and reviews as to stifle all activity? As Professor Schmitthoff shows us, comparative corporation law has been a productive and practical exercise within Europe; it may become a transatlantic activity as well.[1] As we proceed with conferences, hearings, symposia, and even rules[2] on "corporate governance" (as the topic has become known) we will need all the guidance we can get from our foreign peers.

Professor Roth has done us a special service by describing systematically and with great economy of language the modes through which society attempts to steer corporations in the direction of the public interest.[3] As one goes through the list one sees that we and the Europeans have put our emphasis in different places. In the past, the United

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1. For a detailed description of the earlier history of this development, see E. STEIN, HARMONIZATION OF EUROPEAN COMPANY LAWS: NATIONAL REFORM AND TRANSNATIONAL COORDINATION (1971).

2. For a summary of reactions to the SEC's call for comments on corporate governance, see [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,653.

3. By way of comparison one thinks of the much more elaborate and abstract treatment of alternatives in C. LINDBLOM, POLITICS AND MARKETS: THE WORLD'S POLITICAL-ECONOMIC SYSTEMS (1977). For European-American comparisons, see A. SHONFIELD, MODERN CAPITALISM: THE CHANGING BALANCE OF PUBLIC AND PRIVATE POWER (1965).

States has given a critical role to formal regulation, both by industry-oriented agencies such as such as the ICC, CAB and FCC, and by purpose-oriented agencies such as those controlling pollution, consumer safety, and environmental pollution. Looking at the performance of these agencies, we have come to have doubts. We see the mountains of costly paperwork involved. We see projects delayed for years by proceedings that grind remorselessly through courts and agencies. We find industry growing soft and noncompetitive under the shield of agencies that have acquired parental feelings about their charges. For such reasons we have tried painfully to prune some of the excesses of regulatory action. We would still feel uncomfortable with the private, informal governmental–guidance processes more natural on the continent. We still find such relationships insufficiently visible, controllable, and definable. The example of the socialist countries is one that attracts virtually no American analysts and, as Professor Schmitthoff shows, very few Europeans.

The proper subject of corporation law, however, is not control by outside agencies, but rather control embedded within the internal managerial structure of the corporation. American lawyers have watched with some trepidation the fact that Germany has not only survived but prospered while harboring as curious an aberration as co-determination. That concern has been heightened by an awareness that Great Britain, seeking relief from its industrial problems, which include labor restiveness and slack in the managerial system, has been giving serious consideration to importing the institution into its own law.

Professor Schmitthoff sketches for us the prospects of change in that common–law country. At the same time the new German amendment, advancing labor representation to a position of parity, warns management that a first step towards co-determination may lead to further encroachment on its power position. Thus far I have not detected any enthusiasm for this institution among American managers and not very much in union circles. The habit of adversary relations between capital and labor is too deeply rooted to be easily displaced.[4]

Professor Roth leans towards a drastic solution for the problem of reconciling the conflicting interests at stake in the process of corporate management. He would deprive the shareholders of their legal claim to select corporate management and turn managerial power over to independent trustees. Bringing down to date the Berle-Means conclusion

4. My views as of an earlier time appear in Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23 (1966).

that shareholder control in the "modern" corporation is an ineffective pretense, he concludes that such a change would not be a significant sacrifice for the shareholders. Furthermore, it would clear the way for a disinterested decisionmaker to make the difficult choices between interests free from an exclusive fiduciary tie to the shareholders.

With all respect, I have doubts about each of these propositions. Professor Roth has focused his previous work on investment companies and may have tended to over-extrapolate his findings. The shareholders of mutual funds—particularly closed-end—seldom resort to the vote to cope with management. For one thing, the real manager is not directly subject to their vote but is tied to the fund by an investment advisory contract; voting the manager out would involve first a change in the rather nominal board of the fund so as to obtain a board that will terminate the contract agreement. For another, the remedy of selling out is a relatively effective one; shrinkage of the amount invested in the fund has quite direct economic effects on the managers. In an ordinary manufacturing corporation, the shareholders' position is more complex.

I am persuaded by the Eisenberg analysis, that as to corporations other than AT&T and a few analogous giants, shareholder revolts are a realistic possibility.[5] When one takes into account the blocks held by individual families and institutions, one sees that at many corporations there are nuclei that could support a purge. Alongside that factor one notes the possibility that managerial inadequacy will depress the market price of the corporation's stock to the point where it is attractive to make a tender offer in order to take over control. While it is relatively uncommon to combine a tender with a proxy fight as in the Curtiss Wright-Kennecott situation,[6] the tender offer would make no sense at all if the successful tenderer, as holder of the controlling shares, did not have the power to displace management. Without either the tender offer or the proxy fight to fear, the independent trustee could defy the shareholders. Thus, the proposed change would impact heavily on shareholders and lead to the loss of much of the value of their investment.

This would be a strange time at which to impose such a sacrifice. The lot of the holder of equity securities since 1973 has been a harsh one. In the United States, millions of shareholders have deserted the stock market, the market value of stocks as calculated by the Dow

5. M. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS (1976).

6. Kennecott Copper Corp. v. Curtiss-Wright Corp., [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,565 (2d Cir. Sept. 28, 1978).

Jones index has declined drastically during the period since 1973 when simply holding even with inflation would have required a very substantial increase,[7] and the price of assets obtained through the purchase of stock has sunk so far below the price of reproducing them directly that tender offers have become the fashion.

All of this has, naturally, had devastating effects on the market for new equity securities. Thus, the case is strong for the proposition that the present weak point in the capitalist system is the vulnerable position of the capitalists themselves and not the danger that excessive concentration on profit maximizing will lead to injury to other interests. Merely perfecting the provision of information about the desperate situation would not do much to cure those problems. Perhaps this is an American-centered view; it could be argued that Europe has begun only very slowly to impose by government decree restrictions in the interest of the environment, consumer safety, etc. Thus, there may be more room left for social responsibility as a restraint on the excesses of enterprise.

Nor am I optimistic about the ability of a trustee to reconcile or trade off the claims of the various parties interested in a corporation. We are familiar with the problems trustees have in reconciling the rather straightforward conflicts between life tenants and remaindermen.[8] Although these problems tend to fall into repetitive categories, trustees have had to seek judicial instructions on many occasions. It is hard to see how trustees would decide how much to expend on air-pollution control equipment—at what expense to their workers' salaries and to their stockholders' dividends?

What they would do would depend to a large degree on who appointed them. If, as seems very possible, the gap would be filled by a public-interest trustee we would have a situation to which the closest analogy would be our experience with directors who represent the United States government on corporate boards. They have certainly had difficult roles to play because of the dual character of their responsibilities. Of these I am most familiar with the work of the Overseas Private Investment Corporation (OPIC).[9] This body was established to take over the portfolio of insurance against foreign expropriation that

7. According to one calculation, $.90 invested in the Dow stocks in 1965 would have shrunk by late 1977, by virtue of inflation and the market, to $.44. TIME, Aug. 29, 1977, at 44.

8. *See* 2 A. SCOTT, LAW OF TRUSTS § 183 (3d ed. 1967); 3 *id.* § 232.

9. *See* Griffin, *Transfer of OPIC's Investment Insurance Programs to Private Insurers: Prospects and Proposals*, 8 LAW & POL'Y IN INT'L BUS. 631 (1976).

had been built up by various branches of the United States government. It has had much difficulty in trying to decide whether to behave like an insurance company or a development-assistance organization. Congress has hoped that it could, with the assistance of Lloyd's and other private underwriters, put the risk on a strictly actuarial basis. At the same time it has sent OPIC signals that it should put more stress on poorer countries, on enterprises that will not export to the United States, on small corporations, etc. Each of these runs counter to the instincts of the business executive. Without being critical of those who manage OPIC, one comes to believe that they have an impossible assignment. One suspects that Professor Roth's trustees would be equally bewildered by the messages that come to them.[10]

10. I have made much the same comments in reviewing the rather similar proposals made in C. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR (1975). Vagts, Book Review, 49 S. CAL. L. REV. 635 (1976).