PARTICIPATION
IN
CORPORATE
GOVERNANCE

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Declaration

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Abstract

Over the last thirty years there has been a remarkable functional convergence in the way companies are run. Behind directors, asset managers and banks usually participate the most in setting the ultimate direction of corporations, as they have assumed the role of stewardship over shareholder voting rights. At the same time, an increasing number of people's livelihoods and old age now depend on the stock market, but these ultimate contributors to equity have barely any voice. Why has there been such a separation of contribution and participation?

Two positive theses explain this convergence in corporate governance, one political, one economic. The first positive thesis is that laws which guarantee participation rights in investment chains (either for shareholders against directors, or for the ultimate contributors against institutional shareholders) were driven by a progressive democratic movement, but very incompletely compared to its social ideals. The second positive thesis is that when there have been no specific rights in law, the relative bargaining power of different groups determined the patterns of participation, whether the outcomes were reasonable or entirely arbitrary. In practice, the separation has grown between those who contribute to equity capital and those who participate in governance. These theses are preferable to existing narratives in political literature, and law and economics, which entail predictions of different forms of rational interest-driven institutional evolution. On the contrary, participation in corporate governance is largely unprincipled. The evidence is found in the historical development of participation rights in the UK, Germany and the US.

Does the separation of contribution and participation matter? One normative thesis is derived from the historical evidence. It proposes that the separation of contribution and participation is a pressing concern, precisely because participation in corporate governance, as it stands, manifests no coherent principles. Asset managers and banks have gathered shareholder voting rights through no better reason than their peculiar market position as investment intermediaries. They have significant conflicts of interest when they exercise voting rights with other people's money. They are able to use votes like any other self-perpetuating interest group would, because they are not effectively accountable to their natural beneficiaries: the ultimate investors. To ensure that the successes of modern corporate law are not unravelled, corporate governance should protect the principle of a symmetry between contribution and participation. This will mean that in the future, corporate governance becomes more economically efficient, sustainable, and just.

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Part I. Concepts
1. Introduction and overview

At the heart of economic life, in modern democratic society, lies a tension between the benefits of large-scale organisation and the concentration of power. When Adam Smith remarked in 1776 that directors were prone to ‘negligence and profusion’, because they were in charge of ‘other people’s money’, he may well have hoped that large corporations, like mercantilism, would soon be a thing of the past.¹ It might have been hoped that partnerships of butchers, bakers and brewers would make the economy,² so that Britain’s wealth, and the wealth of all nations, would come from small competitive businesses. From the late 19th century, and then particularly with Berle and Means in 1932,³ corporations had won legitimacy. Discussion moved away from the inherent flaws of some people managing ‘other people’s money’ to how to manage the ‘separation of ownership and control’. Another change came over late 20th century discourse. Problems of corporate accountability in mass production were gradually resolved into strategies for limiting agency costs when principals’ welfare was at stake. Now, in the wake of the financial crisis that began in 2007, it is apparent that modern systems of investment have led more people to depend on the fortunes of the stock market than ever. But at the same time very few of those same people exercise any economic voice. Asset managers and banks tend to hold most voting rights in corporate governance. This may not differ so much from the long course of history, but why do some people participate in corporate governance more than others, and does it matter?

There are no neat answers that a single, unqualified thesis could capture. Instead, three theses are proposed – two positive and one normative – but all come with uncertainty. Chapter 2 starts by summarising the state of corporate governance today to show that on the question of who participates most, there has been a remarkable functional convergence in modern economies. Financial institutions, particularly asset managers and banks, have assumed the role of stewardship. They have done this chiefly by appropriating the votes bought with retirement and other savings from most of the working population. Because of the relatively new nature of intermediated investment and retirement, the language of the ‘separation of ownership and control’ has become outdated. The concept of the ‘separation of contribution and participation’ enables a broader view of the agency problems in modern investment. It captures those who ultimately contribute to equity capital (whether by buying shares through a broker, having a trust

² Smith (1776) Book I, ch 2, §2
³ AA Berle and GC Means, The Modern Corporation and Private Property (1932)
or contract based pension, or life insurance policy), but do not necessarily retain ‘ownership’ rights. It captures everyone who participates in controlling a company, but does not hold control completely. The chapter concludes by acknowledging that a participation right, like the more absolutist notion of control, is just one mechanism of accountability, like markets or legal duties. However these different mechanisms of accountability are best seen as complements, rather than substitutes. This justifies an independent focus on participation in corporate governance.

Chapter 3 elaborates the two positive theses. The first is that the gradual spread of participation rights in corporate governance is the product of a progressive democratic movement, but it remains very incomplete. Progressive democrats have consciously sought to ensure that directors were accountable through the vote, that dispersed shareholders had voting rights, and to some extent that the ‘ultimate contributor’ of equity capital had a voice. They wanted to socialise, not ownership, but power: to put power into the hands of the many, and not just the few. But this social ideal has plainly not been carried into full effect. Nor is it possible to see the law as successfully carrying any other political ideology through. This political narrative explores what shaped the law. The second positive thesis holds that, when there was no specific regulation for participation rights, the patterns of participation over time reflect the varying bargaining power of economic actors. Many existing political and economic theories stress or presume there is a rational process of institutional development. But the outcomes of politics, or a market buffeted by bargaining power, cannot be equated with rationality. Very often the outcomes were arbitrary from a welfare viewpoint. History shows, and human behaviour means, that we continually deviate from welfare maximising patterns of choice, both in politics and economic affairs. Ultimately, this means participation in corporate governance is unprincipled.

The historical evidence that supports these two positive theses is provided in Part II. The United Kingdom, Germany and the United States provide the main case studies. The reason to focus on these jurisdictions is that in terms of ‘legal family’, they can be taken as broadly representative of the Commonwealth, and the European Union, while the US is a unique jurisdiction in itself. This captures a large part of the global economy, and their differences in ownership and regulatory structure serve to illustrate vividly, not just the familiar varieties, but also the fundamental commonalities of modern corporate governance. As pre-eminent industrial economies, the UK, Germany and the US also have among the longest and most challenging histories.

Chapter 4 examines the changes of rules on director elections, in terms of both appointment and removal rights. The idea that directors ought to be easily electable or removable
by a majority of voters in a corporation’s general meeting can be traced into the old common law, and Hanseatic traditions in German Länder, but it had met heavy opposition from executive interest groups who wished to be entrenched. After Berle and Means’ foundational treatise, Labour and Democrat governments in the UK and US saw it as good corporate governance to make those traditions compulsory. To some degree this approach was revived in Germany in 1965. However, before there were compulsory rules, or as those rules were relaxed, UK directors could typically be removed only by a 75 per cent vote, German directors insulated themselves from the general meeting with two-tier board structures, and US directors tended to push for staggered elections where they could only be dismissed for a good cause. Company constitutions too frequently erected obstacles to directors’ electoral accountability, deepening the separation of anyone who contributed to a company from the ability to participate in governance.

Chapter 5 examines how shareholder voting rights were distributed. Before there was specific regulation in the US and Germany in the 1920s, and as the number of small investors grew, companies began issuing vast swathes of ordinary shares with no voting rights or shares with multiple voting rights for management. Threatened with disenfranchisement, a popular outcry in the US, particularly supported by Woodrow Wilson and an economist named William Ripley, pressured the government and the New York Stock Exchange into adopting a one-share, one-vote rule. In Germany, a one-share, one-vote law was proposed in 1931 in a still-democratic state. Perhaps paradoxically, it was adopted in 1937. In the UK, after the sniff of a similar wave of voteless share issues in the late 1950s, the London Stock Exchange applied regulatory pressure and institutional investors exercised their muscle, to maintain a one-share, one-vote standard. Thus, the historical evidence shows that a one-share, one-vote standard was not what an unregulated market would produce. Instead, when left to the market, participation rights were shaped by arbitrary fluctuations in bargaining power, which progressive democrats sought to contain with law reform.

Chapter 6 goes behind the modern shareholder, ‘piercing the institutional veil’. What shaped the participation rights of those who made the ultimate contributions that went to financial institutions, and then into companies’ equity capital? In the UK, Germany and the US today, beneficiaries of pension funds often have a vote to elect their trustees, to some extent. In the UK this was largely a product of collective agreements made by trade unions. The law then codified the practice in 1995 and 2004. In Germany, the codetermination rights had their roots in the 1848 democratic revolutions and the 1918 Stinnes-Legien Abkommen. The post-war Social Democrat government codified these practices and traditions into law. In the US, a voice in
pension funds came out of collective agreements in the private sector (when trade unions were strong) but also, and particularly from 1997, the laws of many states. Still, there has been significant instability in the voice that pension beneficiaries have had, particularly because rights usually depended on the legal form of the pension. In all countries, changes in the collective organisation of beneficiaries and workers changed the number and strength of codetermined or multi-employer plans.

In the other sectors of investment, life insurance policy holders would typically have no voice, even though insurance based pensions were offered by employers as pure substitutes to codetermined pension schemes. Mutual fund investors were frequently incapable of exercising any voice (even if they wanted to). People buying shares through a retail bank or other broker would find that the bank invariably appropriated voting rights on shares through standard form contracts. Significantly, because of the peculiar rules on share deposits, German banks came to vote on all kinds of shares: they used their dominant market position to acquire voting rights through standard form contracts. This market practice was codified into law in 1937. In the UK and US, asset managers were usually delegated management of pension fund assets, and would appropriate shareholder voting rights in the same way. In the end, apart from large pension funds that were codetermined and took investment in-house, asset managers and banks in all jurisdictions tended to participate most in modern corporate governance.

Chapter 7 contains the third thesis. It uses the evidence from Part II to address the normative question of whether the separation of contribution and participation represents a pressing concern. Overall the historical evidence suggests that our patterns of participation in corporate governance cannot be regarded as the product of any principle. Significant scope for ‘negligence and profusion’ in financial institutions and on corporate boards remains. Modern corporate law has ensured minimum standards of accountability of directors to shareholders, but the risk is that financial intermediaries will continue to cut the ultimate contributor out. The one normative thesis is that, if the successes of modern corporate law are not to be undone, the law must strive to maintain a symmetry between people’s contributions to equity, and their right to participate in its use: a symmetry between ultimate investment and voice. As a minimum, through every link in the chain of investment the contributor should have a right to vote for representatives who – at least via intermediates – ultimately elect the company board. The persuasiveness of this principle depends on the goal one seeks. But whether the goal is more expertise and better stewardship, whether it is to ensure an economically productive or socially just system of corporate law, the symmetry thesis embodies an irreplaceable principle. In contrast
to the basic principle, no single policy option should be regarded as ultimately ‘right’.
Accordingly, three different models to create a symmetry of contribution and participation, and
their application to each country’s legal tradition and context, are proposed. Chapter 8 concludes.
Although the ‘separation of ownership and control’ has been central to corporate governance, its meaning has an ambiguous relationship with modern investment. There is little doubt about its cross-disciplinary centrality, in law, management, economics, and sociology, and that in most cases it remains a useful proxy for discussing agency costs in one particular setting. ‘Ownership’ engenders proprietary relationships, as in owning a share. ‘Control’ is closely allied to the idea of exclusive dominium, which in turn ties to the old incidents of property. These relate to legal concepts, but ones that were more appropriate when people bought shares directly, and thus had a relatively direct relationship to companies. Today most people make the contributions that become equity capital through a multitude of transactions, usually intermediated.

Because of intermediaries, it has been said that there is now a problem of ‘separation of ownership from ownership’. However many people who are separated do not keep any ownership rights at all. Some people may be direct registered shareholders. Many have an equitable ownership interest in shares under a trust. Some invest in a managed fund where they receive an ownership interest in that fund, though not the target of their investment. But others might have contract based pensions, or be life insurance policyholders, only with contractual, not ‘ownership’ rights. Moreover, it is rare for any single person to exercise ‘control’ in modern corporate governance. Instead many voices participate in shared decision making. Corporate governance involves an increasingly complex and global network of financial intermediaries. So if the goal is to understand properly why some participate in corporate governance more than others, is the best conceptual vocabulary still the separation of ownership and control?

This chapter contends that the language of a separation of contribution and participation better describes the problems of modern investment. Section (1) suggests that while there may still be a variety of ownership structures around the world, there has in fact been functional convergence in corporate governance to a remarkable degree for some time. Exemplified by the UK, Germany and the US, this lies in the fact that financial institutions – asset managers and

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2 AM Honoré, ‘Ownership’ in AG Guest (ed), *Oxford Essays in Jurisprudence* (1961) ch V, refers to ‘those legal rights, duties and other incidents which apply, in the ordinary case, to the person who has the greatest interest in a thing admitted by a mature legal system.’
3 MR Cohen, ‘Property and Sovereignty’ (1927) 13 Cornell LQ 8
banks – participate most in casting shareholder votes, while the ultimate contributor of equity capital is usually separated from meaningful influence. Section (2) elaborates the concepts of contribution and participation, and why they are preferable to ownership and control. It is suggested that the core idea of a ‘contribution’ is where a person gives something of value over a period of time in expectation of a return. The critical welfare problems arise when that person is a ‘non-adjusting investor’, so they cannot easily change other investments to counteract the risks upon the contribution they make. They lack bargaining power. ‘Participation’ means having a voice through a representative vote in a joint decision making procedure. Section (3) concedes that, just like control of assets was never the only way to protect ownership, participation is not the only way to safeguard a contribution. Markets, and a mix of rules, standards and regulation, sit alongside participation rights as mechanisms of accountability in enterprise. However the strengths and weaknesses of these different mechanisms suggest they are best seen as complements rather than as substitutes. This means participation rights – and their separation from the ultimate contributor – deserve independent attention in modern corporate governance.

(1) Participation today: a summary

Ownership structures vary a great deal across different countries, but functional convergence appears to have largely been achieved in terms of who participates most in corporate governance. This is not immediately apparent without looking behind the institutional shareholder, so it is necessary to give a short summary of how modern corporate governance works. In almost any system, participation can be analysed on three levels, so as to simplify the chain of investment. First, there are rules for election or removal of directors. Second, there are rules on how voting rights may be allocated among shareholders. Third, there are rules concerning the influence of the ultimate contributor on institutional shareholders. Millions of contributors’ investments are organised by various shareholding institutions, and toward the top asset managers and banks are able to deal directly with company boards. This is the capital side of investment, although analogous rules and relationships can be said to exist for employees who invest their labour, and trade unions which organise employee voice. Outside the private
sector, publicly administered enterprises, or enterprises subject to specific regulation can involve appointees by governments, consumers, or other stakeholders, if it is thought that standard private sector and competition rules fail to protect those groups’ interests. In the diagram above, labour lawyers have traditionally focused on the three spheres to the right: the relationship between the employer (represented, in companies, by a board), the trade union, and employees. Company lawyers have traditionally focused on the two spheres on the top left: the relationship between directors and shareholders. But less has been said about the relationship between the shareholder, particularly when it is an institution, and the ultimate beneficiaries. This is where the picture of convergence begins to emerge.

(a) United Kingdom

In the UK, first, most large company boards are appointed by existing board members, but the company’s general meeting can always remove any director with 28 days’ notice and a fair hearing. The fact that this power is not publicly exercised except in a few cases is less important, because it is a potent weapon to ensure directors respond to the general meeting’s interests. Second, the general meeting is composed of whoever is on the members’ register, though in practice the members are shareholders. The voting rights of members follow, by default, a ‘one-ordinary-share, one-vote’ standard, and public companies do not deviate in practice.

Third, most registered shareholders are institutions managing assets for a vast pool of beneficiaries, primarily pensioners, life insurance policyholders, or investors in mutual managed funds. Pension trust beneficiaries have some statutory voice to hold their trustees accountable, but these rights are form-dependent: applicable only for pension trusts or trust corporations. Also, pension trustees usually delegate investment management to an asset management firm. Today, under 10 per cent of listed shares are individually held. Many of these retail investors buy shares through a High Street bank or online broker, which could potentially be the registered shareholder itself. Both asset managers and banks assume shareholder voting rights through standard-form contracts with their clients. Asset managers typically have, say, a one to six person corporate governance department, which is given instructions on how to cast votes by the fund’s

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5 Companies (Model Articles) Regulations 2008 reg 20(b) and the UK Corporate Governance Code 2012 B.2
6 Companies Act 2006 ss 168-169
7 cf M Moore, Corporate governance in the shadow of the state (2013) 210 ff on the ‘statutory shotgun’
8 CA 2006 ss 112-113
9 CA 2006 s 284
10 The word ‘beneficiary’ is used in a non-legal sense here, so as not to prejudge whether in fact a beneficial proprietary interest exists. It is used in a largely synonymous way to ‘contributor’.
11 Pensions Act 2004 ss 241-243
12 Expressly foreseen by the Trustee Act 2000 s 11
13 See the chart at ch 6(1)(a)
managers on issues that appear important. Otherwise, the corporate governance department will follow a ‘proxy advice’ company’s recommendations. The recommendations will be in line with the asset managers’ own priorities. At any given general meeting in a large UK company, the majority of votes are fixed in this way: by asset managers, sending instructions through proxy advice firms.

(b) Germany

Germany’s system of corporate governance differs in board and beneficial structure, though less in shareholder voting rights. First, the board is split into two-tiers: an executive (Vorstand) runs matters day-to-day, while according to the law a supervisory board (Aufsichtsrat) oversees the general strategy. The executive is appointed by the supervisory board, except that one executive director should hold the employees’ confidence. Any executive can be removed by the supervisory board for an important reason, which includes a non-binding majority vote of a company’s shareholders. The supervisory board in companies with over 2000 staff is elected half by shareholders, and half by employees, albeit that the chair with a casting vote is invariably a shareholder representative. The general removal standard is a three quarter majority vote of shareholders or employees. Companies with 500 to 2000 staff have one third employee board representatives, and in principle a German public company can (like a UK company) adopt a Societas Europea structure, with a one- or two-tier board and a different configuration of employee rights. This has slowly become more common. Second, among shareholders the rule of one-ordinary-share, one-vote prevails.

Third, banks usually exercise most shareholder voting rights. Germany does not have as large a retirement savings base as the UK because there is an income linked state pension. Where occupational pensions do exist, pensions beneficiaries may be able to codetermine their representatives if they are in ‘fund’ or ‘facility’ form. But these pension types remain as a minority. Most occupational pensions either come from insurance contracts or, with insurance,
are simply a contractual promise from the employer, allowing balance sheet savings to accumulate on the employer’s books and so be ‘reinvested’ back into companies.²⁵ This considerably strengthens Germany’s insurance industry and gives each company a large accounting surplus. Probably in part because of this, many more shareholders in Germany are other companies.²⁶ Most shares in German companies were traditionally required to be bearer shares, and deposited in banks for safe keeping. Whatever the source of contribution, banks acquire voting rights through standard-form contracts, and may cast votes on their depositors’ behalf, subject to the duty that they act in the depositor’s interests.²⁷ They should follow instructions, but these are rare. Although German banks have low proportions of share ownership, their proportion of voting rights is usually a collective majority, and this is usually enough to pre-determine all elections for the shareholder supervisory board representatives, and the executive.²⁸

**(c) United States**
The US system of corporate governance differs from the UK and Germany at the board and shareholder level, but resembles the UK at the beneficial level. First, most large US companies incorporate under Delaware law, though other states are not radically dissimilar in their main features. Directors are generally appointed by the existing board subject to stock exchange independence standards,²⁹ but unlike in the UK, shareholders are typically excluded from proposing new nominees until such time as the Securities and Exchange Commission implements rules to implement that right at federal level.³⁰ Directors can be removed by the shareholders, but if companies opt to stagger elections over three years, shareholders must show a ‘cause’. If the board is not staggered, shareholders can remove directors ‘without cause’. Most companies with initial public offerings have staggered boards, but in 2010 the trend was that institutional shareholders were pressuring companies to opt back into non-staggered boards over time. Second, shareholder voting rights are mostly one per ordinary share, but there are far more multiple voting shares than in most Commonwealth or European countries.³¹ Stock exchanges have a loose limit, requiring voting rights not to be ‘disproportionate’.³²

Third, shareholders are predominantly institutions which represent retirement savings: pensions, life insurance, and mutual funds. A minority of pension funds that are large enough,

²⁵ Betriebsrentengesetz 1974 §1  
²⁶ See ch 6(3)(b)  
²⁷ AktG 1965 §135(2)  
²⁹ eg New York Stock Exchange Listed Company Manual §303.00  
³⁰ Dodd Frank Act 2010 §971  
³² NYSE Listed Company Manual §313.00
primarily public sector or collectively bargained multi-employer plans, take corporate governance in house. The trustees are frequently half or partly elected by their beneficiaries, depending on collective agreements and state law. Asset managers mostly provide investment services to smaller funds, private employer plans, 401(k) savers, insurance policyholders and investment company shareholders. The US retains a larger base of individual shareholders, who invest through brokers, but these brokers may not vote on their clients’ behalf. Brokers apart, asset managers routinely take over the role of voting on behalf of their ultimate beneficiaries, guided again by proxy advice firms.

(d) Functional convergence and costs

It would be wrong to suggest that between the UK, Germany and the US there are not meaningful differences of principle and practical importance. In ‘The End of History for Corporate Law’, the differences that Henry Hansmann and Reiner Kraakman focused on in relation to shareholder, labour or managerialist models of corporate law persist 15 years on: relative to one another, the UK remains more pro-shareholder, Germany is more pro-labour, and the US is more pro-director. But these are characterisations which place their focus on the top tiers of corporate governance. They leave out the patterns of participation through the whole investment chain.

The central ambiguity in all theses that focus on shareholder primacy in corporate governance is that, even assuming shareholder primacy might be an end point, it is not at all clear who the shareholders will actually be. If the ‘shareholder franchise’ had become ‘the ideological underpinning upon which the legitimacy of directorial power rests’, what did that really mean? In fact, behind the registered title of ‘shareholder’ today, intermediary institutions are in the driving seat in all three systems. For participation rights, emphasis upon the ‘varieties of capitalism’ starts to seem less significant than the startling commonality of all modern economic systems. For participation rights, debate over when or whether systems might converge and history might end has come to seem less pressing than why there already has been such a remarkable functional convergence. In its simplest terms, in no major economy do people who make the ultimate investments in companies have the most significant voice. Financial institutions do.

The remarkable functional convergence in modern corporate governance systems raises

33 Dodd-Frank Act §957
35 Blasius Industries Inc v Atlas Corp, 564 A2d 651 (1988) per Chancellor Allen, who adds the qualification that institutions make shareholder voting ‘a less predictable affair than it has been’.
36 cf P Hall and D Soskice (eds), Varieties of Capitalism (2001) ch 10
the question of what associated costs might arise. Adam Smith believed directors were prone to ‘negligence and profusion’. Majority shareholders, if unregulated, are thought to extract ‘private benefits of control’. Would financial intermediaries similarly exercise voting rights in their own interests rather than in the interests of the ultimate contributor? This is critical because in a systems of block ownership managerial agency costs might be reduced but minority/majority costs rise. In dispersed ownership systems, minority/majority agency costs may be fewer, but lead to exacerbated managerial agency costs. The two might cancel each other out.37 Yet in either system, institutional intermediaries can create a ‘third dimension’ of agency costs, visualised in the chart below. Institutional agency costs are a function, not of ownership structure, but of the absence of rights of the ultimate contributor. Smith’s twin categorisation remains a good framework: there is, first, a risk of ‘negligence’ if institutional shareholders can continue in office without working diligently. Second, there is a risk of ‘profusion’ (or unjust enrichment) if institutional intermediaries can use their voting rights in companies to further interests that conflict with their clients.

To give a central example of ‘profusion’, suppose that an asset manager specialises in selling a particular type of retirement product to companies, such as life insurance, individual defined contribution pension accounts, or contract based pensions. It, and its competitors in the same market, will have a collective incentive to encourage the companies where they own shares to abandon competing products, such as trust based pensions, especially those shared among multiple employers, which are large enough to have asset management in house. Asset management firms (e.g. Legal & General, BlackRock, Henderson, AXA, or State Street) will be naturally antipathetic toward such pension schemes. In the case of German banks (e.g. Commerzbank or Deutsche Bank) an equivalent incentive exists to use shareholder voting to encourage directors to buy Hausbank services from one of the big three. When banks hold blocks of shares in the major insurance firms (e.g. Allianz) there is also an incentive to use shareholder voting power to sway companies to buy insurance based pensions, rather than collective and codetermined pensions. These potential conflicts of interest are systemic, in the same way that they are for auditors which also sell management consultancy services, or credit rating agencies that price government debt while their shareholders trade in

37 B Cheffins, Corporate Ownership and Control: British Business Transformed (2008) ch 2
international bonds.

An example of ‘negligence’ is asset managers being ‘rationally reticent’, so that they may cast votes, but do little in the way of positive governance proposals. This problem would seem to derive from further underlying conflicts. For instance, asset managers or bank managers tend to be very highly paid. They may therefore not wish to challenge super-inflationary rises in director pay, lest the spotlight reflects back on them. The economic gulf that exists between top financial managers and their ultimate clients creates more general conflicts. The highly paid will have a natural scepticism of more equal company pay scales, regardless of the socio-economic merits. This will foster a hostility to trade unions, or other people who seek to control inequality across the workforce, regardless of the socio-economic merit in doing so. This can be called a ‘social’ conflict of interest. What views do asset managers and bankers typically have on environmental and social responsibility? It is not clear, but the more that the socio-economic position of asset managers and bankers deviates from other people, the more it can be expected they will vote differently in aspects of corporate governance. This is relevant because all that voting is done using other people’s money.

The normative debate will be returned to in chapter 7. But before this, the essential point here is that the possibilities for conflicts of interest would not necessarily be captured by the language of ownership and control. The ultimate investor may or may not own anything, for instance if they have a life insurance policy, or a contract based pension. But the issues do not change. Moreover, the institutional intermediary may or may not control anything, because they are not large block-shareholders. So can, and should, the language of ownership and control be replaced?

(2) Contribution and participation

(a) Ownership to contribution

It seems that ‘ownership’ has become a concept that is unsuitable in the world of modern investment, but what could go in its place? It could be agreed that the language of agency costs is closer to the mark, and it is functional. A standard definition is that there is an agency problem if one person’s welfare is at stake through the actions of another. But what was it about the old separation of ownership and control that raised the particular welfare problem? One answer

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given by Stephen Ross, one of the 20th century economists to revive John Stuart Mill’s language of ‘delegated agency’, was that a welfare problem arises because of asymmetric information. Asymmetric information is found in almost all transactional relations, so focus on information imbalances alone would probably capture too much. However it is very notable that Ross himself did ‘not treat the bargaining problem explicitly’. Can the concerns that motivated the separation of ownership and control be reconciled with an understanding of agency costs to form one concept that is particularly applicable to corporate enterprise?

The first step is to recognise that ownership truly is unsuitable, and that non-ownership relationships raise functionally identical concerns. ‘Ownership’ is a troublesome collective noun, a proxy concept for a bundle of rights, duties or incidents. But the concerns that lie behind the separation of ownership and control, or delegated agency, are distinct from the proprietary and personal distinctions that it engenders. Legal form and abstract categories, when they are not updated in line with social needs, can both conceal and obscure much more than they explain. On concealing, Otto Kahn-Freund wrote that bourgeois law had a tendency:

In other words, the general categories of ‘property’, ‘contract’ and ‘person’ can hide very different types of each. Significant differences could emerge when talking about people who make an initial investment and (1) rely on the return for consumption, not production, (2) make the investment as a dependent, not a commercial party, or (3) are natural and not legal persons. But in this case, the concept of ownership is not so much concealing the extension of

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40 JS Mill, Principles of Political Economy (1848) Book V, ch XI, §11
43 Ross (1973) 63 American Economic Review 134, 134
inappropriate rules, as *obscuring* a clear view: focus on ownership limits, in an unwarranted way, the scope of the welfare problems.

The second step is to see that the incidents of ownership can be scattered anywhere along the investment chain, subject to compulsory rules. Most (but by no means all) transfers of the incidents of ownership stem from an objective manifestation of consent. For example, if A has £1000 and wishes to give it to B in expectation of a profit in return for a fee, A and B could manifest an intention that (1) ownership in the £1000 passes to B, subject to a contractual right to a specified return, like in a life insurance contract, or (2) ownership remains with A while B carries out the investment work, as in an agency and bailment relationship, or (3) legal and beneficial title splits, as in a trust, or (4) the money is invested in a company, where ownership transfers, but A acquires ownership in the chose-in-action known as a share. Along with the right to a return, the right to exercise any votes, or to sell assets, can be combined and extended along multiple steps of investment chains. Retaining legal or beneficial ownership has several advantages, the main one of which is probably priority in insolvency. Although, generally speaking, ‘property carries responsibility’, fewer potential liabilities attend to holding money than physical property. Thus, it is often better to have ownership rights. But precisely because it is better, a person who gives up ownership could well be more vulnerable in welfare terms than one who retains it.

In the examples just given, if A and B change the agreed fee, A can be compensated for the risks of giving up ownership rights. Also, A might be able diversify other investments so as to minimise any risks of the transaction. But some parties are better at adjusting their risk profile than others. The ability to diversify derives from the volume of resources a party holds: with more assets, there tends be a greater ability to ‘adjust’. Commercial banks can diversify the risks of their lending business as easily as an asset manager can diversify its share portfolio. But, there are also non-adjusting creditors, and similarly, there are non-adjusting investors. A lack of capacity to diversify risks means that the non-adjusting party is more vulnerable. All transacting parties may give consideration for a bargain, ownership might go here or there, but some will make contributions where their welfare is more at stake.

If the key welfare problem centres upon the non-adjusting investor, it makes sense to abandon the language of ownership, in favour of a functional understanding of contribution.

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46 eg *National Provincial Bank v Charnley* [1924] 1 KB 431, 449-450, per Atkin LJ
Ironically, the language of the separation of ownership and control was originally formulated by Marx and Engels in relation to the industrial worker, at a time when the labour theory of value posited that people owned their bodies and so should own the product of their work. The worker was said to be separated by contract from the fruits of labour. Marx and Engels extended this analysis in a brief passage to shareholders and corporations, but then the idea underwent a subtle shift. It is virtually certain that Berle and Means were directly inspired by Marx and Engels, but in their analysis the separated actor – the shareholder – did have ownership of a share. The relevant separation had become the separation of this ownership right from ‘control’. But the original concern covered people who contributed something of value to companies (i.e. workers investing their labour), whether or not they still held ownership rights in law.

Whether or not the old Marxist discourse was ever appropriate, modern investment has outpaced it. A more natural conceptual language should be used. If the language of contribution, centring on the non-adjusting investor, is adopted, it would capture everyone down the investment chain that ultimately provides investments to companies. The hallmark of a contribution would be exchanging value for a period of time in expectation of a return, but lacking the ability to adjust other investments to compensate for the risk. A large, wealthy shareholder could still be regarded as making a contribution, even if they had the capacity to adjust their risk, but only if they make a transaction (e.g. buying a share) that would be formally equivalent to a non-adjusting investor (taking on the risk of failure). However, such a party’s welfare would not be at stake, and therefore this person lies at the periphery of the analysis. The welfare concern lies with the non-adjusting party, which would have no equivalent capacity to opt into a comparatively risk free transaction. The same concept of a non-adjusting investor would also extend to employees of an enterprise, to non-adjusting creditors in the approach to and in insolvency, to consumers of enterprises that hold a natural monopoly, to the public in systemically central enterprises, and so on. It has much the same outcome as stakeholder analysis, but poses the analysis in precise transactional terms.

Ultimately any conceptual dividing line will be formulated to serve the normative analysis

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49 K Marx, Das Kapital (1894) vol 3, Part IV, ch 27
50 Berle said he sought to be ‘the American Karl Marx’, see Beatrice Bishop Berle Diary (12 September 1934) which was held, and cited, by JA Schwarz, Liberal: Adolf A. Berle and the Vision of an American Era (1987) 62. See also H Brick, Transcending Capitalism: Visions of a New Society in Modern American Thought (2006) ch 2, 76. It is also noteworthy that Berle was tutored by Harold Laski. AA Berle and GC Means, The Modern Corporation and Private Property (1932, Harcourt 1991) 5 the ‘property owner who invests in a modern corporation... surrenders his wealth’ in the same manner as the ‘wage laborer surrendering the direction of his labor to his industrial master’. 64, ‘With the corporate revolution, this quality has been lost to the property owner much as it has been lost to the worker through the industrial revolution.’
51 eg TA Kochan and SA Rubinstein, ‘Toward a Stakeholder Theory of the Firm: The Saturn Partnership’ (2000) 11(4) Organizational Science 367, 369, defining a stakeholder as (1) one which invests valuable resources, (2) is at risk if the firm fails, and (3) the power they have in or over the organisation. The definition offered here prefers to focus on their points (1) and (2), precisely because (3) is not a given.
of the author. Pro-shareholder theorists seek a concept of risk bearing, and the like, which appears to elevate the normative claims of shareholders, while pro-stakeholder theorists choose a concept which to them delineates a larger group of people. Conceptual delineations simultaneously embody normative assertions, sometimes subtle, but always there. Here, the normative assertion is that the welfare of non-adjusting parties is more at stake than for others, and this entails the economically and morally significant agency problem that was originally conceived by the language of separating ownership and control. Whatever views may exist about the broader stakeholder debate, the focus remains here with those who ultimately provide equity capital. But whatever else, it should be agreed that the functional concept of contribution is more suitable for discussing modern investment than the legal formalism, and notional confines, of ownership.

(b) Control to participation

If ‘ownership’ can be replaced, does ‘control’ need to be too? Control is clearly still a useful concept in any context where someone exercises exclusive influence, though admittedly even a legal-beneficial owner of personal property is curtailed by the implicit, underlying regulation of all property rights by the state. Although this may have greater importance as a philosophical matter than in practice, control of things is always shared because individuals rely on society for mutual recognition of one another’s rights. When sovereignty is shared, the idea of control already seems too absolute. In companies, as with all social institutions, control is shared even further. Capital is ultimately utilised according to the directions of the board. But particular decisions are delegated to managers, supervisors, and other employees, according to the firm’s perception of the productively efficient division of labour. Often a worker at the end of the chain of delegation has much more practical control than a director. Even more, company shareholders (or other stakeholders) retain residual authority over the board through the relevant statute and the company constitution’s system of appointment and removal rights. In turn institutional shareholder decisions may be influenced by whatever rights are bargained for by, or are set in statute for, the ultimate beneficiaries. This very fact of multiple divisions of competence makes the concept of ‘control’ descriptively uncomfortable. Like ownership, control can be and is scattered everywhere.

At any particular level in the chains of employment and investment, as organisations

54 See generally, MR Cohen, ‘Property and Sovereignty’ (1927) 13 Cornell Law Quarterly 8
grow, the likelihood of there being any single decision maker decreases. Employees in large organisations work in groups, or their tasks are set in consultation with supervisors. A director is one member of a board. There is not necessarily a majority shareholder, rather than millions of dispersed shareholders. And then millions and millions of people make the initial contributions that work their way into the stock market through institutional investors. In this manner, people necessarily participate – albeit with different levels of influence – in reaching a decision about what to do, rather than having the exclusivity of influence that the word ‘control’ might suggest. At the level of the shareholder, or below, people’s views will usually be aggregated through voting for representatives, rather than voting on specific proposals. If there is disagreement, a majority or super-majority of votes will determine the collective decision. But if decision-making is joint, shared through a vote, then it is plainly more appropriate to speak about ‘participation’ instead. Whether one speaks of ownership or contribution, in modern enterprise it is no longer ‘control’ from which there is a separation.

(3) Participation and other mechanisms of accountability

Chapter 2(2) has contended that the separation of contribution and participation is a more functionally accurate way to describe the problems of modern investment. Before, control was seen as a potential (but not a necessary) incident of ownership and a way to reduce agency costs. Control rights could decrease the vulnerability of a non-adjusting investor’s welfare to agents which used the investment. But just as ‘control’ is not the only potential incident of ownership, it must be conceded that ‘participation’ is far from being the only strategy to reduce agency costs that come with a contribution to investment. Two other major ‘mechanisms of accountability’ are commonly identified as the market, and legal duties. There are different ways to enumerate and categorise strategies to make an agent act in a principal’s interest, and none have a monopoly on correctness. But if participation is just one among a number of mechanisms of accountability, in a way that control might have been, can it be substituted? Could a system of rights on the market, or a group of legal duties, perform a replacement function of accountability? The best answer seems to be that all mechanisms of accountability have strengths and weaknesses, and this indicates why they should be seen as complements, rather than substitutes for one another.

55 cf RC Clark, Corporate Law (1986) 93
Markets and non-transaction costs

The basic strength of markets as an accountability mechanism is that they potentially allow the freedom to associate and disassociate with different people and organisations. The classic idea of a market is that people are free to make or not make contracts on terms they choose themselves.\(^{57}\)

If shareholders sell their shares, if pension funds change their asset managers, or if investors in an American 401(k) plan can shift their provider, this can potentially send a signal about their satisfaction with the quality of the investment's management. Market signals tend to operate in a negative fashion: by itself disassociation does not convey a preference about what (if anything) was unsatisfactory. However, it can have an indirect instructive effect if a market leader is visible providing different products or terms, which its competitors can observe, emulate, or improve upon.\(^{58}\)

Adam Smith identified three kinds of competition: competition among buyers, competition among sellers, and ‘competition’ between any given buyer and seller as they haggle over price and terms. The first two competitions make the extent to which people actively buy, sell or switch their stakes highly relevant. In mass markets, with millions of shares, and millions of saving accounts, an isolated act will do little. But in a very competitive market with narrower profit margins, highly effective signals can be sent by buyers to sellers with a small proportion of people changing business (e.g. not one person but perhaps, say, 3 per cent of investors). What happens ‘at the margin of the market’ can determine what happens in the terms for everyone,\(^{59}\) depending on how effectively the seller is capable of practising price or term discrimination, and whether competition law permits. The market mechanism does involve positive transaction costs, chiefly in the form of gathering information, searching out an appropriate contracting partner, the costs of negotiation, and so forth.\(^{60}\) But even so, markets tend to have an advantage over legal rights, which require potentially very costly litigation to enforce, and voting mechanisms, which typically require a majority to achieve an outcome.

A drawback of markets is that in practice one side in Smith’s third ‘competition’ can have more choice than another. If the disadvantage to all sellers of changing a particular transaction

\(^{57}\) See also, below at ch 3(2) for definitional qualifications.


\(^{59}\) MJ Trebilcock, An Economic Approach to the Doctrine of Unconscionability in BJ Reiter and J Swan (eds) Studies in Contract (1980) 380, 412-413, asking ‘whether at the margin of the market, there are enough consumers who are sensitive to the content of these clauses to bring effective pressure to bear on suppliers to modify them in an acceptable way.... For example, if only 10 per cent of the buyers of insurance policies or dry-cleaning services studied all terms scrupulously before contracting and were influenced in their choice of policy by their evaluation of the so-called fine print clauses, and if no supplier of insurance or dry-cleaning services was able to ‘term discriminate’ between these consumers and other consumers in the market, there would be strong competitive pressures on each supplier to adjust the terms of his contracts so as to avoid losing this potential business....’

term cannot be outweighed by buyers acting collectively to trigger a loss of business, then markets will be foreclosed as a mechanism of accountability.61 One party is told to ‘take it or leave it’, and lacks the bargaining power to get a different result.62 This seems very similar to identifying ‘imperfect competition’ where there is wide departure from ‘perfect elasticity of supply’ for market participants.63 In the context of equity investment, these are all different ways of saying that one party is a non-adjusting investor.

What makes an investor ‘non-adjusting’, or lacking in bargaining power, or unavoidably subject to ‘take it or leave it’ deals? Classic reasons have ranged from saying that the market participants are not informed,64 or they are insufficiently organised to take collective action,65 or they cannot ‘hold out’ as long as long in negotiations because they hold fewer resources.66 Thus, the concept of bargaining power in any negotiation derives from (1) information asymmetries, (2) relative ability to take collective action, (3) relative wealth. The consequence is that one party is more likely to appropriate more of the joint surplus in a transaction than another.67 This differs from supply and demand per se, which envisages that markets clear at an equilibrium intersection of the two. The concept of equilibrium economics was originally formulated with commercial sales markets in mind, and originally it rightly excluded those markets where there could be an ample joint surplus, and where unequal bargaining power could be most pervasive.68

The most controversial element in the concept of bargaining power is whether relative access to resources (as opposed to information, and collective action problems) limits the utility of markets. This suggests that inequality of wealth is habitually perpetuated into transactional terms. ‘Freedom of contract’ becomes a fearsome weapon in the fist of the rich, and a blunted tool in the clutch of the poor.69 It suggests that markets are increasingly deprived of their normative justification, because ‘private autonomy’ becomes one party imposing its intentions on another.70 This legitimises society in declining to spend taxpayers’ money on courts to enforce

61 cf Jensen and Meckling (1976) 3(4) JFE 305, 330, ‘If my competitors all incur agency costs equal to or greater than mine I will not be eliminated from the market by their competition.’
62 F Kessler, ‘Contracts of Adhesion – Some Thoughts About Freedom of Contract’ (1943) 43(5) Columbia L R 629, 632-3, ‘standardized contracts are frequently contracts of adhesion; they are à prendre ou à laisser. Not infrequently the weaker party to a prospective contract even agrees in advance not to retract his offer while the offeree reserves for himself the power to accept or refuse; or he submits to terms or change of terms which will be communicated to him later.’
63 cf J Robinson, The Economics of Imperfect Competition (1933) Book IX, ch 25, 1. This definition of imperfect competition appears indistinguishable from the concept of inequality bargaining power because resource inequality would seem to be a common basis for imperfect elasticity of supply that Robinson mentions. This is discussed just below.
64 eg WS Jevons, Theory of Political Economy (3rd edn 1888) ch 4, §74
65 eg JS Mill, Principles of Political Economy (1848) Book V, ch XI, §§8-12
66 eg Smith (1776) Book I, ch 8, §12
68 F Jenkin, The graphic representation of the laws of supply and demand and other essays on political economy (1887, 1996 edn Routledge) Part I discusses commercial sales markets, and first formulated the classic graph later adopted by Alfred Marshall. Part II discussed labour markets, where the same principles and graphical representation were thought to not be applicable.
69 O Gierke, Die Soziale Aufgabe des Privatrechts (1889) 22
any agreement it perceives as unfair.\textsuperscript{71} One view is that, so understood, bargaining power lacks ‘any economic basis’.\textsuperscript{72} This seems to go too far, given that Adam Smith himself spoke squarely in terms of workers being incapable of holding out in a dispute because of their relative wealth.\textsuperscript{73} A second view is that inequality in resources potentially corrupts all market transactions, making ‘freedom of contract’ a cruel euphemism for ‘blind coercion’.\textsuperscript{74} This view, held by many socialists, appears to go too far in the other direction, because it can readily be seen that there are many transactional contexts (e.g. commercial sales) where two parties genuinely do stand upon an equal foot.

A third view is that any attempt to maintain a unified theory of market interactions should be abandoned. Plainly in some transactions, among some parties, information asymmetry or collective action problems will be more clearly at issue than relative wealth. Friedrich Kessler found it natural to speak of people buying insurance policies, including life insurance,\textsuperscript{75} as lacking bargaining power, while in contracts for reinsurance it was typical that ‘parties of equal skill and bargaining power are dealing with [one] another.’\textsuperscript{76} Similarly, among workers who are saving for retirement, and therefore buying into occupational pensions, bargaining power may be spoken of in the classical terms familiar to Adam Smith. Thus, the bargaining power of the ultimate investor – the life insurance policyholder, or the pension beneficiary – can realistically be seen to be shaped by a greater relative need, based on lack of resources. What about shareholders? It can probably be said that for many small, individual shareholders, markets ceased to be a mechanism of accountability a long time ago, probably because many individual shareholders used also to be ordinary people looking to save for retirement.\textsuperscript{77} By contrast, among organised institutional shareholders, including trade unions which run pension funds, asset managers, banks, and so on, issues of relative wealth are less pressing, while collective action and information problems come to the fore.

It is possible that the language of bargaining power would not be comfortably received in corporate governance discourse. However this issue can be easily overcome by instead using the language of the ‘non-adjusting investor’. If the issue of relative wealth also appears as an uncomfortable conceptual ‘transplant’, the issue can likewise be overcome by speaking of ‘non-
transaction costs’. Transaction costs are plainly embedded in corporate law discourse, but less attention has been given to the costs that each party has if they do not reach agreement. For instance, if the non-adjusting investor risks an undignified retirement, while an asset manager risks nothing by not coming to an agreement, then the non-adjusting investor has higher ‘non-transaction costs’. The ‘costs of not transacting’ could also affect a director of a company (who wants to maintain a job) compared with a very large activist investor (who can get anyone), an asset manager in a competitive market (who needs to hit revenue targets) compared with a massive pension fund (which can switch business), or a group of pension trustees compared with a trade union representing its members’ interests in retirement. Typically, the costs of not transacting will be higher for a natural person bargaining with a corporation, or at any rate a corporation with considerable organisational resources. Plainly these issues represent a central controversy in the history of advanced economies, and are not likely to be satisfactorily resolved soon because people have different interests at stake. This will be returned to in more detail in chapter 7(2)(c). But for now there appear to be good enough reasons to suppose that markets do not solve everything, and are often limited in achieving accountability in corporate governance.

A final potential drawback of markets is that over-reliance on them as accountability mechanisms can produce standoffs that shut down production. The use of ‘exit’ in various contexts can be beneficial if the message is gradually received and acted upon, but quick shocks can also be destructive of value, for instance if a mass exodus of custom or capital leaves a business bankrupt while slower changes could have allowed the enterprise to be rescued. While markets operating in limited fields can be beneficial, it is important to see there is room for the use of other mechanisms, and so to avoid ‘economic civil war’.

(b) Legal rights and minima

Some of the shortcomings in market interactions can be remedied through courts imposing, and ultimately supervising, compulsory terms in transactions. Problems of collective action, or holding resources, need not apply to the same degree when bringing a claim in court, provided

79 Hirschman (1970) 24
80 AA Berle, ‘For Whom Are Corporate Managers Trustees: A Note’ (1932) 45 Harvard Law Review 1365, 1368-9, ‘The only thing that can come out of [giving unlimited power to directors], in any long view, is the massing of group after group to assert their private claims by force or threat - to take what each can get, just as corporate managements do. The laborer is invited to organize and strike, the security holder is invited either to jettison his corporate securities and demand relief from the state, or to decline to save money at all under a system which grants to someone else power to take his savings at will. The consumer or patron is left nowhere, unless he learns the dubious art of boycott. This is an invitation not to law or orderly government, but to a process of economic civil war.’
that the court system does not erect substantial barriers to filing and pursuing litigation. Directors’ duties, fiduciary duties, and duties of care for asset managers or trustees, implied terms that cannot be excluded from contracts, and specific terms made compulsory by law, can all be a potential way to ensure some modicum of accountability. Rules, standards or principles can be formulated at high levels of generality, or with minute specificity. A court can develop precedents, and a regulator could be empowered to issue ad hoc guidance or binding regulations to suit changes in the market over time.

The main drawback of compulsory legal rights, however, is that their mechanisms of enforcement tend to be institutionally incapable of doing much more than either enforcing rigid patterns of behaviour, or creating minimum standards. Assuming that the outcome is the imposition of some kind of liability, they cannot, unlike the market and market-linked devices, create a more positive motivational environment. This is another way of saying that the human capacity to innovate is not by itself assured by court based remedies. This is true whether a right or a duty is formulated in a positive manner or not.

For example, what is typically called a duty of loyalty, and equally what is called a duty of care, in practice resolves into a duty to avoid various conflicts of interest, and to stay above a standard regarded as negligent. Such rules and standards are critical in themselves to ensure that directors, asset managers, fiduciaries, trustees, or other contracting parties maintain some level of professional conduct. It can also be true that by emphasising the positive view (‘loyalty’, ‘care’, and so on) there is an ‘educational and socializing’ effect in the law. The development of a positive culture of professionalism and accountability, however, takes time and may remain vulnerable to an unscrupulous few driving the competition where strong incentives point in a different direction. Such duties have to be policed by the courts or a regulator. They penalise bad behaviour, but they are hardly capable of enforcing any particular model of good behaviour. Such rights and duties necessarily create ‘a space within which culture and ethics... can be fostered and come to play a meaningful role’, although what else might influence that culture is debatable, and probably multi-faceted.

To give a fuller example, company law typically imposes a duty on directors to act in the interest of shareholders or other stakeholders. In the UK, this is found in section 172, while many American states have enacted ‘constituency statutes’ requiring directors act in the interests

of all stakeholders. This resembles the German duty, following from the understanding of acting in the interests of the Unternehmen an sich. It usually comes down to directors’ discretion to balance the interests of all stakeholders. These kinds of provisions are particularly instructive because, though applicable to directors, the same issues arise with all duties to act in another’s interests. Such duties are found throughout the chain of investment: for UK and US pension trustees and asset managers, and German banks. Terms can also be implied in contracts to require actions which fulfil the parties’ ‘reasonable expectations’, particularly in the case of life insurance companies. These duties are formulated in a pro-active way. But less comes from pro-active formulation than the aspirational idiolect might suggest. In the UK, the Companies Act 2006 section 172 is worded ambiguously, but for this very reason serves to illustrate the point. It proclaims that a director has a duty to do what ‘he considers’ in ‘good faith’ will ‘promote the success of the company, for the benefit of its members as a whole, and in doing so have regard to the long term consequences and just about every stakeholder (except directors). But however this section is interpreted, it can do no more than require minimum standards of conduct.

One interpretation of section 172 is that it creates an ‘enlightened shareholder value’ hierarchy, so that if company decisions could not conceivably make profit in the long term, a director will be in breach of duty by not putting that shareholder interest first. Section 172 cannot be breached unless the director subjectively ‘considers’ (perhaps after a rational process of thought) he or she is not putting shareholder value first, and so cases of breach being established will be rare. But, on this view, the subjective nature of the duty only underlines the requirement that directors think and act (and think they are acting) in the interests of shareholders first, and above other stakeholders. If this, the strongest view, were taken it still would only be in marginal and occasional cases such as careless public announcements, or distributions pending insolvency, where liability might bite. Constant supervision by the court would be impractical to achieve a more positive objective. Yet the actual case law to support such a strong shareholder value interpretation is difficult to find at present.

A second interpretation is that section 172, despite its syntactical ambivalence, could not...
have the effect of requiring shareholder value be pursued, enlightened or otherwise, not least because the words ‘shareholder’ and ‘value’ simply do not appear. Section 172 speaks of ‘members’ because many companies, such as those limited by guarantee, may have no shareholders, and a member is whoever is entered on the members’ register. True, members are shareholders most of the time, but companies can if they choose register employees as members, or people in the community, or any stakeholder, and they will hold all member rights. Moreover, directors are meant to promote the success of the ‘company’, but the part of the existing law that was codified was not the old idea that the company means shareholders. Instead, section 172 re-codified the conception of the company that composed employees and members, and all the stakeholders who are connected by the web of relevant rules (admitting that those rules could favour some more than others).

On this second, stakeholder-balancing view, such an interpretation is not merely a matter of preference. It is compelled, among other things, by the textual distinction section 172 draws between ‘the company’ and ‘the members’. If companies and members were the same, the two could not be distinguished in section 172. Directors may place employee, environment or community interests over dividends whenever, according to their conscience, this would promote the company’s success. This is the same as a ‘constituency’ statute in effect, although more specific rules could exist elsewhere, such as for takeovers. The case law supports this view. For example, in Shepherd v Williamson it was contended that a director, Shepherd, breached his duty under section 172 by reporting to the Office of Fair Trading that the company was in a cartel. It was argued this did not promote the company’s success, and indeed on any rational view, Shepherd’s actions were not going to increase shareholder profits, especially as the company was being wound up. But Proudman J held that under section 172 Shepherd was promoting the success of ‘the company’. Effectively he did this by placing the interest of the community (in  

93 CA 2006 s 112 and Companies (Model Articles) Regulations 2008, Sch 3, art 1  
94 cf Greenhalgh v Ardene Cinemas Ltd [1951] Ch 286, 291, where Lord Evershed MR refers to ‘corporators’ as being the company. Technically this would indicate whoever subscribed to a memorandum, and this may or may not include shareholders, directors, employees and others, although it appears Lord Evershed MR mainly had shareholders in mind.  
95 See the Companies Act 1985 s 309(1) ‘The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company’s employees in general, as well as the interests of its members.’ This was introduced following the recommendations of the Report of the committee of inquiry on industrial democracy (1977) Cmnd 6706 albeit without the requirement for employee voting rights for directors.  
96 Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 2 AC 500, 507, per Lord Hoffmann at [10] ‘Judges sometimes say that a company ‘as such’ cannot do anything; it must act by servants or agents. This may seem an unexceptionable, even banal remark. And of course the meaning is usually perfectly clear. But a reference to a company “as such” might suggest that there is something out there called the company of which one can meaningfully say that it can or cannot do something. There is in fact no such thing as the company as such, no ding an sich, only the applicable rules. To say that a company cannot do something means only that there is no one whose doing of that act would, under the applicable rules of attribution, count as an act of the company.’ 
97 eg the Indian Companies Act 2013 s 166  
98 Shepherd v Williamson or Re Phoenix Contracts (Leicester) Ltd [2010] EWHC 2375 (Ch)
securing fair competition) over the financial interests of members. At most, section 172 still turns out to entail conscience based discretion. By stating directors must ‘pay regard’ to stakeholders, at most section 172 replicates other statutory provisions, such as the duty to act for proper purposes, the duty of care, or a combination. Despite its wording it can do no more than a minimum standard.

A third view is that, whether section 172 is a soft shareholder value norm in marginal cases or not, whether it functions as a defence or a duty, what really drives companies to shareholder value is business culture. It can be agreed with some certainty, that a director would be found in breach of section 172, or a similar provision, if evidence were found of bad faith attempts to damage a company’s success, and possibly the duty of care is applicable in going through the process of showing regard to stakeholders. But it is extremely doubtful that the duty can go much further. Shareholder value is a cultural norm, not a legal norm, and neither it, nor a ‘stakeholder interest’ culture, can be written into law and enforced without impossibly constant oversight and monitoring that would stretch even the most well resourced regulatory body. It would require a regulator to substitute its decisions for the decisions of every company board.

A combination of factors may produce a culture where shareholder value, stakeholder welfare, the beneficiary’s interests, or the client’s interests, are promoted over other things. But if this happens, the style of legal duties will only be one thread in a web of incentives and constraints. The construction of the markets will also play a role, including the rules concerning the right of shareholders to sell their shares, or pre-empt sales and buy themselves. But arguably the most influential factor will be whose voice in an organisation is heard the most.

(c) Participation rights

Participation rights are one kind of term that can be negotiated, or mandated, in any consent-based obligation involved in forming an organisation. The central tool of participation is the vote. This is a mechanism for aggregating the preferences of multiple persons in order to conclude an appropriate course of conduct. This is what ‘voice’ usually means, albeit that voice can be used in a looser sense where it may be ignored, rather than be listened to, or be advisory rather than binding. Participation can be ‘direct’, where people vote on specific issues, or ‘representative’, where delegates are chosen to act on the voters’ behalf, and a representative vote

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99 L Sealy and S Worthington, Sealy and Worthington's Cases and Materials in Company Law (10th edn 2013) 341
102 Hirschman (1970) follows this expansive definition.
could involve positive election rights, a right to remove the representative, or both.

Participation through the vote to select representatives has a unique quality. The irreducible core of participation rights is that people act similarly to the interests of those to whom they owe their positions, no matter how independent, or duty bound, they may be. It is true that representatives are usually in a position to follow their conscience rather than the mood of a crowd that might later vote them out, but over time the essential identity of interest prevails. Any vote carries with it positive information about preferences, and plainly this can be to a higher or lower degree of specificity. A vote for representatives may also create a positive motivational environment, which other legal rights cannot match. This is because people will often want to keep their jobs in future. Negative outcomes are also possible: living under a permanent threat of losing one’s job can be destructive, and lead to irrational behaviour, because statistically people tend to ‘choke’ under undue pressure. However if terms are predictable, the rules transparent, and the voters themselves not subject to irrational changes of preference, these issues can be minimised.

The drawbacks of participation rights lie mainly in becoming overly optimistic about what they might achieve. First, the concept of participation can be configured in numerous ways in the details, which may make representatives more or less responsive. A direct vote for a representative, for example, will probably lead to greater responsiveness than a vote for intermediate delegates, which in turn appoint representatives. Second, voting mechanisms can leave minorities vulnerable, where their interests diverge from the majorities. Unlike market rights which allow the minority to leave, a voting mechanism per se does not resolve this difficulty. Third, while participation rights can propel a representative to look out for the interests of those he or she represents, if reality does not play out so well, removal is not a remedy to recoup the potential losses, or strip the conflicted gains. Accountability through legally enforceable minimum standards is needed to do this. Fourth, in a similar fashion to markets, there are costs of organising collective action in using a voice. Fifth, because an organisation is made up of people, there is the possibility that organisations solidify around bad practices and cultures. However, being ineffective or hard to operate or being open to human error does not mean participation rights are useless. People still tend to follow the interests of those to whom they owe their jobs.

\[103\] cf Ashby v White (1703) 92 ER 126, Lord Holt CJ, 954, ‘It would look very strange, when the commons of England are so fond of their right of sending representatives to Parliament, that it should be in the power of a sheriff, or other officer, to deprive them of that right, and yet that they should have no remedy; it is a thing to be admired at by all mankind.’


33
No matter how many or few people participate, someone’s voice is heard.

Comparing the different mechanisms of accountability, it seems clear that no single one leads to all the answers. It also is conceivable that a contribution is separated from the right to sell an asset (or that those rights are frustrated in any number of ways), or that a legal system would allow a contribution to be separated from any kind of legal duty. These possibilities create their own problems, and are also worthy of independent discussion. But like the relationship of control to ownership, participation has an independent, and unique relevance to protect contributions to enterprise.

(4) Conclusions

The separation of contribution and participation is among the most important problems in modern investment chains. While ‘ownership and control’ have been historically seen as important concepts, they do not necessarily capture the breadth of today’s issues. Whatever ownership structure a company has, there can be a similar functional outcome in who influences corporate governance, and a similar functional outcome in terms of agency costs of institutional shareholders. In developed countries, even those as diverse as the UK, Germany, and the US, financial intermediaries tend to dominate corporate governance. This potentially creates welfare damaging agency problems for non-adjusting investors.

A functional understanding of the contribution that a non-adjusting investor makes to enterprise enables a more realistic conceptual analysis. It embraces the position of trust-based or contract-based pension beneficiaries, mutual fund or life insurance policyholders, whether or not they retain ownership rights. Like contribution is to ownership, so participation is to control, but this does not make participation the only accountability mechanism. It was conceded that rights on the market, and systems of legal duties, can complement and strengthen accountability in corporate governance. However, they cannot reasonably be seen as substitutes. Differences in bargaining power often negate the utility of markets, and other legal rights are institutionally incapable of doing more than creating minimum standards. This leaves the irreducible fact that people tend to act in the interests of those to whom they owe their jobs, and whoever participates in choosing. Participation is uniquely important, and equally so is the question to follow: why do some people participate more than others in corporate governance?
3. Two positive theses: politics and economics of participation

Chapter 2 has set out the case for re-examining corporate governance through a new perspective: the separation of contribution and participation. A ‘contribution’ involved a relation lasting over a period of time where something of value is given in expectation of a return, especially by a ‘non-adjusting investor’. ‘Participation’ meant sharing in decision making, at any level on the investment chain, in concert with others, and a central method was a vote for representatives. However it was observed how asset managers and banks have assumed most voting rights in large companies in the UK, Germany and the US. So why have the people who make the ultimate contributions to enterprise become separated from participation? Chapter 2(1) alluded to a significant body of law that regulates how far directors are (in some fashion) responsible through the vote to shareholders. This raises a question itself: why did the law act to prevent a separation between directors and shareholders? It was also seen that the law has (to a lesser extent) made pension trustees accountable to beneficiaries. But then, this seems to leave a gap, particularly when the ultimate investor, or a pension fund, delegates investment management to an asset manager or a bank. What explains the separation between shareholding institutions and the ultimate beneficiaries?

This chapter proposes two positive theses for the political and economic development of participation rights. These are that (1) progressive democratic movements consistently pushed for the spread of participation rights in law, but only incompletely compared to their social ideals, and (2) where there was no particular law, participation rights mainly depended on the economic actors’ bargaining power. This could grow the separation of contribution and participation, or narrow it. Either way, the evolution would be unprincipled. The outcomes were not rational because at root the actors were human, and people face constraints. It has been said there is a need to integrate rational choice theories with contextual understanding of human behaviour, without it dissolving into ‘laundry list’ impressionism.\(^1\) We still ‘lack a science of man.’\(^2\) What is offered here may not meet this aspiration fully. But a positive, contextual understanding can draw on recent advances in behavioural psychology that foots context on an evidential basis. Contextual complexity is evident through history. And history is the awkward antidote to ambitious theory.

\(^1\) P Gourevitch and J Shinn, *Political Power and Corporate Governance* (2005) 93, discussed below at ch 3(1)(b)
\(^2\) F Kessler, ‘Natural Law, Justice and Democracy – Some Reflections on Three Types of Thinking about Law and Justice’ (1944) 19 Tulane Law Review 32, 60
(I) Politics: what shaped the law?

(a) Political theories

What have political theories already said about the development of participation in corporate governance? Contemporary theories begin with Mark Roe’s *Strong Managers, Weak Owners*. Roe was less concerned with rules on director elections, shareholder voting, or beneficiaries’ voice *per se*, than regulation of financial institutions – banks, insurance companies, pension funds, and mutual funds – and how this regulation had broken concentrated shareholdings in the US. Roe’s thesis was that the ideology of ‘populist’ politics, represented by Woodrow Wilson, Louis Brandeis, and William O. Douglas, drove de-concentration of institutional shareholding. Roe said ‘populists’ favoured laws that prevented financial institutions holding blocks of shares. This had gone so far that by 1990 two of General Motors’ largest institutional shareholders could not even require a meeting with the board about how to choose the new CEO because each owned under 1 per cent of shares. Roe emphasised the behavioural anomalies of political decision-making. People tended to ‘anchor’ their opposition to the first manifestations of impersonal power they saw: namely financial institutions. People also have a *status quo* bias, and so legislators stuck to familiar regulatory patterns (like the US inheriting UK banking laws) because the familiar shapes perceptions of the desirable.

Roe subsequently extended his explanations for ownership structures around the world, based on degrees of ‘social democracy’. In absence of a clear ‘populist’ story outside the US, the thesis in *Political Determinants of Corporate Governance* was that stronger trade unions, with more job security, necessitated that capital build its power in response by holding blocks of shares. It did not actually matter whether block shareholding or social democratic institutions came first. Once

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1. M Roe, *Strong Managers, Weak Owners* (1994) chs 5 and 7. Major elements were the tradition inherited from the Bank of England Act 1694 of banks keeping out of equity, the National Bank Act 1864 restricting powers of non-state based banks, and the Glass-Steagall Banking Act 1933 segregating retail and investment banks. Also the McFadden Act 1927 allowed national banks to have state branches, but only in compliance with state law, and the Bank Holding Company Act 1956 restricted equity ownership by banks through holding companies.


5. Roe (1994) xiii-xv and compare ch 6(3)(b)


they existed, they locked each other in. The evidence for this thesis was said to lie in leximetric indicators of social democracy such as an OECD employment protection index, or a ‘political index’ generated through a poll of political scientists,\(^{10}\) which loosely correlated with the number of firms without a 20 per cent blockholder (as in Graph 6.1 below).\(^{11}\) There were also loose correlations with the Gini coefficient, and GDP.\(^{12}\)

Roe’s later methodology had become very different to before. While *Strong Managers* was emphatic that ‘history matters’,\(^{13}\) *Political Determinants* stressed that ‘focus on the historical sequence misses the point’.\(^{14}\) In place of historical sequence was a logical construct based on the rational incentives of interest groups. This did not touch on the reasons for participation rights as such, as its focus remained on ownership structure. However Roe’s frames of reference – the ideologies of populism and, later, social democracy – held considerable explanatory power.

The later Roe was critical of the work by Raphael La Porta, Florencio Lopez de Silanes, Andrei Shleifer and Robert Vishny (collectively known as LLSV). They did have an explanation for some participation rights on a seven point ‘anti-director rights’ index.\(^{15}\) This index included (1) one-share, one-vote rules, (2) rights to vote by proxies by mail, (3) shares not being blocked before meetings, (4) cumulative voting, (5) an oppressed minority remedy, (6) pre-emption rights on new issues, (7) the percentage of share capital needed to call a meeting. Curiously, however, this anti-director rights index did not include anything on director election rules. They argued the strength of these rules in favour of shareholders, and minority shareholders, was largely due to a country’s legal origin. Echoing Friedrich von Hayek, they thought common law judges, due to their close attention to factual circumstances in case law,
progressed the law in ways that are superior to elected legislatures. The common law is efficient, and so it would develop superior minority shareholder protections. LLSV's ultimate goal was explaining ownership structure. They believed poor minority shareholder protections mean rational investors do not buy shares for fear of expropriation. Even blockholders are reluctant to have small stakes, for fear of expropriation by management. This drives concentration, but dispersed systems are usually preferable because fewer blockholders extract private benefits of control.

While Roe and LLSV had offered competing explanations for ownership structure based on populism or social democracy, and legal origin, Gourevitch and Shinn added the elements of legislative structure and political coalitions. They also said more about participation rights. Ultimately, a country's legislative system, if more 'politically cohesive' would determine which coalitions between shareholders, directors and workers (or 'owners, managers and workers') would prevail. Consensual political structures with more proportional representation were slightly more likely to produce more pro-worker and fewer pro-shareholder results than majoritarian systems. Their statistical correlations were weak, and the rights of beneficiaries behind institutional shareholders did not feature among these factors. But this was because the angle of their lens was aimed to capture a general picture: ultimately concentrating on the multiple and complex drivers of ownership structure. Ownership structure came from a whole mix of a country's 'degrees of coordination' and minority shareholder protections, which in turn (as Figure 4.2 shows to the right) partly related to legislative systems.

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**Notes:**


17 See also R Posner, *Economic Analysis of Law* (1972) 99, 'In searching for a reasonably objective and impartial standard, as the traditions of the bench require him to do, the judge can hardly fail to consider whether the loss was the product of wasteful, uneconomical resource use. In a culture of scarcity, this is an urgent, an inescapable question. And at least an approximation to the answer is in most cases reasonably accessible to intuition and common sense.'


20 Gourevitch and Shinn (2005) 69, 'consensus systems reduce the impact of vote shifts by giving leverage to a wide range of players through coalitions, and thus have lesser swings of policy.'

21 Gourevitch and Shinn (2005) 75, Figure 4.3, showing the shareholder protections index against the index of political cohesion, and very little relationship, if any.
Gourevitch and Shinn’s open acknowledgement of the loose correlations related to their contextual understanding of human behaviour. Thus, they were closer to the earlier Roe, and further from the later Roe or LLSV. They rejected that legal incentives played no causal role, or that everything was (as some economic sociologists suggested) ‘constructed’ or based on mere ‘impression’.22 They endorsed an ‘incentives-centred perspective’ and anchored their ‘inquiry in debates from the law-and-economics tradition concerned with the “nexus of contracts,” incomplete contracting, transaction costs, and principal-agent theories’.23 However, they also emphasised most how historical ‘context makes for twists and turns that require something more flexible for causal understanding’.24 For political choice, they said ‘scripts and ideology surely matters’ and ‘in confusing situations, one’s “priors” are a guide to action’. It followed that ‘an abstract concept of optimum efficiency has substantial weaknesses as an explanation’.25 This said, integrating alternative modes of reasoning, between the overly contextual, avoiding ‘a collage or a laundry list of factors’, and the unwaveringly rational, ‘remains an open theme for the future’.26

Part of the difficulty in the theses of LLSV, Roe, and Gourevitch and Shinn was that much of their evidence relied on indices which coded the protective ness of various laws into numbers. Unfortunately, these early leximetric tables contained many ‘coding errors’. This was particularly true of LLSV,27 as they themselves conceded in 2005.28 In a more rigorous study of shareholder rights, Mathias Siems found that in 20 coded countries, there was little correlation between legal origins and a comprehensive 60 variable list of shareholder protections. In fact countries were converging toward uniformly higher levels of protection.29 Because Gourevitch and Shinn used LLSV’s numbers, their correlations were also affected. On labour rights (though not social security laws), Simon Deakin, Priya Lele and Mathias Siems traced 40 indicators in 5 countries. It was too early, with too few countries, to tell how big the differences would be with the OECD figures that Roe used.30 For ownership structures, it has been suggested that dispersed
or blockholding systems are much more about the character of a country’s state pension system (income linked, or minimum safety-net),31 than other variables in company or labour law. Nevertheless, it can be said that the prisms of political ideology and interest group action utilised by Roe and Gourevitch and Shinn remain significant for understanding the development of the law.

More recently, John Cioffi and Martin Höpner posited the thesis that ‘pro-shareholder corporate governance reforms’ were largely being driven in the US, Germany, France and Italy by ‘center-left political parties’.32 ‘Pro-shareholder laws’ were taken to encompass issues such as making hostile takeover bids easier, one-share, one-vote regulation, more protective fiduciary duties, disclosure rules, and restraining bank power.33 Cioffi and Höpner posed this as superficially paradoxical. One might suppose that increasing shareholder power would naturally conflict with centre-left objectives by ‘shifting income and wealth from wage earners to shareholders’.34 Their study focused mainly on law reforms of the last 30 or so years, where the general explanation was that centre-left parties wished to ‘appeal to the middle-class core of the electorate (which now contains much of the working class) as current savers and potential investors’.35 While Gourevitch and Shinn emphasised the possibilities of coalitions of shareholders, directors and workers cutting across a liberal/coordinated market economy distinction, Cioffi and Höpner emphasised how general political movements could cut across shareholder, director and worker interests.

The politics of corporate governance became much more contentious after the global financial crisis.36 This triggered significant changes to the law in the UK, Germany and the US.37 Using the US Dodd-Frank Act 2010 as an analytical example, John Coffee proposed that crises typically propelled reform.38 During a crisis interest groups would coalesce more effectively around the issues they saw because the costs of inaction would appear to have been increased compared to the costs of taking collective action. This theory is inherently appealing because if

33 Cioffi and Höpner (2006) 34 Politics Society 463, nb there appears to be an error at 478, as it is said that the German one-share, one-vote rule was introduced in 1998. In fact it was introduced by the Aktiengesetz 1937. See ch 5(2).
34 Cioffi and Höpner (2006) 34 Politics Society 463, 464
35 Cioffi and Höpner (2006) 34 Politics Society 463, 492
36 cf PD Culpepper, Quiet Politics and Business Power: Corporate Control in Europe and Japan (2011) positing that the ‘policy salience’ of corporate law reform is usually low.
37 See ch 7(2)(b)
anything should motivate change, it should be a crisis. Coffee was, of course, speaking in terms of relative likelihood for large scale reform to take place. But this likelihood would hinge on the responsiveness of the legislature to the electorate, and the interference (if any) of the courts.

It would be inaccurate to conclude, and Coffee did not conclude, that crises would always impel positive reform, rather than lead to socially and economically damaging political changes, or that a major crisis might not simply drag on for an indeterminate time. It would also be inaccurate to say that major changes could not be achieved without a crisis. History is full of crises, so it is often possible to point to something that coincides with reform. However, it is also possible to identify times of massive social change (for instance from 1906 in the UK, from 1964 in the US, or from 1972 in Germany) when depressions and wars seemed more remote. Whenever reforms took place a set of ideas had to be available, and had to have entered mainstream political discourse. Yet Coffee must have been right that, given some certainty about what to do, crises should make change more likely.

Probably the most sustained account of corporate law development which explicitly dealt with participation rights for shareholders at some length is Christopher Bruner’s Corporate Governance in the Common-Law World. Bruner highlighted the unwarranted tendency to see uniformity in common law countries following an ‘Anglo-American model’. In fact, large variations exist between the US on the one hand, and the UK, Australia and Canada on the other. Bruner put his finger on the US/Commonwealth divide, which seems significant as the Commonwealth as a whole still composes well over 2 billion people on a 7 billion planet, and among the total number of common law countries the US tends to be an outlier. Among the developed Commonwealth countries that Bruner examined, company law can accurately be described as shareholder-friendly, while there tends to be more employee protection, and a more comprehensive welfare state. Bruner posited that there was a symbiotic relationship between social welfare policy and shareholder rights. Political actors would be more reluctant to press for greater shareholder rights as they could be used to damage the interests of workers and other stakeholders, unless there were stronger welfare protections. Stronger welfare made stronger shareholder rights possible, and the lack of adequate welfare protection had stopped the US

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39 P Davies, Introduction to Company Law (2010) ch 9, 289
41 eg the Trade Disputes Act 1906, the Old Age Pensions Act 1908 and the National Insurance Act 1911
42 eg the Civil Rights Act 1964, the Voting Rights Act 1965, and Social Security Amendments Act 1965
45 Bruner (2013) ch 5
doing the same.\textsuperscript{46}

Bruner’s sophisticated account of shareholder rights covered, notably, the right to elect or remove a director, control over takeovers, the ability to change a company’s constitution, and being the focus of fiduciary duties.\textsuperscript{47} Chapter 2(3)(b) has already suggested that being owed fiduciary duties, as under the UK Companies Act 2006 section 172, despite aspirational language, is not effective to positively promote the shareholder’s interests in practice, and so it is difficult to regard directors’ duties as creating shareholder rights \textit{per se}. However the effective right of enforcement of other duties, which ties into section 172 through the derivative claim, would indeed make shareholders the foremost beneficiaries of directors’ duties. This does only allow members to sue (unless the courts open derivative claims or unfair prejudice petitions to stakeholder enforcement\textsuperscript{48}). This aside, Bruner’s theory has an obvious attraction as it describes a normatively sensible stance: would it not be unwise from the viewpoint of most voters and worker coalitions to push for shareholder rights, when in absence of employment protection and social security those rights could take away labour’s share of income?

The question is, did matters actually play out as Bruner’s account suggested they \textit{should} have done? Bruner focused on law reform in the UK from 1948 to today, largely on the post-1960s reforms in the US, and on similar periods for Australia and Canada. It can be accurately said that post-war improvement of Commonwealth welfare states coincided with post-war reforms to company law, largely following the model initiated in the Companies Act 1947. A potential inconsistency could be that in the US in the 1960s shareholder rights to remove the board were in decline,\textsuperscript{49} and this is precisely when collective bargaining was strong and Lyndon Johnson’s Great Society was being built. By contrast, clear support for Bruner’s thesis does exist when looking at the anti-takeover movement in the 1980s. But more generally it is just not that clear that politicians in any country were in fact thinking, or sub-consciously behaving, in such a rational manner, so as to consistently link corporate law reform to welfare considerations.

Bruner’s positive theory also embodies a significant normative disagreement, which echoes the Berle-Dodd debates. Is it true that securing rights for shareholders (especially on director elections and shareholder voting rules) would negatively affect employees and other stakeholders? Why would improved shareholder rights not make directors (to some extent) more...

\textsuperscript{46} Bruner (2013) ch 5, 143

\textsuperscript{47} Bruner (2013) ch 3, especially 29-52


\textsuperscript{49} See ch 4(3)
careful in their work so as to benefit everyone? In absence of shareholder rights, why would it not be true that directors, or management appointees, simply acted as an autonomous interest group to everyone’s detriment? The basic reply seems to be that people (and directors included) do not always act rationally on selfish interests, and so directors who are less beholden to shareholders can be inculcated with a culture of social responsibility. The trouble is, first, evidence supporting its presumption, or of its success in prediction, appears scant. The danger is not that most people are selfish, because they are clearly not. Instead the danger is that the selfish drive the competition. Second, the enlightened director theory comes largely from a special context. It may be more relevant to the US, as a theory of ‘the second-best’, in the sense that hope of social legislative reform has increasingly been shut down, when it has not been elsewhere.

Takeovers, which animate Bruner’s account, present different issues to many other shareholder rights, including participation rights, because they often sharpen the conflicts between stakeholders. For instance, the choice could be between an old management abiding by implicit understandings to maintain living wages, job security, fair trade labelling, or local community production, and a new management that will scrap them in order to redistribute wealth to shareholders from employees, local communities and environmental protection. This vividly illustrates the point that not all shareholders (eg the incumbents, compared to new bidders) act in the same way: different strategies can appear rational for different shareholders. Without sharp changes among shareholders, the ordinary landscape of participation rights do not present such vivid conflicts because mutual trust and a pattern of reciprocal, long term commitments tend to dispel raw self-interest.

If the theory of social welfare depends on political reformers appreciating, or subconsciously acting with the effects of employees and stakeholders in mind, would it not be an equally, or even a more rational strategy to increase employee and stakeholder participation in corporate governance? Why not improve rights of other stakeholders against shareholders, instead of limiting those rights for everyone? Alternatively, if shareholder power still presents a threat to other stakeholders, why would a rational political choice not be to reform the character

52 See A Smith, The Theory of Moral Sentiments (1759) I
55 eg E Appelbaum, R Batt and I Clark, ‘Implications of Financial Capitalism for Employment Relations Research: Evidence from Breach of Trust and Implicit Contracts in Private Equity Buyouts’ (2013) 51(3) BJIR 498, examining Mervyn’s, EMI, Stuyvesant and Cadbury
of shareholders? These are essentially the same replies of Berle to Dodd in 1932.\textsuperscript{56} These issues are taken up again in chapter 7. But for now there are just enough questions here to leave space for another positive account.

(b) A first positive thesis: political movements in context

So far the existing literature offers a mixture of views about the development of participation rights in the political sphere. None exactly gives a sustained account of participation rights, leaving room for a targeted focus, and none quite engages with what goes on behind the shareholder. There are, however, elements of truth in all accounts, including legal origin theories: there are family resemblances in legal systems. Political ideology, overlapping coalitions, the legislative system, and the timing of crises, all affect change. Social concerns are raised in any type of shareholder rights reform.

A starting point ought to be that the very diversity of theory is telling. Social science is not as freely amenable as natural science is to isolating mono-causal patterns. This is eloquently illustrated by a catch-phrase the literature has developed, namely what ‘matters’. For different purposes, through the political discussion it has been said that ‘history matters’,\textsuperscript{57} that ‘legal origin matters’,\textsuperscript{58} (indeed, ‘legal history matters’\textsuperscript{59}) and that ‘political structure matters’.\textsuperscript{60} It is asked back: ‘Do Norms Matter?’\textsuperscript{61} ‘Does Law Matter?’\textsuperscript{62} And anyway, ‘What Matters in Corporate Governance?’\textsuperscript{63} The different emphases, and rhetorical questions highlight that good arguments can be made for all of it ‘mattering’ to some extent. But also causes can ebb and flow in importance depending on their ontological context.\textsuperscript{64}

A larger point is that multi-causality stems from how human decisions are made through political and legal institutions. If people are the actors, different people have many different reasons for action, and so in collective decision-making many things ‘matter’ because, to different people, they literally do. Historians, tend to think that ‘comprehension of the past... changes perpetually with the historian’s emphasis, interest, and point of view’ so the ‘search is no longer

\textsuperscript{56} AA Berle, ‘For whom corporate managers are trustees: a note’ (1931-1932) 45 Harvard Law Review 1365, saying that the preferable outcome would be that ‘corporate administration will be held to a high degree of required responsibility - a responsibility conceived not merely in terms of stockholders’ rights, but in terms of economic government satisfying the respective needs of investors, workers, customers, and the aggregated community.’

\textsuperscript{57} Roe (1994) vii

\textsuperscript{58} RL La Porta, F Lopez-de-Silanes, A Shleifer and ‘Law and Finance’ (1998) 106(6) Journal of Political Economy 1113, 1138

\textsuperscript{59} D Kershaw, ‘The Path of Self-Dealing Law’ (2014) Forthcoming

\textsuperscript{60} Gourevitch and Shinn, 10


\textsuperscript{63} L Bebchuk, A Cohen and A Ferrell, ‘What Matters in Corporate Governance?’ (2009) 22(2) Review Financial Studies 783

\textsuperscript{64} To wit, see T Lawson, \textit{Reorienting Economics} (2003) 221, under the heading ‘An indication that realism/ontology matters’
for a determination of the course of human events as ubiquitous and invariant as that of the course of the planets.\textsuperscript{65} History can be seen as valuable in itself, but it is also true that looking into the past is most useful for what it can explain about problems today. It teaches, said Frederick Maitland, ‘that each generation has an enormous power of shaping its own law... that they have free hands.’\textsuperscript{66} Going further, the outcomes of laws, especially regarding the distribution of any right ‘is a matter of human institution solely. The things once there, mankind, individually or collectively, can do with them as they like.’\textsuperscript{67} A Benthamite view that people might be bound to a throne of pleasure or pain,\textsuperscript{68} or a view from the Hegelian/Marxist tradition that people are bound into a long run dialectical logic of development,\textsuperscript{69} has rightly lost favour. People are autonomous in each generation, at least so far as they have the capacity and consciousness to see and choose among a range of options.

Because people are conscious yet imperfect actors, the most persuasive political theory, and the first positive thesis, is that a progressive democratic movement has driven the development of participation rights in corporate governance that were written into law, but in a way that is highly incomplete compared to its social ideals. Participation rights have primarily developed, not in rational response to particular institutions or other fields of law, so much as because of conscious decisions – albeit with limits. This can be verified or falsified with reference to history, and it yields the prediction that political groups or coalitions who are progressive democrats will continue to push for broadening the number of people who participate in corporate governance, at all necessary levels of rules.

The concept of ‘democracy’, as used here, involves a basic Periclean desire to see that ‘administration is in the hands of the many and not of the few.’\textsuperscript{70} The desire is to socialise not ownership, but power. There are, then, multiple conceptions or ‘models of democracy’,\textsuperscript{71} that build on this basic concept. It was said in chapter 2(3)(c) that the core understanding of participation rights here involves a representative vote. Other conceptions can involve direct

\begin{footnotesize}
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\item \textsuperscript{65} A Gerschenkron, ‘Economic Backwardness in Historical Perspective’ in BF Hoselitz (ed), \textit{The Progress of Underdeveloped Areas} (Chicago 1952) and A Gerschenkron, \textit{Economic Backwardness in Historical Perspective: A Book of Essays} (1966) ch 1, 5
\item \textsuperscript{66} Letter of Frederick William Maitland to Albert Venn Dicey (c. July 1896) in CHS Fifoot (ed), \textit{The Letters of Frederick William Maitland} (Cambridge 1965) II, 116, and quoted in CHS Fifoot, \textit{Frederic William Maitland: A Life} (1971) 143
\item \textsuperscript{67} JS Mill, \textit{Principles of Political Economy} (1848) Book II, ch 1, \textsuperscript{51}
\item \textsuperscript{68} J Bentham, \textit{An Introduction to the Principles of Morals and Legislation} (1780)
\item \textsuperscript{69} See G Kitching, \textit{Marxism and Science: An Analysis of an Obsession} (1994)
\item \textsuperscript{70} Thucydides, \textit{History of the Peloponnesian War} (ca 411 BC) Book 2, para 37, where Pericles said, ‘Our government does not copy our neighbors, but is an example to them. It is true that we are called a democracy, for the administration is in the hands of the many and not of the few.’
\item \textsuperscript{71} eg D Held, \textit{Models of Democracy} (3\textsuperscript{rd} edn 2006) giving a broad summary. David Held also prophetically stressed the key feature while chairing a public lecture in 2010: ‘in any kind of democracy, you do need mechanisms to change your leadership. I mean, the art of democracy is you no longer have to chop off the heads of your leaders because there are ways of removing them.’ See https://www.youtube.com/watch?v=CkYcKYzZbA, at 1:06:00.
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participation, a broader ‘social contract’ containing reciprocal rights and duties, the integration of basic human rights and the rule of law to make voting genuinely free and informed, and deliberative debate through an inclusive process of social communication. Whichever the conception, at the centre is a clear idealistic commitment to moral equality among people.

The relationship of democracy to equality was expressed admirably well by one of its historical opponents, who happened to be the ‘father of modern company law’. Robert Lowe MP fiercely opposed the Second Reform Act 1867, and in the Third Reading said this.

This principle of equality which you have taken to worship, is a very jealous power; she cannot be worshipped by halves, and like the Turk in this respect, she brooks no rival near the throne. When you get a democratic basis for your institutions, you must remember that you cannot look at that alone, but you must look at it in reference to all your other institutions. When you have once taught the people to entertain the notion of the individual rights of every citizen to share in the Government, and the doctrine of popular supremacy, you impose on yourselves the task of re-modelling the whole of your institutions, in reference to the principles that you have set up...

The meaning of ‘progressive’ democracy is also clearly expressed here by Lowe. Brooking no rival, ‘progressive’ means the desire to increase the number of fields in life, and particularly the number of social institutions, where power is in the hands of the many, not the few.

Where does progressive democracy sit among other kinds of ideology? Between Roe’s concepts of ‘populism’ and ‘social democracy’, there is little difference. Roe had suggested that ‘populism’ differed to ‘social democracy’ in ‘the means and degree’, but this was a distinction he was forced into by his view that this division explained dispersed or concentrated shareholdings. He defined ‘populism’ as a desire to ensure ‘no institution acquire significant power’, and this was identified with figures such as Woodrow Wilson and Louis Brandeis. ‘Social democracy’ was said to mean commitment to private property, but favouring ‘employees over capital-owners when the

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72 Plato, Crito (ca 350BC)  
73 C Gearty, Civil Liberties (2007) 3  
74 J Habermas, Between Facts and Norms (1996) ch 7  
76 HC Hansard Deb, Representation of the People Bill, Third Reading (15 July 1867) col 1543. I should disclose that I write most of what you find on Wikipedia, including this superb quote (so it is not me copying Wikipedia, but the reverse). I became acquainted with the colourful Robert Lowe, and read his Parliamentary speeches in Hansard for the first time, in my second year of undergraduate studies.  
77 MJ Roe, Political Determinants of Corporate Governance (2003) ch 27, 199-200  
78 On which, see the introductory remarks in ch 6  
two conflict. It is an unknown quality of history how American social democracy would have developed if the judiciary had not strangled reform by its states (such as the eight hour day, agency work regulation, promotion of unions, progressive income tax, and so on) in the *Lachner era* cradle. But if Wilson and Brandeis were held up by Roe as proponents of populism, then it would seem that their records of support for ‘employees over capital’ is indistinguishable from social democracy, as indeed both concepts are from progressive democracy.

Arguably a better taxonomy of political ideology was suggested by Otto Kahn-Freund in 1931, and it remains important for the long run of history. Kahn-Freund rejected categories like being ‘pro-employee’ or ‘pro-employer’ because, being reduced to a type of actor, they are insufficiently complex, not least because it is usually debatable what being pro-employee, or pro-anything, really should entail. Instead he suggested four categories, defined in terms of their ‘social ideals’. These were, (1) liberalism, which ‘condemns all combinations and leaves the structuring of social relations to the free play of social and economic forces’, (2) social conservatism, which ‘places the existentially isolated, uncombined individuals of the working class under the social protection of the state’, (3) collectivism, which ‘leaves the structuring of social relations to the conflict between the two classes which are party to the basic contradiction in society’ - namely labour and capital, and (4) fascism, which is a hybrid: it shares liberalism’s dislike of state intervention, social conservatism’s embrace of welfare provision for insiders, and collectivism’s view that associations are key actors in class conflict.

Kahn-Freund’s categories were, of course, stylised to fit with contemporary German politics (mirroring ‘ideal types’ of bourgeoisie, *Rheinland* industrialists, socialist workers, fascists). Progressive democracy could probably cut across elements of each, except fascism. It could contain elements of liberalism, but would not ‘condemn all combinations’. It would approve social conservatism’s social protection, but be committed to inclusion and not admit people were ‘existentially isolated’. It would endorse collectivism’s desire to leave groups to govern themselves, but not accept a ‘basic contradiction in society’. Eighty years on, people with progressive democrat views also fit across any of Gourevitch and Shinn’s owner, manager and worker coalitions. The meaning of Cioffi and Höpner’s ‘left’ and ‘right’ is highly contextual, though at

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80 Roe (2003) ch 3, 24

81 No doubt such a statement could fuel an endless debate, but it is probably worth reflecting on LL Brandeis, *The Fundamental Cause of Industrial Unrest* (1916) in US Commission on Industrial Relations, *Final Report and Testimony* (Government Printing Office 1915) vol 8:7659-7660 ‘The social justice for which we are striving is an incident of our democracy, not its main end… the end for which we must strive is the attainment of rule by the people, and that involves industrial democracy as well as political democracy.’ See Wilson’s post-war policy in RB Gregg, ‘The National War Labor Board’ (1919) 33(1) Harvard Law Review 39.

least in late 20\textsuperscript{th} century politics, progressive democrats cut across both.

In 21\textsuperscript{st} century politics, groups seeking significant change which oppose the social ideal of progressive democracy are loosely (and often pejoratively) labelled as ‘neo-liberal’, and ‘neo-conservative’. The social ideal of neo-liberalism views individuals as having the full capacity to take rational decisions, except where they organise through the ‘coercive’ organs of the state.\textsuperscript{83} Public sector administration, which is an important channel for collective action for progressive democrats, should be reduced except to set minimal ‘rules of the game’. Collective autonomy is replaced by individuals and their families. The social ideal of neo-conservatives views collective organisations (including corporations) as acquiring not just legal but also moral personhood. Whether or not legal personhood is a fiction, and whether or not the actions of legal persons can be dominated by internal interest groups, those persons are to be accorded fundamental rights on the same plane as natural persons. Neo-conservatism therefore differs from neo-liberalism because state power may be used to attain goals of natural and legal persons alike for instance by subsidising corporations through regulation or tax.\textsuperscript{84} It will favour: ‘Whoever controls the corporation.’\textsuperscript{85} Both neo-liberalism and neo-conservatism can comfortably view the corporation as a fiction and a nexus of contracts.\textsuperscript{86} By contrast, the progressive democrat would conceive of the corporation as an ‘institution’, in the sense that people positively create or institute it.\textsuperscript{87} Multiple constituencies contribute to making a corporation what it is, but these contributions are shaped by relationships of power that a progressive democrat must actively acknowledge as a step towards more equal distribution of power.

The vast majority of people today – especially in the mainstream of different democratic parties – do not share either a neo-liberal or neo-conservative position. One of the consequences of late 20\textsuperscript{th} century individualism, and the stratification of old class divides, is that people identify with a broader variety of personal experiences than can be transplanted into overarching ideologies. Single issue political parties flourish as collective identities have diminished. Alternatively, many are removed from the political process altogether because they do not engage or vote. Yet most people place their beliefs alongside existing institutions, and are cautious about

\textsuperscript{83} Represented by R Nozick, Anarchy, State and Utopia (1974).
\textsuperscript{84} Represented by the majority decisions in \textit{Citizens United v Federal Election Commission}, 558 US 310 (2010) and particularly onwards from the text: ‘Despite the corporation-hating quotations the dissent has dredged up.’
\textsuperscript{85} Scalia J in oral argument of \textit{Burwell v Hobby Lobby Stores, Inc.}, 573 US _ (2014) at page 53 of the transcript or 52.30 in the recording.
\textsuperscript{86} \textit{Burwell v Hobby Lobby Stores, Inc.}, 573 US _ (2014) per Alito J, adopting a modified nexus of contracts theory at page 18.
radical change, precisely because over the late 19th and 20th centuries, progressive democracy continually defeated its ideological competitors. No other political ideology has come close in successfully manifesting its social ideals in the law. But it does not follow that progressive democrat ideals have been achieved fully.

Given the conclusions that will emerge over the coming chapters, particularly on the growing dominance of asset managers in the UK and the US and banks in Germany, an alternative to the first positive thesis must be pre-empted. By the end of chapter 6(3), it may seem tempting to conclude that a consistent political ideal was carried through, namely a fascist one from the 1930s, and a neo-conservative one today. It could be thought, this drove the shape of participation in corporate governance, so that ‘democracy of capital [was] to disappear as it did in politics’ during Nazi Germany.\textsuperscript{88} People give up their rights to ‘the leadership’ of any association,\textsuperscript{89} or to ‘[w]hoever controls the corporation’.\textsuperscript{90} Sporadic evidential support could certainly be found in the \textit{Aktiengesetz 1937}, but then perhaps also in the retention of its main provisions in 1965, parts of the US pension reforms in 1974 or the Tax Reform Act 1986, various court decisions, and maybe even the Stewardship Code, insofar as it mirrors norms from the \textit{Aktiengesetz 1937}. It could be thought that legislative and judicial policy contained a conscious design to propel market developments, which fall within the second positive thesis. But the temptation to see a \textit{conscious} political ideology at work should be resisted. Those ideologies are ‘contradictory and seemingly superficial’,\textsuperscript{91} with ‘no consistent picture... a series of ever-changing goals’.\textsuperscript{92} Precisely because of this, it is best to not overestimate the ‘political self-awareness’ of people who pursue political change \textit{ad hoc}, and economic self-interest as convenience dictates.\textsuperscript{93} The influence of both fascism and neo-conservatism has been too unconscious in the long run to be credited within the scope of this political thesis.

To what extent can the political groups who consciously seek change achieve their objectives, and where are the limits? One view is that interest groups rationally pursue their goals to achieve collectively self-interested outcomes.\textsuperscript{94} If this were true, then an immediate question

\begin{thebibliography}{99}
\item \textsuperscript{88} JCD Zahn, \textit{Wirtschaftsfuhrerum und Vertragsethik im Neuen Aktienrecht or Economic Leadership and Contractual Ethics in the New Corporate Law} (1934) 93, ‘Die Demokratie des Kapitals wird ebenso verschwinden wie die politische.’ See ch 4(2).
\item \textsuperscript{90} Scalia J, again, in oral argument of \textit{Barwell v Hobby Lobby Stores, Inc.}, 573 US _ (2014) at page 53 of the \textit{transcript} or 52.30 in the \textit{recording}.
\item \textsuperscript{91} Kessler (1935) 83 University of Pennsylvania Law Review 393, 395
\item \textsuperscript{92} Neumann (1941) 40
\item \textsuperscript{94} GJ Stigler, ‘The Theory of Economic Regulation’ (1971) 2(1) Bell Journal of Economics and Management Science 3
\end{thebibliography}
would surely arise as to why progressive democrats had not already dominated entirely. Why would neo-liberalism and neo-conservatism not have been effectively eliminated in the same way that social conservatism, fascism, or communism had been? By definition progressive democrats represent the most numerous interest group: the many over the few. This surely constitutes an advantage. It is true that political ideologies are transient forces, lasting only so long as the socio-economic divisions which underpin them prevail. But achievement of political aims will depend upon the channels for taking collective action, and levels of organisations. Assuming (and this is an historically heroic assumption) there are representative channels for collective action, a small organised group of people (eg 5 out of 200) can dominate a large body of disorganised people.95 But even then an essential precondition for any kind of group, ideological movement, or coalition, to realise its objectives is to understand the issues and to have the capacity to act on them. In short, people need to develop a collective self-consciousness of their interests to become a cohesive interest group.

A second view from behavioural psychology suggests some basic reasons why, even assuming there are good long run incentives to organise and take political action, people do not act rationally in political affairs. Positive theories necessarily employ a model of human behaviour which can equally affect hypotheses about work,96 consumer decisions,97 or politics. This means our ‘cognitive biases’ (many of which were identified by Roe’s earlier work, and by Gourevitch and Shinn98) have practical implications for all positive theories. There are probably over a hundred, depending on how they are grouped or enumerated. Three can be highlighted again. First, people usually favour the status quo99 which tends to compound the familiar concept of ‘rational apathy’.100 In politics this can mean it takes time before people realise their ‘true’ preference for reform, or before people reinvent their institutions in line with contemporary social needs.101 Second, and related, we tend to ‘anchor’ our choices to arbitrary ideas when we do not think the issues through slowly.102 For instance, private actors will gravitate toward default or model rules, unless there are strong counter-incentives. This might include default rules in Model Articles or other implied terms on director elections, voting rights, or election of pension

95 See VI. Allen, Power in trade unions: a study of their organisation in Great Britain (1954) 251
98 See ch 3(1)(b)
100 eg JS Mill, Principles of Political Economy (1848) Book V, ch XI, §11
101 cf OW Holmes, The Common Law (1890) 5-8
trustees. In politics, reformers will always be conditioned in what they seek to do by the way existing institutions function. Third, people’s motivation to work, invest effort and take action is significantly related to how others react.\textsuperscript{103} If collective action persistently seems to come to nothing, people become dejected and give up trying. Again, this accounts for collective action being a slow process, if the obstacles are very strong.

All this said, it still appears difficult to view models of rational behaviour, or their refinement by behavioural psychology, as adequate to give any complete long run account of the drivers of social institutions. The main reason is that cognitive biases are identified through testing that confirm average tendencies in human behaviour (e.g. if 100 people can opt to have an occupational pension, 49 will do it immediately, 83 within twenty years; but if all have to opt out, then only 14 will,\textsuperscript{104} roughly, on average). The criticism that one cannot or should not draw analogies from tests in controlled experiments to the real world probably misses the mark,\textsuperscript{105} because behavioural psychology repeatedly shows how and why simplistic rational choice models fail to make accurate predictions.\textsuperscript{106} But precisely because average tendencies are identified, the possibility for ‘deviant’ behaviour tomorrow, creative dissent, innovation, and the reinvention of a different consciousness always remains outside the realms of what today’s behavioural scientists might find.

Thus, the third view is that if a thesis seeks to explain the development of social institutions, it must be carefully qualified: general tendencies can be identified, but what matters most is what people consciously choose to do. It cannot rely on people being rational reactors to incentives, nor can it write a rulebook of behaviour, and apply it. Theory must come with a large dose of equitable flexibility: universal norms cannot suit all particular circumstances.\textsuperscript{107} An historically grounded thesis must suggest that in any country change would typically come from something akin to the following:\textsuperscript{108}

unseeing, market-driven, but convention-constrained experimentation, evolving routines of trust, reciprocity and quality certification which sometimes succeed and sometimes fail, and accidental concatenations of war, occupation, revolution or inflation that lurched

\textsuperscript{107} cf Aristotle, \textit{Nicomachean Ethics} (ca 350 BC) Book V
into reverse financial systems which previously appeared to be working passably well.

Thus, until we have a better science of humanity, history is the awkward antidote for ambitious theory. But also until then, we can probably say that the better theory is one which leaves room for people being conceived as conscious actors.

With these qualifications, the progressive democratic thesis better explains the development of participation rights than previous theories. Bruner contended that shareholder rights have gone along with social welfare development, but though this is a normatively logical connection, it does not prove to be an inevitable one. Gioffi and Hüpner posited that centre-left parties had mostly pushed shareholder rights, although this view captures neither the particularity, nor the generality of political ideology, especially as over the years ‘left’ and ‘right’ traded ideological territory. Gourevitch and Shinn suggested shareholder rights related to legislative structure, but again legislative arrangements do not appear relevant. LLSV contended that shareholder rights followed legal origin, but this simply appears mistaken. What did matter was the beliefs that people held themselves. If Roe had focused on the law itself, rather than on the secondary effects on ownership structure, if he had looked at what people actually intended to do, he would have found just how profoundly political ideals mattered.

People who understood themselves as pursuing a progressive democratic agenda repeatedly sought to spread shareholder participation rights, and subsequently the right to participation in institutional investments: to socialise, not ownership, but power. The long-run political project has been to extend democracy from the political sphere to every level of society, including the economy. But the importance of this positive thesis lies not so much in the general tendency it identifies. Like the ‘populist’ thesis, or the ‘centre-left’ thesis, it might even seem obvious. The importance lies in the light it can shed on competing theories, in the detail of development, and in how the detail can clarify the desirability of reform.

(c) Historical development: a summary

It is worth summarising now how the first positive thesis applies to the historical development of participation rights, before the extensive treatment of the evidence in chapters 4, 5 and 6. Again, the first positive thesis is that compulsory participation rights in law spread because progressive democratic movements pushed for them, but only incompletely compared to their social ideals. It is important to emphasise, again, that progressive democrats belonged to all major modern political parties – Liberal, Conservative, Labour, Christian Democrat, Social Democrat,
Republican, Democrat – although in some more than in others. This said, there were limits to the manner in which democratic objectives were achieved, based on the way people thought about the issues. The law did not evolve in a fully principled fashion.

In the UK, first, the rules for director elections were initially set by default in common law cases on small community corporations, like churches and local councils. In the pre-democratic years of the 18th century, a progressive judiciary, notably Lord Hardwicke and Lord Mansfield, implied basic standards of representative accountability in company constitutions. They promoted basic rights to dismiss corporate directors for a reason determined by the general body of members. The first modern Companies Acts, however, instead drew inspiration from the mass chartered corporations with a different tradition, and envisaged only three-quarter votes to remove directors, unless the articles said otherwise. Little changed until 1947, because the vast majority of corporations left the articles at a three-quarter vote for removal. Then the post-war Labour government, directly inspired by Berle and Means’ work, legislated for today’s rule of removal by ordinary resolution. This still left a number of issues, such as payments for loss of office, appointment processes, and what the common law default might be today.

Second, rules on voting rights were, in the 18th century, set on a sloping scale to favour small investors, encouraged by Pitt the Elder’s Public Companies Act 1767, which contained measures against vote-splitting. Larger companies wished to avoid this, and erected high thresholds excluding small investors, although the default rule of graduated voting remained in Tables B and A until 1906. Graduated voting was undercut in 1877 by Lord Jessel MR in *Pender v Lushington*, with a justification based on unimpeded use of votes as property rights. Vote splitting became allowed again, so as to make one-share, one-vote the norm. Deviation from this standard did not become an issue until 1957, when institutional investors and the London Stock Exchange announced their opposition to non-voting shares being issued in the course of takeover bids. From the Jenkins Report 1962, the next Labour government gave express backing to the regulatory stance of not listing non-voting shares. A combination of legal defaults, institutional and regulatory pressure meant that the one-share, one-vote norm prevailed.

Third, behind institutional shareholders, people tended to have very few rights unless it was in pensions and won by collective agreements with trade unions. The first express legal regulation was proposed in 1976 by a Labour Party that was committed to the spread of industrial democracy. This never went into law, although by the early 1990s, the practice had become sufficiently widespread for John Major’s Conservative government, following a report authored by Roy Goode, to enact legal rights for beneficiaries to elect at least a third of their
pension trustees in the Pensions Act 1995. This was subject to an opt-out, and was peculiarly wedded to the form of non-state retirement saving that embodied a proprietary right. Life insurance plans were untouched, and the technical voting rights of mutual fund investors were nugatory because an asset manager would take over governance functions. Nevertheless, the pension rules were extended and made compulsory by the Pensions Act 2004. In late 2013, under the Coalition government, and under a Liberal-Democrat department, the question had become how influence might extend into the use of funds by asset managers, to whom retirement money or long term savings in any form is frequently delegated.

In Germany, first, director elections rules initially followed a company’s constitution. On unification in 1870, there was a requirement for a supervisory council (Aufsichtsrat), which Prussian industrialists pushed for so as to make management beholden to major banks. The more outward looking Hanseatic states, which did not previously have two-tier boards as a practice, retained the flexibility to have the general meeting directly elect or remove the executive (Vorstand). However, over the years till 1937, more and more German companies interposed supervisory councils between the general meeting and the executive, usually packed with bank functionaries. The fascist government passed the Aktiengesetz 1937 to make the supervisory board’s intermediating role mandatory. The executive became irremovable by the general meeting, and then only by the supervisory board with a good reason, as the Führerprinzip was spread to all organisations. In the Aktiengesetz 1965, this was turned back slightly, by counting an ordinary resolution by the general meeting as a good reason for supervisory boards to remove executives. But further reform of the supervisory board by then was complicated by the goal of Social Democrats to extend codetermination, given workers’ traditional place on the supervisory board.

Second, the distribution of voting rights among shareholders was formally a matter of choice in German company law, until the hyperinflation crisis of the early 1920s. A series of court cases attempted to put a hold on the increasing use of wild multiples on voting rights, while in 1931 the still-democratic government proposed introducing a one-share, one-vote principle in law. This was eventually enacted in the Aktiengesetz 1937, which by that time paradoxically suited the fascist dictatorship, as it eliminated contenders for economic power who previously gathered multiple voting rights. With regulation of director elections, votes in German companies were sidelined equally. The same regulation remained post-war, except that government discretion over exemptions was removed.

Third, German law’s enfranchisement of the contributors of capital behind institutional
shareholding remained precarious. The tradition of codetermination that made its way into pensions came from the democratic revolutions of 1848. After the revolution was crushed, a Paulskirche Parlament representative named Carl Degenkolb put codetermination into practice in his own factories. The same rights were eventually enacted by the Social Democrat government with the Betriebsrätegesetz 1920. However occupational pensions were destined to remain a less salient political issue because, with an income-linked state pension, people were less reliant on occupational pensions. There were codetermination rights in some occupational saving schemes, but sporadic court decisions, mostly in the 1960s and 1970s, restricted employee rights depending on whether the form of pensions savings constituted a ‘facility’. It was decided that insurance schemes and employers self-investing their workers’ money did not carry codetermination rights. Meanwhile, German banks gathered the voting rights in shares through standard form contracts. The Aktiengesetz 1937 codified the principle that banks could vote using the rights of all its shareholding depositors, and this principle more or less remains up to today. Banks merely have the duty to vote in their depositors’ best interests: a so called duty which essentially cannot be breached. Social Democrats and Greens had it in their political platform to abolish banker voting rights over the 1980s and early 1990s. But when they won government, interest had dwindled. The issue was partly pre-empted by some minor changes in the Kontrolle und Transparenz Gesetz 1998 (Control and Transparency Act 1998) concerning banks’ (less relevant) direct shareholdings.

In the US, first, state legislation determined the position of directors and election rules. In the early 19th century there was a general practice, following the common law, that directors would be elected and removed by the general meeting for any reason. This, however, became complicated with experiments in cumulative voting: itself initially seen as an innovation to give the smaller investors some voice. Ironically, this led to courts developing the rule that directors could not be removed without a good reason, so as to protect those minority directors. By 1932 Berle and Means, chief architects of the New Deal’s economic policies, were blaming the erosion of no-cause removal rights for diminishing director accountability. In the years following, many states, like the UK, followed Berle and Means’ recommendations in revitalising no-cause removal. However, particularly in Delaware between 1960 and 1974, the general position was confirmed that companies could opt to have for-cause removal along with staggered boards. In the post-crisis Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, a right for shareholders to nominate board candidates was introduced, but implementation of the rules by the Securities and Exchange Commission was struck down by the DC Appellate Circuit court.

Second, shareholder voting rights, at the inception of the republic, remained closer to the
old common law traditions of graduated voting, or even one vote per person. The practice varied between company types and in states, but by the early twentieth century, this had changed. Companies began issuing non-voting shares *en masse*. A popular outcry was led by William Ripley, an economist closely associated with the progressive era and Woodrow Wilson. It put pressure on President Coolidge and then the New York Stock Exchange to restrict non-voting or multiple voting shares. The NYSE officially adopted this policy in 1940, and it remained until 1986. During the Reagan administration, the regulation was undone with increased stock listing competition. When the Securities and Exchange Commission hurried to issue new rules, the DC Appeals Circuit held the SEC had no power to mandate voting rules. Subsequent re-regulation allowed multiple voting, unless it is disproportionate.

Third, behind the shareholders, and post-Second World War, more and more Americans were saving for retirement through occupational pensions. Trade unions had sought to administer the pensions of their members alone, but the Republican driven Taft-Hartley Act 1947 limited union involvement to half a pension trust’s board seats. This was vetoed by President Truman, but the veto was overridden. There was never any express right to elect private sector pension trustees, despite a number of proposals by Democrat Congressmen from the 1980s. What existed depended on collective agreements, or on the state laws establishing public sector pensions. State legislation created rights for the beneficiaries of schemes to exercise increasing influence, particularly after the Uniform Management of Public Employee Retirement Systems Act 1997 required public disclosure and easy accessibility of the rules. This led to a diminished number of employer or politically appointed representatives, and more pension board members elected by beneficiaries. But union and public sector state pensions aside, the majority of votes rested in asset managers’ hands. No rights existed among purchasers of life insurance companies, nor among mutual investors. However, for people who bought shares through retail banks or other brokers, the Dodd-Frank Act 2010 made the step of banning those intermediary broker votes.

Overall, the tendency to increase the spread of participation rights among more and more people must be seen primarily as a progressive democratic cause. The primary opponents to the extension of participation have ranged from outright fascists (with the *Aktiengesetz* 1937), to the post-war Republican party (the Taft-Hartley Act 1947), to courts of various demeanours. The times when the law on participation was developed, however, came from very different political groups. In the UK, the chief drivers were the Labour governments in 1947 on director elections, in 1962 on shareholder voting rights, and in 1976 and 2004 on pension beneficiary voice. A Conservative administration in 1957 and then in 1995 also played a significant role, because then
the Conservative party was content to make modest reforms within the democratic mainstream. In Germany, the still-democratic administration of 1931 proposed the one-share, one-vote rule, the Christian Democrats made minor reforms in 1965 to the director election rules, while the Social Democrats had proposed (but not implemented) bank voting reforms in the 1980s and 1990s. In the US, it was the progressives who lobbied for the one-share, one-vote rule in the 1920s, the New Dealers who, like Berle and Means proposed, hardened the regulatory backing for it, and inspired the (temporary) state-based spread of no-cause removal for directors. Similarly it was progressive Democrat interests, in union and state public pension funds, which pushed over the late 20th and early 21st centuries for participatory corporate governance reforms: seeking to eliminate non-voting or multiple vote shares, and to eliminate staggered boards. Analysing the trend as a progressive democratic movement is accurate.

However, there are significant limitations to this account when ideals are compared to outcomes. If the UK Labour Party was interested in ensuring that people saving for retirement could hold those managing their money to account, why was regulation only focused on pension trusts? Essentially, there is no good reason for this form based limitation. There is, however an explanation: the law was anchored to what collective agreements were doing already, and beneficial ‘owners’ might superficially appear to have more of a moral justification for a voice than someone with a contract pension or a life insurance policy. Such is the seduction of ownership. Why were the German Social Democrats not acting on precisely the same issues, and why did they forget their course of proposed bank reforms from the 1990s? One reason is simply that the political salience of occupational pensions was not so great, and the other is that bank law is obscure, misunderstood, and compared to health, education or labour rights, it could be regarded as boring. Calls for corporate reform have continually focused on employee codetermination and executive pay. This is not unjustifiable, but it does mean democratic objectives are not always consistently pursued. Among American Democrats, the position is admittedly more difficult. Between 1980 and 2014, there were just two years, despite having four Presidential terms, where the Democrat party could legislate freely at Federal level. This was due to its tripartite electoral system, and even then there has been hostile court intervention. But still, it can legitimately be asked why (even given regulatory competition issues) reform was not pushed harder at state level, and why before 1980 legislation was not pursued to favour all kinds of retirement plan equally.

This is not an account which relates to differences among majoritarian or consensus based political systems, as Gourevitch and Shinn proposed, because there have been possibilities
in each for reform, and also because the functional outcomes in the UK and the US are essentially similar to Germany. Financial intermediaries, whether asset managers or banks, participate most in corporate governance. The political story is not dissimilar from Cioffi and Höpner’s ultimate conclusions, except that it departs from the distinction between ‘left’ and ‘right’. Because it focuses on participation rights, rather than the rules on takeover bids and directors’ duties, there is some contrast with Bruner’s thesis that shareholder rights are not generally increased unless there is growing social welfare protection: in the UK, most dismissal protection, for example, emerged in the 1960s after shareholder rights were boosted, and the story simply becomes complicated in terms of timing for shareholder rights being undone in the US. Again, genuinely different views might exist when focusing on takeover bids. Either way, the political story could only be part of the answer for why participation rights evolved in the way that they did. This is about what shaped the law. But what happened when there were no specific participation rights? Legal reforms begin with the environment that politicians inherit, and often this starting point was set by the market.

(2) Economics: what shaped governance in the marketplace?

(a) Law and economics
What have existing theories said about how participation rights developed when they were left to the market, when there were no specific participation rights written into law? Law and economics theories appear to offer at least a preliminary view, as they model what should happen in an idealised ‘free market’ state: voluntary interactions will generally lead to efficient outcomes.

In discussing law and economics, it is critical at the outset to see how ‘positive’ and ‘normative’ theory intertwine in the standard account. In ‘The Methodology of Positive Economics’, Milton Friedman famously argued that positive economic theory should construct a model that will predict the consequences of rules, policies or institutions. Friedman thought that the process is like ‘an “objective” science, in precisely the same sense as any of the physical sciences.’ Hypotheses for how economic consequences will play out are founded on a set of assumptions, and it does not necessarily matter whether those assumptions match the real world or not. For instance, it is obviously untrue that all people act rationally all of the time, or that all shareholders seek to maximise private profits at any social cost. But what is important, on this

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58 M Friedman, ‘The Methodology of Positive Economics’ in M Friedman, Essays in Positive Economics (University of Chicago Press, 1953) ch 1, 4
view, is the theory’s ‘predictive power’. So, the only relevant test of the validity of a hypothesis is comparison of its predictions with experience. The hypothesis is rejected if its predictions are contradicted (“frequently” or more often than predictions from an alternative hypothesis)...

Empirical evidence can be used both ‘in constructing hypotheses and in testing their validity.’ But once this ‘positive’ enquiry is over, normative conclusions can be drawn. Any policy conclusion, said Friedman, ‘necessarily rests on a prediction about the consequences of doing one thing rather than another, a prediction that must be based - implicitly or explicitly - on positive economics.’ In this way, economic models are useful because, with a given set of assumptions, they make predictions, and if the predictions are not falsified normative implications can be drawn.

However, while Friedman’s views can accurately be said to represent much of modern economics methodology, they do not embody the only approach. One of the most influential articles in the law and economics movement was Ronald Coase’s ‘The Problem of Social Cost’, and here the methodology contains a subtle but significant difference. Coase came to the dramatic conclusion that in a hypothetical world where transaction costs did not exist, people could always trade resources or rights to maximise their economic value (and so reach both an allocatively and productively efficient solution) no matter what the initial distribution of rights was, if there was room for a bargain. In the examples Coase used, he posited that only the existence of transaction costs – the costs of discovering transactional partners, informing, negotiating, drafting a contract, monitoring compliance – prevented an efficient result (both allocative and

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110 Friedman (1953) 8-9
111 Friedman (1953) 12
112 Friedman (1953) 5
113 RH Coase, ‘The Problem of Social Cost’ (1960) 3 Journal of Law and Economics 1, 5, ‘But as the payment would not be so high as to cause the cattle-raiser to abandon this location and as it would not vary with the size of the herd, such an agreement would not affect the allocation of resources but would merely alter the distribution of income and wealth as between the cattle-raiser and the farmer.’ 6, ‘Whether the cattle-raiser pays the farmer to leave the land uncultivated or himself rents the land by paying the land-owner an amount slightly greater than the farmer would pay (if the farmer was himself renting the land), the final result would be the same and would maximise the value of production. Even when the farmer is induced to plant crops which it would not be profitable to cultivate for sale on the market, this will be a purely short-term phenomenon and may be expected to lead to an agreement under which the planting will cease. The cattle-raiser will remain in that location and the marginal cost of meat production will be the same as before, thus having no long-run effect on the allocation of resources.’ 8, ‘It is necessary to know whether the damaging business is liable or not for damage caused since without the establishment of this initial delimitation of rights there can be no market transactions to transfer and recombine them. But the ultimate result (which maximises the value of production) is independent of the legal position if the pricing system is assumed to work without cost.’ 10, ‘With costless market transactions, the decision of the courts concerning liability for damage would be without effect on the allocation of resources.’ 15, ‘It is always possible to modify by transactions on the market the initial legal delimitation of rights. And, of course, if such market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value of production.’ Emphasis added.
114 Coase (1960) 3 Journal of Law and Economics 1, 15
productive) being reached.

The difference between these approaches is that Friedman’s method starts with hypotheses and assumptions, but claims these can predict reality, while Coase’s predictions are also hypothetical. The predictions of efficient outcomes are only for a hypothetical world of no transaction costs. One way to view Coase’s axiom\textsuperscript{115} (that absent transaction costs, distribution of rights is irrelevant, and transactions will always be efficient) is that it could never be disproven by appeal to the real world. This might have the very unfortunate consequence of Coase’s axiom being unfalsifiable. A second view is that conditions might be found under which a transaction cost free world is approximated, which could test the validity of the claim. Could real markets, that approximated zero transaction costs, be observed and how would they function in practice? A third way is to say that Coase was merely describing a normative ideal, and that the model could be refuted but only through appeal to logical argument. The purpose of this would appear to be to set up an ideal model of ‘the market’ against which the efficiency of interactions in the real world could be measured. It serves to emphasise the importance of transaction costs, and the unimportance of other considerations, in what might hamper market efficiency. Chapter 7(2)(c) will return to this normative centre of Coase’s work.

In the meantime, Coase’s axiom carried a profound influence through the law and economics literature of both the market and the firm\textsuperscript{116} – potentially including positive theories of how participation in corporate governance would develop. Of course, the idea of a ‘market’ (and a firm for that matter) is ambiguous because it has no objective, fixed character. All the rules of contract, property, trusts, tort, unjust enrichment and more determine basic issues such as when bargains are enforceable. Is there an action for misrepresentation, or also for failure of disclosure? Is there an action for duress, or also unconscionable conduct? A market’s nature also changes with the strength of the remedies that are available for breaches of obligations (compensatory damages, specific performance, restitution, priority in insolvency, and so on). When people say ‘free market’, like ‘freedom of contract’,\textsuperscript{117} they tend to mean something closer to a position where transactions take place without fraud or duress, but they may remain sceptical

\textsuperscript{115} This is not to say the ‘Coase theorem’, developed by Richard Posner and others, which says that efficient results take place, not just in a transaction cost free world, but in a world with very low transaction costs. Coase disavowed this, but this nevertheless leaves the question of whether Coase’s own contention was accurate: that transaction costs were the only reason that prevented efficient bargains being made.

\textsuperscript{116} RH Coase, ‘The Nature of the Firm’ (1937) 4(16) Economica 386, also posited that transaction costs determined the boundaries between the firm and the market, and again excluded bargaining power from its analysis.

\textsuperscript{117} cf Lord Jessel MR, \textit{Printing and Numerical Registering Co v Sampson} (1875) 19 Eq 462, 465, ‘if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.’
of many more safeguards than that.\textsuperscript{118}

Each author’s preferred list of market failures matters less than what is left off all lists. Everyone must admit some market ‘intervention’, even if it is no more than the public policy of prohibiting exclusion clauses for the use of fraud or force.\textsuperscript{119} Thus those who favour ‘free’ markets tacitly condone a limited set of compulsory terms requiring damages in tort, or requiring restitution for unjust enrichment.\textsuperscript{120} But with this aside, there is a relatively clear line of thinking on what a ‘free market’ is meant to achieve. The question would then be (at least in the Friedman tradition), did any historical periods approximate a free market model, so as to test the claims?

It makes sense to concentrate on three representative examples from differing departmental backgrounds of management, law, and economics. While there are differences of emphasis, each had an affinity to the Coasean tradition: the starting presumption of a limited number of issues that prevented economically efficient results. This came down to transaction costs for Coase, and maybe other authors acknowledged additional constraints. But the critical unifying theory was that distribution of rights was not an issue \textit{in itself}: if distribution of rights made a difference, it was only because there were positive transaction costs.

Within management literature, Michael Jensen and William Meckling were possibly the first, and best known, contemporary authors to begin formulating a theory about how corporate participation rights might, in a free market, be shared.\textsuperscript{121} Within the ‘nexus of contracts’ that made up a firm, they plainly acknowledged that there were already specific legal regulations. For example, in 1976 they pointed to the US securities exchanges’ restrictions on non-voting shares,\textsuperscript{122} but wrote (somewhat cryptically) that otherwise ‘forces exist to determine an equilibrium distribution of outside ownership’. ‘Ownership’ in this context referred to equity claim holders with voting rights, in ‘equilibrium’ with both nonvoting shareholders or the voting rights held by a company’s inside managers.\textsuperscript{123} This fitted with their approach that ‘specification of rights is generally effected through contracting’, their concern with ‘the equilibrium contractual form’ between managers and outside equity or debt, and their emphasis on the ‘essential contractual

\textsuperscript{118} eg F Easterbrook and D Fischel, ‘The Corporate Contract’ (1989) 89 Columbia Law Review 1416, 1434, listing duress, fraud, infancy or insanity, or negative external effects on third parties.

\textsuperscript{119} cf Mill (1848) Book V, ch 1

\textsuperscript{120} This characterisation of exclusion clauses, in effect conceptualised as compulsory terms, may not be widely accepted already. However it is suggested that this is the appropriate way to see the issues because if there can be an exclusion of something, there logically has to be a rule of law that is operating like a term in any transaction. This therefore doubts what might be an alternative view of seeing the ‘process’ of transacting as entirely distinct from the ‘substance’. At bottom the rules of ‘process’ resolve into protections against unfair opting out of the general law. cf Henderson v Merrett Syndicates Ltd [1994] UKHL 5, per Lord Goff, ‘the law of tort is the general law, out of which the parties can, if they wish, contract’.


\textsuperscript{122} Jensen and Meckling (1976) 3(4) Journal of Financial Economics 305, 353, ‘Given that the securities exchanges prohibit the use of non-voting shares by listed firms...’

\textsuperscript{123} Jensen and Meckling (1976) 3(4) Journal of Financial Economics 305, 352
nature of firms’. In an article concerning labour participation, they stated that if a system ‘arises out of voluntary arrangements among individuals’ it will be more ‘efficient than the alternatives’ because it must ‘grow up and survive in a competitive environment’. In another example, Michael Jensen, writing with Eugene Fama, advanced the same presumption. ‘Absent fiat,’ they said, ‘the form of organization that survives in an activity is the one that delivers the product demanded by customers at the lowest price while covering costs.’

As such, a general idea was forming in corporate governance that – in absence of specific regulation, or ‘fiat’ – evolution of participation rights would be voluntary and efficient. Moreover, it was said that there would be some kind of ‘equilibrium’, a term which suggests that the market clears where supply equals demand, and that unless there are significant changes in either variable, or an exogenous shock, that there is relative stability. Jensen himself remained ambivalent about a one-share, one-vote rule, and this was not a detailed explanation for the evolution of participation rights. But could it be regarded as containing a hypothesis? Was there a prediction that could be empirically verified if (but only if) points in history could be found where conditions approximated a competitive environment, absent fiat? For example, absent fiat would shareholders really be enfranchised through voluntary interactions? Would there be an equilibrium in shareholder voting rights, changes in supply and demand aside? And what would happen to the rules on director elections? Without specific laws, what would happen to the voice, if any, held by the ultimate beneficiaries of institutional shareholders? Would voluntary interactions also reach an equilibrium in those rules?

Among legal scholars, and also working within the nexus of contracts paradigm, Frank Easterbrook and Daniel Fischel sought to explain the character of legitimate compulsory legal rules in corporate law by asking ‘what would the free market do?’ This account depended on their logical construct of what ideal markets should do. For instance, like Jensen and Meckling had, they acknowledged the existence of the one-share, one-vote regulation in the US securities markets. But this regulation could be justified precisely because it copied what (in their assessment) the market would have done anyway. In their view, one-share, one-vote regulation served a market-mimicking function, because the idea that ‘Voting flows with the residual interest

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127 Jensen and Meckling (1976) 3(4) Journal of Financial Economics 305, 351-2; ‘...we have assumed that all outside equity is nonvoting... Simply put, forces exist to determine an equilibrium distribution of outside ownership.’
in the firm... explains why there is so little nonvoting stock'. Of course, to say that directors in
companies where there are many voteless shares ‘will not make optimal decisions’ and that this
‘explains why there is so little nonvoting stock’ leaves an ambiguity about whether they were
positing that markets actually would work in this way, or whether an ideal market would. In any
case, for Easterbrook and Fischel the market mimicking effect was, at the time, the ‘justification
for the New York Stock Exchange’s policy of not listing firms with nonvoting issues’.

Easterbrook and Fischel appeared to slide in and out of describing normative ideals,
while hinting at positive claims about how markets really worked. They wrote that shareholders
had voting rights because it was ‘part of risk-bearing’, or it was related to being the ‘residual
claimants to the firm’s income’. Here there is again an ambiguity, because one might be a
residual claimant (for instance, an asset manager qua registered shareholder) without being the
residual risk bearer (the pension beneficiary or life insurance policyholder). Assuming that the
essence of the argument was based on economic risk, they regarded shareholders as acquiring
voting rights due to their essential vulnerability to risk. This vulnerability meant shareholders
would have the best incentive to use decision making power to maximise firm value, compared to
others with merely ‘fixed’ claims. They dismissed the possibility that bargaining power could be
relevant, because even if deals were ‘take it or leave it’ the results were ‘contracting nonetheless’.

Could Easterbrook and Fischel be regarded as making claims about how free markets
(absent specific participation rights) actually worked? For instance, would shareholders hold
voting rights – indeed any voting rights at all – in absence of stock exchange or other legal
regulation? Possibly the best view is that claims about what might hypothetically be done in
absence of positive legal enactment have ‘no empirical content’, and can only be retroactively
filled ‘by scholars on an artificial and counter-factual basis’. In this respect the theory appears
very similar to the classic, though now superseded, test of business efficacy for implied contract

130 Easterbrook and Fischel (1983) 26 Journal of Law and Economics 395, 409, ‘Voting flows with the residual interest in the
firm, and unless each element of the residual interest carries an equal voting right, there will be a needless agency cost of
management. Those with disproportionate voting power will not receive shares of the residual gains or losses from new
endeavors and arrangements commensurate with their control; as a result they will not make optimal decisions. This also
explains why there is so little nonvoting stock and is a justification for the New York Stock Exchange’s policy of not listing
firms with nonvoting issues.’

this must be the case, because if the argument were based on someone being the residual claimant, then one legal right
(voting) would be attributable to holding another legal right (claiming the residual assets in winding up) but this would merely
beg the question, why should one party be the claimant? It seems most likely that Easterbrook and Fischel would have
approved (as their heading suggests) that that justification comes down to risk bearing.


134 M Moore, Corporate Governance in the Shadow of the State (2013) 247
terms. However this could have the unfortunate consequence that Easterbrook and Fischel’s claims were unfalsifiable through recourse to any evidence in the real world, only contestable in a world of logic: not Friedman, but Coase.

On the other hand, Easterbrook and Fischel’s claim that voting is ‘part of risk bearing’ and suggestion that risk bearing logic ‘explains why there is so little nonvoting stock’ could be taken on its face to embody the view that (unless there has been some regulatory impediment) in free markets votes in corporations will go to the party who takes the risk of business insolvency. This idea would be flatly refuted by the actual development of corporate participation rights. Asset managers and banks hold the votes. They bear no residual risk. The risk stays with the pension beneficiaries, or the life insurance policyholders.

Within economics literature, the nexus of contracts view was shared by Oliver Williamson. His central contention was that shareholders come to have participation rights, and control of the board of directors through a process that ‘arises endogenously’.

... the equity suppliers initially offer to hold debt at a [relatively high] price of $p$. Upon realizing that this is a very inefficient result, the workers who are organizing the enterprise thereupon invent a new general purpose safeguard, name it the board of directors. Upon recognizing that expropriation hazards are thereby reduced, the suppliers of equity capital lower their terms of participation to $p^*$. They thus become the “owners” of the enterprise. Not by history but by logic does this result materialize.

While it is plain that Williamson was not describing an actual pattern of events – not ‘by history but by logic’ – he suggests that, in absence of intervention in the transactional process, ‘equity suppliers’ will control the board of directors as a ‘safeguard’ through a process of ‘logic’. More specifically, the logic was that shareholders were always more vulnerable, and in need of greater protection than other persons in the nexus of contracts that made up a firm. Thus, they needed a governance ‘safeguard’ to encourage their investment. In stating this claim, Williamson

135 The Moorcock (1889) 14 PD 64, per Bowen LJ ‘what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men’, now surpassed by AG of Belize v Belize Telecom Ltd [2009] UKPC 10, discussed at ch 4(1). Belize Telecom Ltd foots implied terms on the ‘reasonable expectations’ of the parties, in an essentially similar manner to that suggested on the first page of F Kessler, ‘Contracts of Adhesion – Some Thoughts About Freedom of Contract’ (1943) 43(5) Columbia LR 629, which also bears remarkable similarities to BGB §§133 and 157.

136 Williamson (1985) 323-324

had not in fact distinguished between different types of shareholder (small retail shareholders or institutional shareholders) nor had he distinguished different kinds of ‘equity suppliers’ (beneficiaries or institutional shareholders).

On the contrary, Williamson made it a ‘central thesis’ of his work ‘that a common theory of contract applies to transactions of all types’. In particular, the only relevant distinguishing feature among different kinds of contract was those where the parties made asset specific investments, compared to those where they did not. Asset specific investments (meaning upon termination of the relation, a party risks loss of the investment) were the factor that created vulnerability. According to Williamson ‘suppliers of finance bear a unique relationship to the firm’ and this meant the ‘whole of their investment in the firm is potentially placed at hazard.’

Here was the logic: one of relative vulnerability of equity suppliers, based solely on making asset specific investments. This justified shareholders acquiring control over the board of directors.

Was Williamson like Friedman or Coase? Was he saying that voting rights should be distributed by market logic to ‘equity suppliers’ in lieu of compulsory rules? If so, beneficiaries of institutional investors, not institutions themselves, should presumably hold votes for company boards. If Williamson’s theory was that those people making asset specific investments should acquire voting rights, then surely this would be the ultimate contributor of capital, rather than an institutional intermediary. An uncharitable explanation is that Williamson simply had not thought about the extent of the investment chain at the time of his writing, and so he confined himself to an argument tailored to elevate the claim of ‘the shareholder’ over the employee or other stakeholders: this was his real concern. But if so, this approach contained a basic flaw. It cannot be simultaneously be claimed that shareholders (in an ideal market or a real one) have voting rights over employees because they make asset specific investments, and at the same time deny that institutional shareholders (who really hold the votes) need to make asset specific investments themselves.

An alternative explanation, which could make more sense and also meet the similar concerns raised in Easterbrook and Fischel’s theory, could be that the ultimate contributors of capital make a rational choice, motivated by a desire to save transaction costs, to delegate shareholder voting rights to institutional intermediaries. The logic of collective action, it could be said, makes such a strategy wise to resolve the problems of rational apathy that are, if anything, more exacerbated among beneficiaries of institutional shareholders. They are vastly more

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139 Williamson (1985) 241
140 Williamson (1985) 32-5
141 Williamson (1985) 304. Note, that among ‘suppliers of finance’ Williamson remarks that some creditors could also make asset specific investments, which left them vulnerable.
numerous than shareholders themselves, and many people simply have not been well informed about where their retirement savings go. The difficulty here is that while delegation of participation rights to financial institutions could be a plausible strategy, under Williamson’s framework it would follow that, at the very least, those contributors would rationally still aim to retain a governance ‘safeguard’ against the potential risks of institutional shareholder agency costs. Why would shareholders contract for a governance safeguard, when beneficiaries of shareholders did not? Surely the ultimate contributors of capital are the true equity suppliers, and the actual suppliers of the ‘asset specific investment’. Why would there be a separation of contribution and participation?

The most plausible answer could actually be found in Williamson’s work itself, but it is one which he dismissed. In his discussion of workers, and why (without a law) they do not play more of a role in corporate governance, Williamson took pains to dismiss the concept of bargaining power. ‘Rarely is power defined,’ he wrote, or if it was the ‘main problem with power is that the concept is so poorly defined that power can be and is invoked to explain virtually anything.’ Obviously, Williamson was correct to seek proper definition, and when speaking of markets, the focus must plainly be on bargaining power, rather than other forms of organisational authority, though these may themselves partly be a product of market transactions. Power in the bargaining context must mean the relative influence that people have in making transactions, rather than the applicable rules within organisations, which begins with ‘non-transaction costs’. If, after all, it was defined Williamson wrote that the pitfall of ‘the power literature’ was to infer power ‘by ascertaining which of two contestants will win in an isolated confrontation.’ Previous authors, he said, had merely desired a different distribution of wealth. Yet echoing Coase, Williamson stressed that ‘if efficiency is driving organizational outcomes, modes that are efficient under one distribution of income will normally remain efficient under another...’ It might indeed be that ‘the employer’s resources are much more extensive than are those of the typical employee’, but this did not matter because ‘the employer is dealing with suppliers and has continuing needs to hire workers’. This claim of equal ‘continuing needs’ is highly doubtful in relation to employers and workers, but more importantly Williamson did not consider that issues of bargaining power might arise among shareholders or beneficiaries saving for retirement, many of whom would be workers themselves.

142 Williamson (1985) 237-238, ‘Such an undisciplined approach to the study of complex social science phenomena is clearly unsatisfactory.’
143 On which, see M Moore, Corporate governance in the shadow of the state (2013) 17 ff, concerning the relations of power that exist under the terms of a company’s constitution and statute, favouring director autonomy.
144 Williamson (1985) 258
145 Williamson (1985) 260-261
Taking these cross-disciplinary examples in the law and economics literature it might be possible, with a generous spirit, to forgive the average reader for thinking these authors were seeking to develop models, within Friedman's methodology, that would make predictions about how real markets work. What would happen through market interactions when the law contained no specific participation rights, particularly regarding the appointment and removal of directors, shareholder voting rights, and a voice for beneficiaries? On the other hand, it must be conceded that perhaps predictions were never part of the theory. Law and economics only sought to define a normative ideal, which is returned to in chapter 7. In sum, there are ideal markets, and then there are real markets, the two are different, and Jensen, Meckling, Easterbrook, Fischel and Williamson were never modelling anything to do with the real world.

What if an officious bystander had enquired when they were writing? If those theorists would testily confirm that they are outside the Friedman methodology, and they align with Coase's hypothetical normativity, then they can be viewed as doing with economic theory what Kahn-Freund and Sinzheimer, as seen in chapter 2(2)(a), had described bourgeois law as having done. Their work extends normative ideals from appropriate contexts (ideal markets) to inappropriate contexts (any real-life markets) under the veil of abstraction. They can have nothing useful to say about reality, except by analogy. But also, this would mean there is an important, unfilled space for a theory about how real markets will work, in absence of specific participation rules. If there is a gap, an account is needed. So either as an alternative to law and economics, or by entering new territory, this is the goal that the second positive thesis will fulfil.

(b) A second positive thesis: non-transaction costs and rationality

Perhaps the most useful result to emerge from the law and economics discussion so far is that there are at least three very different conceptions of markets. The first, represented by Easterbrook and Fischel, holds that in absence of force, fraud, infancy, insanity, or negative effects on third parties, markets are a normatively defensible mechanism of social organisation. This includes markets for participation in corporate governance. Corporate law is no candidate for redistributing rights, like in ‘poverty law’ fields such as employment, and so contracting between equal and unequal parties is ‘contracting nonetheless’.

The difficulty with this first conception is that, at the very least, many ultimate investors

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146 See above, ch 2(2)(a) and O Kahn-Freund, ‘Hugo Sinzheimer 1875-1945’ in Labour Law and Politics in the Weimar Republic (1981) 102
149 (1989) 89 Columbia Law Review 1416, 1429-1430
are in an employment relationship, and saving in occupational pensions. But then if a ‘poverty law’ exception is to be made, it is difficult to see why retail shareholders, or a mutual fund investors, which may be small personal savers should be conceived in a qualitatively different manner. The distinction of poverty is one of degree, not of kind. Building binary distinctions on top of graduated differences is conceptually unstable. More fundamentally, if one party is incapable of exercising any negotiating power over a contract’s terms, the justification of private autonomy to determine the balance of the rights exchanged has dropped away. With this goes the normative justification for the state to use its coercive power to enforce bargains at a cost to the public.150

The second conception of markets, represented by Williamson, holds that asset specific investments are a further, significant distinguishing feature of economic transactions. The role of the law is to prevent opportunistic behaviour and promote welfare, but this is not necessarily assured from the fact of a voluntary undertaking alone. Particularly as contractual relations develop over time, people’s welfare becomes more interdependent when they cannot recoup their expenses upon termination of the relation. Shareholders make asset specific investments as their capital is ‘always at hazard’, although it is unclear what status an ultimate beneficiary might have. But the common reference point, the ‘common theory of contract [applicable] to transactions of all types’,151 is based upon the nature of the exchange and how it develops in practice: not the parties to the contract themselves. If a choice has to be made, this second conception of markets is plainly preferable to the first because it acknowledges at least one more major category of situation (beyond force, fraud, infancy, insanity, and third party effects) which has significant consequences.

The third conception views different markets, like different types of contract, as distinct based on the social context and identity of the parties. Markets involve institutions, networks and exchanges, where people have varying bargaining power. The normative justification for markets and contracts turns on extent to which they serve the goal of social justice,152 and so private autonomy is not an end in itself but rather a means to that end. Bargaining power, which partly flows from the relative wealth of the parties, compounds upon asset specificity, and other transaction failures. This conception aligns with the progressive democratic ideal, because identification of power everywhere, from every source, in every social institution, is a

151 OE Williamson, The Economic Institutions of Capitalism (1985) 241
precondition to ensure its distribution among the many, and not the few. While Williamson appears to have regarded bargaining power (if it existed, or could be defined) as an issue relating to workers, Easterbrook and Fischel acknowledged that (although normatively irrelevant) it potentially relates to a broad range of transactions. Easterbrook and Fischel are right, because the concept is used not merely in labour law,\(^{153}\) but also extensively in landlord and tenant regulation,\(^{154}\) consumer protection laws,\(^{155}\) and regulation in favour of small business,\(^{156}\) across every developed country from the Commonwealth, to the EU, to the US. A unified theory of contractual interactions, which Williamson desired for economics, had passed away in legal theory long ago.\(^{157}\) This breadth of use also suggests that bargaining power is not just a vague ‘slogan’ that makes the ‘liberal intelligentsia’ feel better about itself while doing nothing of substance.\(^{158}\) It is simultaneously a reason for compulsory rights that infuse fairness into all economic affairs, and justice into relations of power and subordination.

The second positive thesis follows this third conception of markets, to explain how participation rights were distributed by markets in reality. It must reject the first two conceptions on the grounds of their oversimplification. Whether or not this was intended by Easterbrook, Fischel, or Williamson, the first two conceptions of markets could not work adequately to explain how participation rights develop in the real world. Accordingly the second thesis holds that, when left to the free market, participation in corporate governance tends to reflect the relative bargaining power of the competing economic actors. Results depend on the degree to which some are ‘non-adjusting’ or ‘adjusting’ investors, which depends on their (1) information (2) collective action problems, and (3) ‘non-transaction costs’ or relative wealth.\(^{159}\) Patterns of participation include the way rules on director election rules are set, in direct or indirect negotiations with shareholders (or other stakeholders), it includes shareholders of different kinds negotiating with the company or each other over the distribution of voting rights that attach to shares, and it includes the negotiations over whether participation rights are given to the ultimate contributors of capital. It includes ‘negotiations’ where there is in fact no negotiation, because

\(^{153}\) eg National Labor Relations Act 1935 §1

\(^{154}\) eg Attorney General of Canada v Nav Canada (2008) FC 71, [19]

\(^{155}\) eg Unfair Terms in Consumer Contracts Directive 93/13/EC recital 16

\(^{156}\) eg Unfair Contract Terms Act 1977 Sch 2(2)

\(^{157}\) F Kessler, ‘Contracts of Adhesion—Some Thoughts About Freedom of Contract’ (1943) 43 Columbia Law Review 629, 636, ‘can the unity of the law of contracts be maintained in the face of the increasing use of contracts of adhesion?’

\(^{158}\) D Kennedy, ‘Distributive and Paternalist Motives in Contract and Tort Law, with special reference to compulsory terms and unequal bargaining power’ (1982) 41(4) Maryland Law Review 563, 622. It might be noted that Kennedy appears to have accepted the graphical caricature of markets in his appendices at 655-657 from neo-classical economics which in fact leave no room for bargaining power. In other words, his critique appears to have adopted a unified theory of contracts. As noted above, the original graphical representations of supply and demand were thought by their creator to be applicable to commercial sales, but not, for example, to labour: F Jenkin, The graphic representation of the laws of supply and demand and other essays on political economy (1887, 1996 edn Routledge)

\(^{159}\) See ch 2(3)(a)
the market only offers take it or leave it deals. The way that participation rights developed simply cannot be understood without bargaining power.

What creates the elements of bargaining power? In terms of resource inequality, the economic development of a country in its entirety: the rise of an industrial workforce which is capable of taking collective action, the invention of retirement, and the creation of a middle class. All the laws and policies of the welfare state, the public sector, and the quality of progressive taxation affect the extent to which people have wealth and therefore basic economic influence. Relevant to collective action problems are a state’s policies on the ease of formation of all forms of economic associations (companies, trade unions, mutual funds, etc), the available fiscal or regulatory subsidies, and the lawfulness of collective action, including the ability to inflict economic loss on competitors. Information advantages can often be a product of organisational size, but also the laws on disclosure of material terms in any transaction. These rules too will be part and parcel of a jurisdiction’s political and economic development. Together these contextual complexities account for the variety of governance outcomes that, for instance, Gourevitch and Shinn documented in their work.\(^{160}\)

In addition to bargaining power, the same limitations on rational behaviour that were discussed for politics in chapter 3(1)(b) exist for exercising choices on the market. When economic actors decide a course of individual or collective action, the same issues of preferring the *status quo*, anchoring our choices to the familiar, and the precariousness of our willingness to invest effort when it could amount to nothing, apply. No matter what their bargaining power, people’s capacity to make objectively rational decisions is further constrained, particularly when we speak of natural persons as opposed to large corporations. Behavioural psychology does suggest that some features of irrational behaviour are less applicable for commercial parties,\(^{161}\) which could be taken to include well advised pension trustees, asset managers, banks. This seems to be because large organisations can put in place policies, thought through over a long space of time, which amount to objectively rational economic choices. Another qualification, as before, is that the results of behavioural experiments give evidence of average outcomes. As in politics, individuals can break the standard human mould. The more careful and reasonable sides of our personalities can become instilled in economic interactions and institutional culture.

Relative bargaining power and rational action can produce multiple results: it could mean the spread of participation rights, or it could mean their elimination, always depending on the

\(^{160}\) See ch 3(1)(a)  
\(^{161}\) eg D Kahneman, *Thinking, Fast and Slow* (2011) 284 and 294, ‘There is no loss aversion on either side of routine commercial exchanges.’ Similarly, human motivations plainly have less relevance in any kind of commercial contractual bargaining.
context of the economic actors. The outcomes could maximise welfare, or be completely arbitrary. The critical point is that not all voluntary interactions, not all contracts are alike, because people are different. It is impossible to understand the changes and variations in corporate participation rights while being blind to the significance of bargaining power, in the abstract or in reality.

(c) Historical development: a summary

How does the second positive thesis match with the development of participation rights? Although, as it has been stressed, it is probably accurate to say that a market is never entirely ‘free’, there do indeed appear to be several historical ‘windows of deregulation’, in the sense that there were no compulsory participation rights. It means that if law and economics theories make predictions about what happens to participation on free markets, these can be verified, or it may simply be theorised what real markets do. Before the detailed treatment in chapters 4, 5 and 6, a short summary is offered.

In terms of director election rules, the windows of deregulation could be regarded as before the UK Companies Act 1947, generally before the German Aktiengesetz 1937, and to some degree throughout most of US history. At those times, director election rules were (generally speaking) default rules. For shareholder voting rights, the historical windows could be before regulatory pressure received government endorsement in 1962 in the UK, before 1937 in Germany, and before 1926 and to some extent after 1986 in the US. For the rights of contributors behind the shareholder, there have only been compulsory rights for UK pension beneficiaries since 2004, and even then participation in selecting pension trustees is form dependent. In Germany, there have been co-determination rights in pensions since 1920, but again this is form dependent. In the US, there is similarly no compulsory, and effect based regulation outside of state law on public pensions. With these ‘windows of deregulation’ open throughout history, it seems possible to compare theories with outcomes. But more importantly, regardless of the view that one may take on what law and economics theories aim to achieve, the second positive thesis of participation, and its predictions, may itself be compared with the evidence.

In the UK, first regarding director election rules, it was already summarised how the common law set a default standard favouring simple majority removal rights, while larger chartered companies tended to favour three-quarter majority removal rights. Before the Companies Act 1947, a three quarter removal rule was the default. The vast majority of
companies simply followed this model: they stuck with the *status quo*, which conveniently meant it was difficult to remove directors from office.

Second, while shareholder voting rights were unaffected by London Stock Exchange policy, company constitutions underwent a shift from graduated voting to one-share, one-vote. This was promoted by Lord Jessel MR in *Pender v Lushington*, but it is notable that the case law remained a default standard. In the 1950s and 1960s stock markets were growing, and the influence of institutional investors was too. Among themselves, institutions were able to use their influence within companies to restrict boards of directors issuing multiple or nonvoting shares, as it was felt these often simply served the interests of management. The influence of boards was quickly overcome by ascendant asset managers.

Third, behind institutional shareholders, bargaining power was key to patterns of participation. While proposals were made in 1976 to require half elected pension trustees, there was no such legal enactment. Before this, British trade unions had slowly been developing similar arrangements through collective bargaining, and were able to do so because in the post war period British trade unionism was at the peak of its economic strength. The 1976 proposals exercised a galvanising and focusing effect – there was a new ‘anchor’ – as it was from this point that a burst of companies ‘voluntarily’ adopted pension schemes where beneficiaries, or the trade union on their behalf, had a voice in selecting trustees. That trend continued over the 1980s, albeit that by the end of the decade the economic influence of trade unions was being broken. Nevertheless, the Pensions Act 1995 wrote the rights into law. Even if employers might have had the inclination or the power to resist codetermined pension trustees, they did not immediately do so. The difficulty was that the law remained form dependant, so that even after the Pensions Act 2004, employers were capable of redrafting pension plans to be in ‘contract’ form. Moreover, pension trustees were frequently content to delegate investment functions to asset managers, who through standard form contracts would appropriate shareholder voting rights. The position by 2014 looked to show avenues for a shift, particularly as a new Association of Member Nominated Trustees provided a similar alternative voice. Greater self-organisation to increase pension trustee bargaining power against asset managers had not yet transpired, although there was potential for change.

In Germany, as the first issue of director election rights remained default up until 1937, different default expectations and macro-economic instability propelled executives to consolidate their power and insulate themselves from accountability. The successive parts of the *Handelsgesetzbuch* that dealt with public companies highlighted the option to choose a right for a
company’s general meeting, or the supervisory board (*Aufsichtsrat*) alone, to appoint and remove the executive (*Vorstand*). This appeared to benefit two groups: first the banks whose representatives packed the supervisory boards, and thus acquired a more direct influence than any small shareholder could hope for. Second, it benefited an *Oberschicht* of autonomous executives, provided they cuddled to the banks. While the interposition of the supervisory board started as a Prussian tradition, particularly after the First World War, more and more companies interposed the supervisory board between the general meeting. In effect, this slide to making the *Aufsichtsrat* a mandatory intermediary was what the fascist *Aktiengesetz 1937* codified into law.

Second, before the one-share, one-vote rule was mandated in 1937, there had been some historical stability. But the stability was entirely lost after World War One. A frenzy of fear about foreign takeovers was used as a pretext by managements to issue masses of multiple voting and nonvoting shares. The Versailles Treaty was partly to blame. Post-war, there could be no restrictions on foreign investment, so incumbent insiders were keen to look for other ways to protect their position. The courts placed some check on skewed votes between 1929 and 1931. But by then it was rather too late because by 1925 most companies had issued so many multiple voting shares that, according to one contemporary study, just one fortieth of capital accounted for 38.2 per cent of voting rights. This example alone represents a large difficulty for the market mimicking view of shareholder voting rights: it is factually unsound to say that when the market is left free shareholders will be enfranchised. Whatever ideal markets do, real markets do not do the same, and so one wonders why the word ‘market’ is being used at all. The evidence suggests that as corporations became more massive, all but a few shareholders were likely to become completely disenfranchised.

Third, behind the shareholding institutions, the ultimate contributors of capital became highly separated from participation. Regulation on German pension beneficiaries followed the codetermination laws, but these were form based: employers could choose to provide insurance contract based pensions or reinvest their workers’ retirement money back into their own business, rather than establish a pension fund where the courts ruled codetermination rights attached. It seems plain that trade unions could have been significantly more active in preferring codetermined forms of pension, but equally plausible that they did not as their members (with an income linked state pension) did not have as much as their British or American counterparts did invested in them. Across shareholders generally, during the 1920s, banks concentrated their power by establishing a common system of share deposits. Through standard form contracts they were able to appropriate all the voting rights on all depositors’ shares. Millions of dispersed
shareholders simply did not have the leverage to propose different terms. After this concentrated market pattern was codified into the *Aktiengesetz 1937*, it remained theoretically possible for shareholders to pass through voting instructions. But it did not change the basic position that German banks would continue to cast most votes in most companies.

In the US, first, director election rules in different states were often similar to basic common law standards of accountability: no cause removal. It appears that over the course of the 19th century, it was gradually eroded, not without the help of courts which misinterpreted the common law to require good cause for removing a director, usually as a default but also sometimes made mandatory. Despite a resurgence in state laws with no-cause removal after Berle and Means, represented in the Model Business Corporations Act, corporations were free to establish in different states. For other reasons, Delaware was attracting more and more companies, so in the post-war years it mattered more. It allowed companies to choose between no-cause and for-cause removal with a staggered board. Most companies chose the latter. However, from the early 1990s, organised campaigns led by trade union and state public pension funds were successfully pushing for amendments: their growing bargaining power translated into reform of more company rules, after initial public offerings.

Second, shareholder voting rights in a sizeable minority of companies during the early 19th century followed a graduated model: more power for smaller shareholders. As free incorporation became more common, the practice of one-share, one-vote spread, until a decisive moment in the 1920s. The multiplication and dispersion of shareholders reached a tipping point. The bargaining power of corporate insiders was greater than before, and with it came a burst of non-voting share issues, exemplified by the Dodge Motor company after a takeover by a group of investment bankers. The very real risk was that issues of voteless shares would accelerate to the degree they had in Germany. This is what propelled intervention, precisely because the market did not mimic a one-share, one-vote pattern. After 1985, however, when the rules were unravelled, the number of multiple voting shares in companies increased speedily once more. This pattern was only counteracted by the growing power of those same institutional investor interests which preferred accountable director election rules: pension funds pushed back with charter amendments to favour the one-share, one-vote standard. By 2014, however, the precarious position was that the US patterns on voting rights were far more unequal than in the UK or Germany.

Third, behind institutional shareholders, the ultimate contributors had won some voice, but only when they had been sufficiently organised. Before World War Two an increasing number
of trade unions had secured collective agreements where unions controlled the pension funds. The Taft-Hartley Act 1947 had mandated that employers control at least half a pension board. But ironically, with a model that was envisaged to restrict union power, codetermined Taft-Hartley plans were spread using collective agreements. The turning point came gradually between 1974 and 1986, when multi-employer collectively bargain plans went into decline. This mirrored the changes in the landscape that unions faced, as employers exercised their muscle to replace collective pensions with individualised 401(k) pensions, if indeed there was any pension at all. Participation in state pension funds, however, persisted and even strengthened as rights for beneficiaries had been written into the law. Otherwise, just like asset managers in the UK, and banks in Germany, US asset managers wrote standard form contracts to assume all voting rights on the investments from pension, insurance or mutual fund money that they came to manage. Brokers had done the same, until the ban in 2010, but as there was no similar regulation for other kinds of shareholder and beneficiary, the separation of contribution and participation had grown.

On this summary it must be evident that an understanding of the dynamics of bargaining power is necessary to explain the shifts in participation rights at particular historical moments. Most notably, it explains the concentration of power in German boards in the 1920s, the erosion of no-cause removal over the 19th century in the US, but also its reversal in the 2000s as institutional investors became both powerful and assertive. Shifts in bargaining power have clear consequences for the distribution of shareholder voting rights in Germany and the US in the early 1920s, in the US during the late 1980s. In the other direction, organised institutional interests stabilised the one-share, one-vote standard in the UK in the late 1950s, and in the US was pushing the re-implementation of one-share, one-vote standards especially from the 2000s. Bargaining power is decisive for asset managers and banks acquiring voting rights through standard form agreements in all countries, as are the changes in bargaining power in each place among trade unions and other associations of contributors in organising a voice among pension beneficiaries: this is seen especially in the UK from the late 1970s, and the US from the 1950s. At the very least, if its predictions about the location of participation rights are not simply false, law and economics theory would prefer to describe many of these matters as resulting from voluntary interactions. But such a positive thesis cannot stand because it lacks predictive power. The alternative to be preferred starts with bargaining power.

But markets often move slowly, and economic actors do not always optimise a raw self interest. Notably, in the UK before the Companies Act 1947, companies generally followed the model set in Table A of a 75 per cent vote to remove directors. Conceivably, shareholders might
have pushed for more accountability, or directors might have sought greater insulation, but instead the model was usually followed. In Germany, trade unions might logically have used their collective bargaining power to demand codetermined pensions to a greater degree, but they have not done so yet. In the US, codetermined trade union and state pension funds with large holdings could have logically, like other large investors had done before, decided to push to be issued significant multiple voting rights on their shares, or to have been entirely agnostic. As major insiders, this could have benefited them, but instead the agenda they favoured was not one to concentrate power for themselves: it reflected the interests of a more open corporate governance, consistent with the more accountable procedures by which their managers were elected. What is in fact in any of those groups’ self-interest could obviously be debated. This very fact highlights the strength of the view that there are multiple rationalities: that choices are contextual, and that no single minded economic rationality exists.

(3) Reflexivity and normativity

So far, the two positive theses have been presented as operating in separate systems, namely what shaped the law on participation rights in corporations, and what happened in the market when there was no specific law. They suggested that participation rights in law can be explained as part of an incomplete programme of progressive democracy, but when matters were left to the market, bargaining power shaped participation rights. This makes sense of today’s separation of contribution and participation. Despite the utility of isolating these two narratives, it must be recognised that matters are not so neat in reality. Politics and economics interconnect, and to some extent work in a reflexive causal pattern.

The main point of interconnection would seem to be that politics often works within the mould of existing institutions, particularly economic institutions. If one thinks, for example, of periods of qualitative change in the structure of the UK economy over the 20th century, it can probably be agreed that only the administrations of Thatcher, Attlee, and Lloyd George represented decisive shifts. In Germany, after the post-World War One disarray, it was probably Hitler and Adenauer, and in the US it was Roosevelt, and Reagan. Subsequent administrations have remained within the same basic political consensus in the years following. Arguably, the UK, Germany and US remain in an ideological frame – and with it an economic construct – shaped by Thatcher, Adenauer and Reagan.

Does economic power predetermine political action, and therefore legal rights, or does
law determine the shape of economic interactions? The answer must be ‘both’. Over the long
term causation is reflexive. The ‘feedback loop’ that Gourevitch and Shinn identified can be
either a virtuous or vicious circle. Economic interests, not least corporations that the law permits
to make unlimited political donations, can and do lobby and corrupt democratic political
institutions. Or other groups could win the upper hand, and politics can then be an instrument
for gradual improvement of the economy. At other times, a symbiotic relationship between
economics and politics can be undone. When people’s consciousness is raised, people can depart
from established practice as they collectively follow a different normative ideal. The course of
history is open to be shaped in whatever way people ultimately choose to shape it. And the
evidence, to which Part II now turns, shows this has been done over and again before.
PART II. EVIDENCE
4. ELECTIONS FOR DIRECTORS

Part I conceptualised the separation of contribution and participation as one of the most pressing issues in modern corporate law, and offered two positive theses to explain the development of participation rights. The first thesis is that compulsory rights in law were driven by a progressive democratic movement which sought to vest power in the hands of the many, not the few. Its aims spread to all social institutions, including the corporation, but like all interest groups it has acted incompletely. This chapter begins to address the evidence in detail, starting at the apex of the corporation. How did the progressive democratic ideology translate into election rules for directors? When Berle and Means published *The Modern Corporation and Private Property*, and as Berle was writing Franklin D. Roosevelt’s foundational speeches, they identified erosion of the ability to remove directors as a primary factor in corporate unaccountability before the Great Depression.

A host of other norms are necessary to ensure that election rights are effective in practice. But the principle of representative accountability required an electoral process, whoever held the voting rights. The corporate electoral process has continually preoccupied law reform.

The second positive thesis is that, where rights regarding the electoral process did not exist in law, the bargaining power of economic actors shaped how participation evolved in the marketplace. Some elements of bargaining power matter more in some contexts, and indeed Berle and Means themselves initially highlighted the issues of collective action problems and information, while being more muted on issues of relative wealth. Nevertheless, this all follows the conception of markets as being normatively flawed where the parties are unequal. It was precisely because of their conception of these imbalances, and the defective outcomes of a free market, that progressive democrats pursued their goals in law reform.

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2 AA Berle and GC Means, *The Modern Corporation and Private Property* (2nd edn Transaction 1991) Book II, ch 1, 129-131 also identified as key rights are voting by proxy, amending the constitution, delegation to voting trusts, and voteless shares.

3 eg in the UK, see the Companies Act 2006 s 336 duty for annual general meeting, ss 303-305 members’ right to call meetings with 100 supporters holding who have paid up £100 each or have 5% of the votes, ss 314-316 members’ right to circulate resolutions), s 324 right to appoint a proxy. In Germany, see the Aktiengesetz 1965 §123(1) one month notice before meetings, §§126-7 shareholder right to submit a counter proposal to an item on a meeting’s agenda and suggest votes on supervisory board members or auditors, §134(3) right to appoint a proxy, §135 duties of depositor banks when acting as a proxy. For the EU see also the Shareholder Rights Directive 2007/36/EC. In the US, see the Delaware General Corporation Law §211 meetings of stockholders, §§212 and 217 right to appoint a proxy for 3 years, and right of fiduciaries to vote, §222 at least 10 days notice of a meeting. Passed under the Securities and Exchange Act 1934 by the Securities and Exchange Commission, Rule 14a-8 allows for shareholder proposals and SEC Rule 14a-11 would allow proposing of candidates for the board of directors, but see below ch 4(3).

4 Berle and Means (1932) 80, but also they drew clear analogies between shareholders and workers at 5 and 64.
When modern UK company laws were first drafted, they offered reasonably strong protection for directors against the wishes of incorporators, a stark contrast to the old common law. In a previous age, corporations were used mostly for local governments, charitable groups and the church. The leading cases held that ‘a power of amotion is incident to the corporation’.\(^5\) This was a majoritarian concept, which saw a corporation’s members as sovereign, and it solidified over the course of the 18\(^{th}\) century. In the words of Lord Hardwicke LC, ‘wherever a certain number are incorporated, a major part of them may do any corporate act’.\(^6\) According to Lord Mansfield in \(R v Richardson\), if a director was to be removed, ‘where the offence is merely against his duty as a corporator, he can only be tried for it by the corporation.’\(^7\) The members of the corporation alone had the collective competence to determine what counted as a good reason both for appointment and removals.

However in the early 19\(^{th}\) century, commercial and legal practice shifted. Common law principles were only the default, and statutory corporations did not need to follow. One study shows that between 1720 to 1799, 69.9 per cent of chartered company constitutions contained express rights to remove directors, falling to 65.9 per cent in the 1810s, and then to just 37.7 per cent for constitutions written between 1835 to 1839.\(^8\) The trends pointed ‘clearly in the direction of a move away from shareholder participation over time.’\(^9\) It was still said at common law that, if a company’s articles were silent, its members could determine the meaning of any ‘reasonable cause’ for removal.\(^10\) But in practice, most directors were becoming entitled to serve out their full terms.\(^11\) During these early years, the terms of charters were being bought from Parliament, usually negotiated by those who would be directors. And the interests of directors were slowly prevailing over those who invested in companies.

The first modern, consolidated companies law, the Joint Stock Companies Act 1856, codified the position that this political quasi-market for corporate charters had reached. In the

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\(^5\) Lord Bruce’s Case (1728) 2 Strange 819, 93 ER 870. See also, Baggs Case (1615) 1 Rolle 224, (1615) 81 ER 448.
\(^6\) Attorney General v Davy (1741) 26 ER 531. See also Foss v Harbottle (1843) 67 ER 189, ‘the majority of the proprietors at a special general meeting assembled, independently of any general rules of law upon the subject, by the very terms of the incorporation in the present case, has power to bind the whole body...’
\(^7\) (1758) 97 ER 426, (1758) 1 Burr 517, 539. Bailiffs of the Corporation of Ipswich purported to remove the elected portmen from office, and then hold an election where another bailiff, Richardson, was appointed in their place. It was held there was no power to remove the portmen, because the amotion was not effected by the corporation, and there was no good cause. See ch 3(3) for discussion of how this was misunderstood by US courts.
\(^8\) M Freeman, R Pearson and J Taylor, Shareholder Democracies? Corporate Governance in Britain and Ireland before 1850 (2012) ch 4, 87-93 and ch 5, 129-137
\(^9\) Freeman, Pearson and Taylor (2012) 129
\(^10\) Inderwick v Snell (1850) 2 Macnaghten & Gordon 216, (1850) 42 ER 83, 85-87, per Lord Commissioner Langdale
\(^11\) cf Company Clauses Consolidation Act 1845 ss 83 and 88, which started with a presumption that directors would not be removed in their terms of office, and that they would rotate in thirds.
first model company constitution, known then as ‘Table B’, article 62 stipulated that directors could be removed only by a special resolution, a three quarter majority vote. By default there would be a staggered board, so only a third of directors would be put up for election at a time. 12 Under the Act, the company’s articles could be amended through a three quarter majority resolution. With that weight in numbers, determined shareholders could always oust directors more quickly if they were prepared to. 13 But at the birth of modern company law, majority rule had vanished. The common law heritage of representative accountability was lost in legislation. 14

In principle, companies could always change their articles of association to stipulate a lower threshold for removing a director: the Companies Acts still only set a default. However, the case law suggests that corporate practice sought to implement the highest thresholds for removable possible. The limit was in effect set by statute, with the three quarter vote for changing the articles of association. This probably reflected directors’ advantage in bargaining for terms of corporate constitutions, given the difficulty for many shareholders to organise. Some courts were active in construing articles to facilitate the general meeting’s voice. 15 But still, the guiding principle of interpretation was to give effect to the constitution as the company constructed it, even if that meant a high threshold to remove a board. 16 Even if the balance of power were weighted heavily in favour of a board, the court’s policy in *Automatic Self-Cleansing Filter Syndicate Co, Ltd v Cuninghame* was to simply give effect to the ‘express contract, mutually stipulated’. 17 The general meeting was, as the Court of Appeal might fondly repeat, entitled to refuse to re-elect

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12 JSCA 1856, Table B, art 48. See also Companies Act 1862 (c 89) Table A arts 59 (staggered board) and 65 (removal by special resolution). The same scheme existed in the Companies (Consolidation) Act 1908 (c 69) s 13. Appointment occurred by default through ordinary resolution and removal by a 75% vote remained the same as before, Sch 1, Table A para 86, ‘The company may by extraordinary resolution remove any director before the expiration of his period of office, and may by an ordinary resolution appoint another person in his stead; the person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected a director.’ cf K Pistor, Y Keinan, J Kleinheisterkamp and MD West, ‘The Evolution of Corporate Law A Cross-Country Comparison’ (2003) 23 University of Pennsylvania Journal of International Economic Law 791, 812, suggest mistakenly that it was an ordinary resolution for removal.

13 CA 1862 s 50 (articles amendable by special resolution).

14 nb Sir Nathaniel Lindley, *The Law of Companies Considered as a Branch of the Law of Partnership* (5th edn 1889) 302, had reinterpreted the common law principle set by Lord Mansfield and Lord Langdale as meaning members could remove directors ‘if they act fairly and in good faith.’ This addition would plainly put the question of validity of removal back in the courts’ hands, and so represented a break from the common law precedent. The point, however, is largely moot, since legislation had erased the common law’s defaults.

15 eg *Isle of Wight Railway Company v Tahourden* (1884) LR 25 Ch D 320, held the right of shareholders to call meetings for a general (if unspecific) purpose of removing any directors was not to be lightly interfered with by directors or the courts.

16 See *Imperial Hydropathic Hotel Co, Blackpool v Hampton* (1883) 23 Ch D 1, an ordinary resolution to remove directors could not succeed because the articles allowed directors to remain in office for three years. Lord Jessel MR said, ‘it is suggested that under clause 44 the company can by resolution remove two directors. In my opinion they cannot. They can only alter the articles of association. On the contrary, by the resolution which was passed, they left the articles alone. The articles remained, prescribing the whole term of office, three years, or whatever it might be.’

17 [1906] 2 Ch 34, Cozens-Hardy LJ held that where dismissing directors required a three quarter majority of votes, and the company’s management was vested in the board, any right to issue specific instructions could not reasonably be less than that threshold. ‘It seems to me that the shareholders have by their express contract mutually stipulated that their common affairs should be managed by certain directors to be appointed by the shareholders in the manner described by other articles, such directors being liable to be removed only by special resolution.’
directors ‘if the opportunity arises under the articles’. But it was rare to find removal provisions through ordinary resolution. It raised the question of whether those higher thresholds were keeping up with the need for more accountability given the growth in mass business.

Directors enjoyed a considerable remedial privilege in dismissal disputes compared to other employees. While ordinary employees could expect damages for wrongful dismissal at best, directors tended to remain in their office unless a dismissal was confirmed in court. If nothing happened, or if they won, they effectively had a remedy of specific performance. In *Southern Foundries (1926) Ltd v Shirlaw*, some of this disparity was addressed. A new shareholder bought up over three quarters of an iron casting company’s shares. It changed the articles to make Shirlaw, the incumbent managing director with a ten year contract, dismissible. Shirlaw claimed damages, and got them. In Lord Wright’s view there could be no specific performance. But Shirlaw’s employment contract meant the ‘company would not without good cause remove him from his directorship… because if they did so they would *ipso facto* terminate his employment.’

The result was to clearly separate control over a company’s board from the expectations created in the employment contract, albeit leaving the door open to substantial costs in removing directors.

Why did Lord Wright in *Shirlaw*, in contrast to the other Lordships, repeat the qualification of the company’s right to remove a director with ‘good cause’? For some time demands among employees had been growing for greater job security. The UK had not followed the continental European trend towards more dismissal protection yet, except as it emerged through collective bargaining. But if Lord Wright was correct that directors at common law should be removed only for a ‘good cause’, two questions he never answered were what ‘good cause’ might actually mean, and who determined whether that standard was met.

After *Shirlaw*, directors may have become marginally more accountable to the general meeting, but the requisite super-majority for removal would still invariably be three quarters. This standard became entrenched when in 1929, the London Stock Exchange codified it as a listing.

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18 John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113, 134, per Greer LJ.
20 [1940] AC 701
21 [1940] AC 701, 723
23 Germany first introduced the Betriebsrätegesetz 1920 (RGBl, 147) with a provision on ‘Widerruf der Kündigung’ that stopped unjustified dismissals which would cause a worker ‘undue hardship’. Then the Kündigungsschutzgesetz 1926 (RGBl I, 399) brought a requirement of reasonable notice before dismissal for everyone, now found in BGB §622. The first modern UK unfair dismissal legislation was not passed until the Industrial Relations Act 1971, following the recommendations of the Lord Donovan, *Report of the Royal Commission on Trade Unions and Employers’ Associations* (1968) Cmd 3623.
requirement,\textsuperscript{24} and given its wording it was hardly clear that a listed company could even lower its removal thresholds. In 1935, the \textit{Financial Times} had begun its first compilation of 30 companies that it believed represented a cross-section of British industry, a forerunner of the FTSE100.\textsuperscript{25} In the period before 1947, among at least six FT30 companies there were no listed companies with constitutions which allowed more relaxed removal rights than a three quarter vote. Every company, except Woolworths, on this major index sought to erect obstacles against removing directors as high as they would be legally tolerated.\textsuperscript{26}

However in the years after the Great Depression, the progressive democratic arguments of Berle and Means were being received in the UK. The wartime Chancellor of the Exchequer, Hugh Dalton, appointed Lord Cohen to chaired a company law reform report in 1945.\textsuperscript{27} The report’s authors faithfully recounted the basic problem of large corporations.

The illusory nature of the control theoretically exercised by shareholders over directors has been accentuated by the dispersal of capital among an increasing number of small shareholders who pay little attention to their investments so long as satisfactory dividends are forthcoming, who lack sufficient time, money and experience to make full use of their rights as occasion arises and who are, in many cases, too numerous and too widely dispersed to be able to organise themselves.\textsuperscript{28}

One of its key recommendations was that investors ought, as a matter of principle, to have broader control over the board of directors.\textsuperscript{29} Then a new lecturer at the London School of Economics, Otto Kahn-Freund argued that the recommendation was not made cherishing ‘the illusion that, at this time of the day, anything like an effective control of the shareholders over the management of a big company can be re-established’ but with the rather more modest objective to ‘check some abuses so as to make shareholders’ meetings and the election of

\begin{itemize}
  \item Stock Exchange Rules and Regulations (1 November 1929) Appendix 35B, ‘Articles of Association should contain the following provisions: - ... 9. That the Company in general meeting shall have power by Extraordinary Resolution to remove any Director before the expiration of his period of office’
  \item The FT30 itself remains in use, but more as an historical artefact, than an important business indicator.
  \item This comes from a search on the Companies House databases, where it proved very difficult to identify company names with any certainty and find their constitutions at the appropriate date. Six out of the thirty were certainly the right companies, namely Fine Spinners and Doublers (art 115, reg no. 00236624), Harrods (art 77, reg no. 00030209), Imperial Chemical Industries (art 102) Rolls-Royce (art 88) Vickers-Armstrongs (art 109, reg. no 00227013) and F. W. Woolworth & Co (arts 73 and 77, reg no. 00104206).
  \item (1945) Cmd 6659, para 9
  \item (1945) Cmd 6659, para 7, with the recommendation for directors’ removal by ordinary resolution in para 130, and summed up on page 84.
\end{itemize}
directors a little more of a reality'. Cohen’s other recommendations followed the same trend: the Board of Trade should be given the power to bring representative actions for shareholders; payments to directors for loss of office subjected to company approval; loans to directors prohibited; notice periods for shareholder meetings lengthened; the right to use company channels to circulate draft resolutions; the right of members to appoint proxies to vote and speak on their behalf; and the right to demand a poll. Small, closely held companies, where directors might be given a reasonably reliable assurance from other investors that they remain in management, were not the target for the proposals. It was the growing scale of enterprise, the factual separation of management’s interests from those of investors, and the powerlessness of investors to help themselves that altered the equation, and called for compulsory regulation.

There can be little doubt that Lord Cohen’s Report, given its reasoning and rhetoric, reflected the growing conviction, systematised by Berle and Means, that accountability required law. A new Companies Bill was drawn up and debated from 1946. During its passage through Parliament the strongest sentiments expressed in the Lords (not not understandably) centred on the recommendation for directors to compulsorily resign at age seventy. There was only a little dissent over the proposal for removal by ordinary resolution. In the Second Reading in the Commons, Sir Stafford Cripps as the President of the Board of Trade, was clear about the Bill’s purpose.

Perhaps the main reason why amendment is now so urgently necessary is that the relationship between management and ownership in limited liability companies has tended progressively to be more and more shadowy. Even before the war, apprehension was expressed on this point, and remedies were then suggested, and, with the great growth in the size of companies, the old relationship, which really grew out of the idea of partnership, where individual owners were closely concerned themselves with the management, has largely disappeared in modern company structure. The growth of groups or chains of companies, which make the true economic entity rather than the

31 (1945) Cmd 6659, respectively, paras 92, 94, 126, 128, 133 and 136; para 132 also recommended equal treatment for investors in who receives proxy forms, to reverse the effect of Wilson v London Midland and Scottish Railway Co [1940] Ch 393.
32 (1945) Cmd 6659, para 130, ‘There is one case that requires special consideration, that of a permanent director of a private company holding office as such under the articles. This right arose in substance as an agreed matter of contract and we consider that an exception should be made to protect a permanent director holding office in a private company at a fixed date...’
33 See Hansard HL vol 144 col 999 (17 December 1946) Companies Bill, 2nd Reading, especially Lord Jowitt LC, col 1018, and Viscount Maugham, col 1044.
company itself, where we get a whole complex of companies operating together—that factor has still further divorced management from ownership. This now well-developed tendency is, in fact, practically ignored by the company law as it exists today, and that is another reason why amendment is required…

Though there was not complete unanimity on every aspect, there was essentially cross party consensus on the final draft. The Companies Act 1947 section 29 prescribed the compulsory right of a company to remove any board member by ordinary resolution. A director would have four weeks' notice and the chance to circulate her arguments for staying. The role of the court became to determine whether a general meeting had enough time to deliberate upon the reasons for a dismissal, but not to decide upon the merits of the reasons themselves. Every director therefore became entitled to reasonable notice before a fair dismissal and the guarantee of fairness lay in procedural integrity: the right to a fair hearing, and of the general meeting's deliberations on the substantive case. If a director believed herself to be treated arbitrarily by her peers, there was a potential personal remedy in *ex post* judicial review. It was a faithful, textbook evolution of company law.

After 1947, there were perhaps four remaining issues. First, was the law effect based, and did it catch all kinds of companies? The Companies Acts was framed for all companies, and contextual reading might suggest voting rights should not be manipulated to circumvent the rule. At first sight the decision in *Bushell v Faith* might have seemed to have left the law as an 'empty gesture'. A majority of the House of Lords allowed a small private company to stipulate that if a director were to be removed his votes would carry triple weight. Even though the effect was to entrench the director, the decision in *Bushell* was probably in line with Cohen’s recommendations. This was a closely held private company, not one where investors and directors were wholly different people. It was vanishingly improbable that the same would work for a large company.

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35 eg the honourable member for Hendon, Sir Hugh Lucas-Tooth apparently thought 'recalcitrant and rebellious minorities' could threaten 'arbitrary resolutions for the removal of the companies’ officers.’
36 See also Hansard HL vol 146 col 365 (1 April 1947) Companies Bill Lords 3rd Reading, Viscount Swinton. See also Sir Stafford Cripps remarks above.
37 CA 1947 s 29 became CA 1948 s 184, which followed into CA 1985 s 303, and now CA 2006 s 168.
40 This view is shared by PL Davies, *Gower and Davies’ Principles of Modern Company Law* (8th edn Sweet and Maxwell 2008) 390-391.
41 It is also highly doubtful that for listed companies such a practice would not be viewed to frustrate the London Stock Exchange *Rules and Regulations, Appendix 34, Sch VII, Part A, (ii) D.4, see CD Morley, Rules and Regulations of the Stock Exchange (3 January 1951)*
Second, could the law be undermined by factual, financial fetters on director dismissal through enormous breach of contract claims? Here the main strategy was legislative limits on long term service contracts. The Companies Act 1985 required that shareholder approval be given for a director’s contract lasting over five years, reduced to two years after 2006.\(^{42}\) In 2010, the Financial Reporting Council appeared to take the idea further still, as the UK Corporate Governance Code 2010 required explanations if FTSE 350 companies did not have annual board re-appointments.\(^{43}\) This appeared to some institutional investors, though well intentioned, to confuse the issues of contractual limits on pay and requiring a permanent election cycle,\(^{44}\) although in practice elections rarely took place.

The third main issue, perhaps the most important was how were directors appointed? The presumption of Berle and Means, and the policy of the Companies Act 1947, had been that if removal rules were mandated, appointments could be left to a company’s own constitution. The Model Articles said either the general meeting, or the directors themselves, could carry out the appointment,\(^{45}\) but the practice in large companies always gave the job to the board. In 1992 the Cadbury Report tacitly endorsed this by formalising the appointments committee’s composition: there should be a majority of non-executive directors.\(^{46}\) This was reiterated in 1998 by the Hampel Report,\(^{47}\) however by 2003 the Higgs Report revealed the outcome.\(^{48}\)

Almost half of the non-executive directors surveyed for the Review were recruited to their role through personal contacts or friendships. Only four per cent had had a formal interview, and one per cent had obtained their job through answering an advertisement.

No mention was made of shareholders ever proposing or electing among a choice of candidates, although this was probably partly because by this time the asset managers, who had appropriated most voting rights, were content to the practice continue, and be codified in the UK Corporate Governance Code.\(^{49}\) Shareholders could always propose nominations, and use their removal rights if necessary to attain a choice of candidate.\(^{50}\) But asset managers were not doing it.

The fourth issue was what had the common law position become if the articles were

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\(^{42}\) CA 1985 s 319 and CA 2006 s 188. In between various corporate governance reports had a recommendation of three years.

\(^{43}\) UK Corporate Governance Code 2010 B.7.1.

\(^{44}\) See ‘UK: stewardship elusive as pension funds buck governance code’ (21 July 2010) Responsible Investor. Three large pensions, Hermes, Railpen and USS, stated they would be support companies not following the FRC’s recommendation.

\(^{45}\) See now, Companies (Model Articles) Regulations 2008 (SI 2008/3229) art 17(1)

\(^{46}\) Cadbury Committee, Report of the Committee on the Financial Aspects of Corporate Governance (1 December 1992) 4.30

\(^{47}\) Hampel Committee, Committee on Corporate Governance: Final Report (1998) 3.19

\(^{48}\) Higgs Committee, Review of the role and effectiveness of non-executive directors (2003) 10.5

\(^{49}\) UK Corporate Governance Code 2010 B.2

\(^{50}\) CA 2006 s 292 ff, requiring 5% of members to exercise the power to circulate a resolution.
silent? For the UK, the legislative framework was unlikely to disappear, but for other common law countries, including the US, the common law position could be instructive. One line of cases suggested that, probably because directors (unlike other employees) often have greater bargaining power, there was no compulsory term requiring good faith in dismissal. But was it still true that a court would merely enforce, as in *Cuninghame*, whatever was in the ‘express contract, mutually stipulated’?

In *Attorney General of Belize v Belize Telecom Ltd*, the Privy Council had to decide whether two directors in the recently privatised phone company should have jobs for life or not. Two directors on Belize Telecom’s board were electable by the shareholder with both over 37.5 per cent of ‘C’ shares and a ‘special share’. The privatisation scheme failed when the buyer, who had bought its stake of ‘C’ shares and the special share with a government loan, went insolvent. The loan’s terms meant the government could enforce a pledge on the ‘C’ shares, but the loan drafters had forgotten about recouping the special share. Nobody, then, held both shares needed to replace two of the directors. The directors argued they could not be removed. The Privy Council advised that the directors could be removed anyway, despite the contradiction to the express terms of the articles. A company’s articles were to be interpreted in their context, and inconsistencies could effectively be scrapped. Lord Hoffmann placed heavy reliance on construction according to the background of the ‘reasonable expectations of the parties’, although, aside from the parties’ intentions, it was not exactly clear what would identify that background. It seems, however, that the key to construction in the context of corporate governance, was that even express provisions must be construed in the light of the requirement that directors are accountable to the general meeting, or at least not just to themselves. The indication was that the *dictum* of Lord Mansfield from *R v Richardson* in 1758 was acquiring the character of a compulsory rule. Members of a company must have a voice in the company administration. They will not be deemed to have had the capacity to have ‘mutually stipulated’ the constitution’s content, in large companies particularly, because power is unequal. The requirement for good corporate governance does not give way to fictitious consent.

The result in UK law today is that directors’ positions, while clothed with a wide power to

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51 Reda v Flag Ltd [2002] UKPC 38, properly understood. It is increasingly apparent that, although the legislature is competent to set limits on damages, the standardised implied term at common law is the reverse for employees who lack bargaining power: Johnson v Unisys Ltd [2002] UKHL 13, [44] per Lord Hoffmann. An employer’s attempt to make an individual employee contract out of the requirement of good faith in dismissals would be regarded as a sham, Autoclenz Ltd v Belcher [2011] UKSC 41, [35]. It would appear that, most consistently with the common law’s tradition, an employee’s peers, who have no conflict of interest, are competent to decide whether a dismissal is fair, and that a Tribunal would give significant deference for their determination. This view remains to be tested.

52 [2009] UKPC 10. The buyer involved in this case was Lord Ashcroft, a convicted criminal and Conservative party member.

direct the enterprise during their time in office, are shadowed by the compulsory right of participation by the general meeting in election questions. The UK’s path had represented a quintessential textbook evolution of good corporate governance, but only up to a point. Although the general meeting of a UK company did not usually play an active role in appointments, it had among the strongest rights in the world to do so. But as will be explored in chapter 6, evolution according to the textbooks may by itself have been problematic, if the landscape had changed, and a company’s constituents were not disposed to engage.

(2) Germany: the Faustian pact

The progression of modern German company law on directors’ elections followed, if anything, the UK’s path in reverse. The modern company laws originated with the *Allgemeines Deutsches Handelsgesetzbuch 1861* (General German Commercial Code 1861) ten years before Germany formed a nation-state.54 On the rights and duties of the Vorstand, or the ‘executive’ (also commonly translated as the ‘management board’), §227 set out the basic rule that its appointment could be withdrawn at any time, without prejudice to compensation claims arising from existing contracts.55 This was identical to UK law from *Shirlaw*,56 except it was only a default rule. Under §209(2) Nr 7 the company’s constitution could change the election mechanism. It was also possible, but not compulsory, that the company included in its structure an Aufsichtsrat, or ‘supervisory council’ (commonly, and perhaps nowadays appropriately, translated as a supervisory ‘board’). Under §225, should a company adopt this organ, it would monitor all aspects of company administration, especially the accounts and finances. But crucially, a supervisory council was not required to intervene in elections.

In the reforms of 1870, as restrictions on company registration were relaxed, §209 was amended to require a supervisory council. States within the German confederation, particularly the Western Hanseatic states, had previously allowed free incorporation. Others, particularly Prussia, had retained the concession system: the need for state permission to incorporate each

54 The ADHGB 1861 covered the states of the German Confederation, which included the states of modern Germany, Liechtenstein and the Austrian Empire. The Prussian state law, the Preussische Aktiengesetz 1843 contained many analogous rules but retained a state concession system. ADHGB 1861 §249 left it up to the German states to determine. For a highly informative historical overview, see P Muchlinski, ‘The Development of German Corporate Law Until 1990: An Historical Reappraisal’ (2013) 14(2) German Law Journal 339. The main developments traced here relate to (1) the two-tier board, (2) the duties of directors (3) the role of banks’ power (4) codetermination, and counters the claim that there is a simple division of liberal and coordinated economies, or insider and outsider systems of corporate governance: the picture is more mixed.

55 See ADHGB 1861 §227

56 See above ch 3(1) per Lord Atkin and Lord Wright in *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701 would adopt the same rule.
company. Prussia insisted on supervisory councils as a price for allowing free incorporation.\textsuperscript{57} They were generally thought to be a way for large shareholders to exert more influence over the executive,\textsuperscript{58} an interest group to which one might suppose the Prussian state would be naturally sympathetic. Yet under §236 it was still possible for the general meeting to elect the executive. The potential for direct, not intermediated accountability remained the rule in the revised \textit{Handelsgesetzbuch 1897} (Commercial Code 1897).\textsuperscript{59} Even following a thorough debate before the draft reforms of 1931 this would have continued to be the case.\textsuperscript{60}

While the law was posed in default terms, how did the supervisory council actually develop? There were certainly enough economic interest groups to fill seats: mostly industrialist family members, bank representatives, interested directors, and (to a lesser extent) small shareholder groups, technical, commercial or legal experts, friends or ‘decorative’ directors.\textsuperscript{61} Walter Rathenau was a firm supporter. He was a liberal politician, who inherited his wealth from his father’s electronic company, AEG. He served there as a supervisory council member. A few years before he became foreign minister and was tragically assassinated, he wrote a tract called \textit{Of Corporate Existence: A Business Meditation}. Rathenau argued that companies should be seen as being real entities with interests distinct from investors.\textsuperscript{62} He was adamant that ‘numerous’ people gave ‘all their spare time freely and without special claims’ to be supervisory directors. The purpose of the extra council was apparently like the British Royal Navy: its simple existence deterred untoward behaviour by the executive.\textsuperscript{63}

Richard Passow, an academic lawyer working in Frankfurt, held a different view. He drew attention to a study of the numbers of the banks’ supervisory council representatives, published in the \textit{Deutschen Ökonomist}.\textsuperscript{64} This showed, for example, that in 1906 the Deutschen Bank had 23 representatives who together held 139 seats on the supervisory council, the Norddeutschen Bank

\begin{itemize}
\item \textsuperscript{58} R Passow, ‘Die Entstehung des Aufsichtsrats der Aktiengesellschaft’ (1909) 64 Zeitschrift für das Gesamte Handelsrecht und Konkursrecht 27, 27-28
\item \textsuperscript{59} HGB 1897 §182(2)
\item \textsuperscript{60} §6(2) Nr 4 E-1931. See T Schnorr, \textit{Historie und Recht des Aufsichtsrats Deutsche Erfahrungen als Beitrag zum Statut der Europäischen Aktiengesellschaft 1991} (2000) 81.
\item \textsuperscript{61} See R Passow, \textit{Die Wirtschaftliche Bedeutung und Organisation der Aktiengesellschaft} (1907) 157 ff
\item \textsuperscript{62} W Rathenau, \textit{Vom Aktienwesen: eine geschäftlich Betrachtung} (1919)
\item \textsuperscript{63} Rathenau (1917) 17. If the analogy was intended to show how effective a supervisory board was at checking the executive, as for instance the British navy was at defeating the enemy, it seems to have been quite unfortunate. AJP Taylor, \textit{The First World War: An Illustrated History} (1974) ‘Who won? The British lost more ships... But, at the decisive moment, the German fleet fled from the British; and, in Jellicoe’s eyes, this was all that mattered. He did not suppose that he could win the war by destroying the German fleet; he thought that he might lose it if he did not preserve his own... the following year Jellicoe was replaced by the more aggressive Beatty. Once in command, Beatty, too, became cautious. He, too, recognized that the Grand Fleet must remain in harbour unless the German fleet came out.’ If supervisory councils were like the Royal Navy at that time, it would follow that in practice they were too timid to act when needed for fear of placing their own positions in danger.
\item \textsuperscript{64} Robert Franz (28 July 1906) \textit{Deutschen Ökonomist}, Nr 1231
\end{itemize}
had 12 with 91 seats, the Dresdener Bank had 7 with 108 seats, and the Bank für Handel und Industrie had 13 with 64 seats.\(^{65}\) This was a forum for the ‘representation of the interests of the big players, hardly an organ of control for the benefit of all shareholders.’\(^{66}\) If Rathenau was right that the German company now had an autonomous interest, it seemed to identify more with the powerful.

In practice the supervisory council was elevated by company constitutions to the status of a controlling board that could not be circumvented.\(^{67}\) Its functions were inflated, and in particular it took over the role of electing the executive from the general meeting.\(^{68}\) Before 1937, the only significant legal changes to company boards came between the Betriebsrätegesetz 1920 (Work Councils Act 1920) and the Aufsichtsratsgesetz 1922 (Supervisory Council Act 1922). These codified what could probably be regarded as the most important collective agreement in history,\(^{69}\) to require that in companies with a supervisory board, one member had to be elected by the workforce, or two members if the board numbered over three.\(^{70}\) Companies could anaesthetise any employee influence by simply inflating the numbers of supervisory directors, a practice that was in any case popular before the War.\(^{71}\) The legal minimum was three, but numbers inflated so much that in a 1931 draft law, the Reichsjustizministerium (the Empire’s Justice Ministry) proposed that board members should be limited to 30, and that directors could sit on a maximum of 20 boards.\(^{72}\)

It could fairly be said that the earlier Companies Acts ‘did not aim at a rigid basis which should shape the legal character of a company limited by shares… they were able to produce the

\(^{65}\) Passow (1907) 157-158

\(^{66}\) Passow (1907) 200, ‘Es ist eine Interessenvertretung der Hauptbeteiligten, kein Kontrollorgan im Dienste aller Aktionäre’.

\(^{67}\) ES Puchelt, Kommentar zum ADHGB (4th edn 1893) Band 1, Art 227, Anm 6, ‘Auch mit der Bestellung des Vorstandes wurde er [der Aufsichtsrat] in der Praxis häufig betraut’, cited in M Lutter, ‘Der Aufsichtsrat im Wandel der Zeit’ in W Bayer and M Habersack, Aktienrecht im Wandel (2007) 394. The fact that supervisory councils did so habitually select the executive was mistaken by some to mean there was in fact a law mandating it before 1937, eg WC Kessler, ‘The German Corporation Law of 1937’ (1938) 28(4) American Economic Review 653, 658, ‘As in the old law, the board of managers is selected by the board of directors. The term of office is five years and it is renewable (par. 75). Under the previous law the term was indefinite. Members of the board of managers can be replaced for an “important reason” (wichtiger Grund). Such a reason includes gross neglect of duty and inability to attend to the ordinary transaction of business.’

\(^{68}\) Passow (1907) 169-175, sampling the constitutions of Dresdner Bank (§15, ‘Die Mitglieder der Direktion werden von dem Aufsichtsrat ernannt’), Hamburg-Amerikanische Paketfahrt AG (§11, ‘Der Vorstand besteht je nach Ermessen des Aufsichtsrats aus einem oder mehreren Mitgliedern, welche vom Aufsichtsrat gewählt werden.’), Gesellschaft für elektrische Hoch- und Untergrundbahnen in Berlin (§18, the same), and Deutsche Waffen- und Munitionsfabriken zu Berlin (§13a the same).

\(^{69}\) Stinnes-Legien Abkommen 1918

\(^{70}\) Betriebsrätegesetz 1920 §70; Aufsichtsratsgesetz 1922 §§3-4.

\(^{71}\) Passow (1907) 154, noting the Deutschen Bank had a minimum of 9 in its constitution but 27 in practice, Dresdener Bank 18-36, but 33; Disontogesellschaft 15-30, Darmstädter Bank up to 18, AEG, minimum 12, and Gelsenkirchener Bergwerks AG 12 to 26.

legal frame of a limited company which did not essentially differ from that adopted in other countries…’

But although formally free to vary, in large corporations the operation of law produced a position entrenching directors, as a numerous and autonomous interest group, as much as if it were mandated. While it was left to market interactions, directors had tended to use their influence to make themselves less accountable.

After the Wall Street Crash, the German government declared a state of emergency in 1931. One emergency decree contained some company law accountability and transparency reforms. But by 1933 the Nazi party had seized control of the German state. It renewed the company law reform agenda in a different direction. Immediately it scrapped worker codetermination, but the larger question it pursued was how to remodel German company law along fascist lines. According to Ernst Geßler, who led the reform, the most influential theoretical voice was Johannes Zahn’s, a researcher for the German Bankers’ Association who had been studying at Harvard.

Zahn argued for Germany to ‘import’ what he supposed were two key principles of US law: the ‘leadership principle’ and the idea of a corporation as a ‘bundle of contractual relationships, between the corporation and the state, between directors and shareholders, between the shareholders mutually.’ The contractual notion was loosely based on the common law idea of the company constitution being a contract between the members inter se, but expanded to include the state. It was a reaction to Rathenau’s view of the Unternehmen an sich, which Zahn described as essentially Marxist-Leninist doctrine. Zahn concluded that the leadership and the nexus of contracts approach had led to the vitality of the American economy. Weimar’s economic weakness lay in its attachment (in Zahn’s assessment) to shareholder democracy – a flaw the Americans had apparently recognised because they had developed the Führerprinzip.

‘When a genuine leader-follower relationship develops,’ wrote Zahn, referring to the coming changes in Germany,

75 Arbeitsordnungsgesetz 1934 (RGBl I, 45)
78 Zahn (1934) 39
79 Zahn (1934) 14-17, cf ch 5(2)
practical meaning. In the first place, the shareholder will have much less to say than before. He will not, however, regard himself as a victim because he will trust the leadership.  

In fact, the case law on which Zahn relied to ground his views of US law showed, quite to the contrary, that American courts were intent to ensure no single major interest (such as a large shareholder) could dominate the company’s organs.  

Furthermore, as he published the New Deal reforms were in motion aimed precisely at reversing the dominance of directors and banks.  

Zahn’s work happened to be reviewed at the time by another German lawyer who had come to the US, but under very different circumstances: forced out by Nazi persecution. Friedrich Kessler wrote that, although his work would hold a ‘worthy place among the comparative studies’ (in some form), Zahn had ‘discovered what he had wished to discover’. Zahn made no reference to Berle and Means major work, and footed his narrative on a ‘contradictory and seemingly superficial philosophy’ that was wedded to an ‘emotional approach’ to scholarship. Nevertheless, Zahn’s principles were written into law.  

In its own words, the aim of the Aktiengesetz 1937 (Public Companies Act 1937) was to ‘carry into effect National Socialist principles within the sphere of economics’. Nazi totalitarianism sought to control the heads of industry through a combination of terror and patronage, and this left little room for accountability of those heads to anyone else. Because of this, the Aktiengesetz 1937 wrought two hallmark changes to director election rules. First, the election of the executive by supervisory councils was elevated to a mandatory feature of company law. Second, executives could only be removed for an ‘important’ reason and could serve up to five years. An important reason included an order by the Reichsminister, and also a withdrawal of confidence from the general meeting. But this made little difference because the supervisory board had a discretion, not a duty, to remove the executive. The supervisory board

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80 Zahn (1934) 95, ‘Wenn sich zwischen Vorstand und Aktionären ein echtes Führer-Geführten-Verhältnis entwickelt, wird das Stimmrecht des Aktionärs sehr an Bedeutung verlieren. Zunächst einmal wird der Aktionär viel weniger zu sagen haben, als bisher. Er wird dies aber gar nicht als ein Opfer empfinden, da er der Führung vertraut.’  

81 Zahn (1934) 95, giving the example of Manson v Curtis, 223 NY 313, 119 NE 559 (1918) where quite contrary to Zahn’s assessments, it was held that a dominant shareholder could not enforce an agreement with another shareholder to have a powerless board. This case, however, is still relied on for much the same conclusions by S Bainbridge, ‘Director Primacy and Shareholder Disempowerment’ (2006) 119(6) HLR 1735, 1746  

82 See below at ch 4(3)  


84 See particularly Zahn (1934) ch IV, 93-96  

85 Official Reasons for the Aktiengesetz 1937, cited in Mann (1937) 19 JCLIL 220, 221.  

86 eg K Robert (a pseudonym), Hitler’s Counterfeit Reich (1941) 38 and 57 and FL Neumann, Behemoth (1941) 227  

87 Aktiengesetz 1937 §75(1), replacing HGB 1897 §182(2).  

88 Aktiengesetz 1937 §75(3)
itself was only removable by default on a three quarter vote.\textsuperscript{89}

None of this had been recommended by the company law committee in 1931.\textsuperscript{90} After all, it was a hard argument to win, then as now, that what companies needed was more unrestricted autonomy for directors.\textsuperscript{91} As Reichsminister Frank said when the law took effect it was clear that the government, ‘did not confine itself to individual technical improvements, but it aimed at and reached a fundamental reform of the law.’\textsuperscript{92} This represented the very opposite of progressive democratic ideals, like those that Berle and Means propounded.

How was the creeping and final emasculation of executive accountability perceived by the legal community at the time? Even before the Nazi seizure there was significant criticism. Hans Reichel wrote in 1930 that Rathenau’s theory of a company as real entity in itself (\textit{die Unternehmen an sich}) was throughout the Weimar Republic used ‘to glorify the Fascist tyranny of the board.’\textsuperscript{93} If that were true, by 1937 the Nazi party gone far further, and had openly appropriated the theory to justify compulsorily disenfranchising investors. Frederick Mann, an academic lawyer who had come from Berlin to London,\textsuperscript{94} wrote that while ‘parliamentary rule within limited companies has thus been severely curtailed, the position of the Board has been materially strengthened.’\textsuperscript{95} There were, naturally, supporters of the new status quo in the legal academy. For instance, one Carl Seydelmann coldly recited how a strong supervisory board was needed to take over elections from the inexpert mass of shareholders with conflicting interests.\textsuperscript{96} The Nazi’s reforms were based on an ideological hostility to autonomous participation in any field of social activity, and it actively manipulated concepts of communal good to enrich its sympathetic elites.\textsuperscript{97}

\begin{itemize}
  \item \textsuperscript{89} Aktiengesetz 1937 §87(2). This replicated HGB 1897 §243(4).
  \item \textsuperscript{90} cf C Windbichler, \textit{Gesellschaftsrecht} (22nd edn Beck 2009) 299-300, who contends that the 1937 reform was based on comprehensive prior research and did not principally serve Nazi ideology, but in light of Zahn’s work this is simply mistaken.
  \item \textsuperscript{91} For an overview of the debates and reform proposals, see R Rosendorff, ‘The New German Company Law and the English Companies Act, 1929 - I’ (1932) 14(1) JCLIL, 94, followed by Parts II and III in (1933) 15(1) JCLIL, 112 and (1933) 15(4) JCLIL, 242.
  \item \textsuperscript{92} FA Mann, ‘The New German Company Law and Its Background’ (1937) 19 Journal of Comparative Legislation and International Law 220, 222.
  \item \textsuperscript{93} H Reichel (1930) Juristische Wochenschrift 1459. ‘Erstaunlich zu sehen, wie im Zeitalter der Demokratie und der Volkssouveränität auf eine Oligarchisierung des Aktienwesens hingearbeitet wird, welche die Aktionärschaft zur bloßen \textit{misera contribuens plebs} herabdrückt. Sogar das abgegriffene Schlagwort vom “Organismus” der AktG mußte herhalten, um eine faschistische Vorstandstyrannie zu glorifizieren.’
  \item \textsuperscript{94} FA Mann later made a remarkable career in international commercial and economic law, along with his wife, Eleonore Ehrlich, who left Berlin with him in 1933, and established a legal advice clinic on the Portobello Road. Lord Denning described Mann in \textit{The Due Process of Law} (1980) as the most learned of all his learned friends.
  \item \textsuperscript{95} FA Mann (1937) 231.
  \item \textsuperscript{96} C Seydelmann, \textit{Die Gestaltung des Aktienrechtes in Deutschland und England: Ein Beitrag zur Frage der Freiheit oder Bindung im Aktienrecht} (1940) 86, ‘Gerade der Aufsichtsrat als bewußt zahlenmäßig begrenzt gehaltener Gremium wird viel eher in der Lage sein – zumal ihm in der Regel bedeutendere Persönlichkeiten des Wirtschaftslebens anzugehören pflegen – nach fachmännischen Gesichtspunkten die Wahl des Vorstandes recht treffen zu können, als die große Masse der Aktionäre mit ihren vielseitig zersplitterten Interessen durch die Hauptversammlung.’
  \item \textsuperscript{97} FA Mann (1937) 224-5, ‘it is an entirely different question in favour of which interests individual rights are to be restricted. The answer given by the theory of the “enterprise as such” shows its kernel: according to it, the decisive factor is the interest of the enterprise. This answer practically involves supremacy of the Board. Supremacy of the Board had already become a fact in the life of German companies and it has now received its theoretical blessing. No doubt, according to the “enterprise as such” theory the Board itself is subject to the interest of the company. But as it is the Board which, in view of the
\end{itemize}
accountability to any member of the public, the executive was, among other things, to ‘lead the company... as the good of the Empire demands’.\(^98\)

After the Second World War the immediate changes to company law were primarily concerned with reconstructing worker codetermination, initially in the *Montanmitbestimmungsgesetz 1951* (Mining Codetermination Act 1951) and the *Betriebsverfassungsgesetz 1952* (Work Constitution Act 1952). After the war, the allies had allowed unions and employers to make collective agreements regarding company constitutions, and they did so, reintroducing and strengthening work councils and board level codetermination. The Acts codified and spread those collective agreements. The 1952 Act required that a third of supervisory board members, rather than a set number that could be crowded out, would be elected by employees. Later, the *Mitbestimmungsgesetz 1976* (Codetermination Act 1976) increased the number of employee or union representatives in all companies with over 2000 to almost half of the supervisory board. There were no significant changes to non-employee participation in company law until the *Aktiengesetz 1965*, and none after that. The 1965 Act did overhaul the former law, but left the basic arrangements of the two-tier board system in place. Still the executive could be removed only by the supervisory board, and only for a ‘good reason’. The supervisory board itself could remain in office for four years, and could still only be removed with a three quarter majority vote.\(^99\) It was true that a vote by the shareholders could count as a ‘good reason’ to remove the executive, but the choice would remain with the supervisory board. Contemporary commentators glossed over the relevance of this continuity, if they questioned it at all.\(^100\)

Why did neither the 1965 Act, nor subsequent reforms, reverse the measures that had entrenched German directors to such a degree? Would this not have been the natural evolution of company law in a democracy? One view was that German company law was more efficient this way. In 1980, the Ministry of Justice published a report written by 29 company lawyers on potential reforms, including the two-tiered board in German law.\(^101\) There was ‘almost unanimity’ in favour of the two-tier system, compared to the older Hanseatic one tier system. Its main justification was that the ‘functional separation between executive and supervisory board allows a clear division of responsibilities and liabilities.’ Apparently not content with this tautology, it added that the supervisory board was the ‘appropriate forum for cooperative criticism.’

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98 Aktiengesetz 1937 §70(1) ‘Der Vorstand hat unter eigener Verantwortung die Gesellschaft so zu leiten, wie das Wohl des Betriebs und seiner Gefolgschaft und der gemeine Nutzen von Volk und Reich es fordern.’
99 Aktiengesetz 1965 §§84 and 102-103
100 eg DF Vagts, ‘Reforming the “Modern” Corporation: Perspectives from the German’ (1966) 80 Harvard Law Review 23, 51, exemplifies this passive acceptance, in an otherwise highly informative article.
101 Bundesministerium der Justiz, Bericht über die Verhandlungen der Unternehmensrechtskommission (1980)
Moreover, the ‘supervisory council can act more quickly than the general meeting, when it needs, to correct obvious defects in the leadership.’\textsuperscript{102}

If those were the Report’s only reasons, they were not very good. But there were also ‘codetermination reasons’ for maintaining two-tiers. With ‘heterogenous and plural composition of interests’ the supervisory board would be ‘cumbersome, and especially if there is parity codetermination there would be a danger of a deadlock.’ It followed that a system of ‘separation of powers’ was preferable to safeguard ‘stability and productivity’. Quite how the executive derived its productive vitality from these lower tiers of ostensibly sluggish electorates was not clear, and nor was it clear why another tier of boards might not amplify this obvious source of German corporate dynamism further still. That said, the Commission appeared to view the functional separation of the boards as not having gone far enough. It acknowledged that before the \textit{Aktiengesetz 1937} there was more of a one-tier board system. But those days, plainly, had gone.\textsuperscript{103} In the next major report in 2006, the two-tier system was hardly questioned.\textsuperscript{104}

The political reality, however, seems to point in a different direction than the efficiency explanation. Underneath the euphemism, the 1980 Report’s authors appeared more concerned to limit employee influence. After 1952 and 1976, if not in 1919, employee codetermination had become an irrevocable component of the German economic landscape. Its place had rested for now on the supervisory board. Reversing the reduction of the executive’s accountability would have meant tampering with this sensitive issue.\textsuperscript{105} Employee representatives had fought hard for the little they had, and needed to hold on. Interests that identified with large shareholders were content with this settlement, because it separated employees from direct influence over the executive. Major shareholders or banks could still dominate the electoral process.\textsuperscript{106}

But was the settlement really good for everyone? It became an article of faith among some corporate governance circles, from the 1965 Act on, that different interests between shareholder and employee representatives meant ‘objective evaluation and supervision of

\textsuperscript{102} \textit{Unternehmensrechtskommission} (1980) 175-176

\textsuperscript{103} \textit{Unternehmensrechtskommission} (1980) 178, b) Mischsystem. At this point the Commission noted the argument that a ‘genuine’ dual system had not yet been attained, perhaps because of codetermination, because the supervisory board could still have positive input, rather than a purely a right of objection. The Commission evidently did not see the separation as having gone far as enough.

\textsuperscript{104} See K Biedenkopf, \textit{Kommission zur Modernisierung der deutschen Unternehmensmitbestimmung: Bericht der wissenschaftlichen Mitglieder der Kommission} (2006)

\textsuperscript{105} There were essentially three unattractive options: (1) companies could have been permitted to sideline or abolish codetermination by allowing the general meeting to bypass the supervisory council. Employees would have objected. (2) employees could have been permitted to instead hold the same proportion of seats on the executive. Shareholders would have objected, because clearly that would have led to more power. (3) some kind of compromise may have been reached, but it is not entirely clear what that could have been, because it is difficult to quantify how much influence an executive director is worth, compared to one on the supervisory council.

\textsuperscript{106} See further ch 6(2)(e)
management’ had become a more difficult task.\textsuperscript{107} It seems true enough that divergent interests could be a source of conflict over distribution of a company’s joint product. However, it always remained unexplained why shareholders and employees did not share a compelling common interest among themselves against executive directors. It was not codetermination that made the executive less accountable, it was the remnants of fascist corporate law. The reality was that the German labour movement and German shareholders had bound themselves in a Faustian pact. They kept things the way they were, because they both wanted to preserve the gains they perceived themselves to have. But the Faustian pact had a price. The executive had become less accountable to everyone.

(3) United States: an unfinished race

The United States’ experience differed from the UK’s and Germany’s, because there was little federal regulation of companies’ electoral rules. US law was in reality the product of fifty laboratories of corporate law, sometimes cooperating, sometimes competing, sometimes innovating, and sometimes inhibited either by federal law or market pressure. State law received the English common law as it was before 1776, including the principles of accountability in corporate elections and dismissals.\textsuperscript{108} The idea that directors of companies could be removed at will was written into New York’s earliest corporations acts.\textsuperscript{109} Moreover in the earlier cases, including one Illinois Supreme Court case in which a younger Abraham Lincoln was the losing advocate, it continued to be held that the right to remove officials was a standard incident of a corporate body.\textsuperscript{110}

American law and scholarship tended to place more emphasis on the positives of administering elections: their regularity, voting procedure and who was enfranchised.\textsuperscript{111} Perhaps it was characteristic of New World optimism and embedded democratic culture, that legislators and legal authors focused less on the negative topic of removal, and more on appointment.\textsuperscript{112}

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\textsuperscript{107} DF Vagts (1967) 52-53. This has been reflected in H Hansmann, \textit{The Ownership of Enterprise} (1996); J Armour et al, \textit{The Anatomy of Corporate Law} (OUP 2009) 85, ‘We suspect (and we are not the first to do so) that the net effect of Germany’s closely-divided supervisory board is to enhance the power of top managers - i.e., of the management board - relative to that of shareholders.’
\textsuperscript{108} In particular, \textit{R v Richardson} (1758) 1 Burr 517, (1758) 97 ER 426, above at fn 7.
\textsuperscript{109} New York, Laws of 1828, see 2 RS 462, chapter VIII, section 33 on the principle of at will removal, cited by Berle and Means (1991) 129. They further cite \textit{Taylor v Hutton}, 24 Barbour 193 (NY 1864) and \textit{Cook, Corporations} (8th edn 1923) vol III, section 624, for the change in the common law principle.
\textsuperscript{110} \textit{People ex rel Stevenson v Higgins}, 15 Ill 110 (1853) concerning trustees of a hospital. Lincoln acted for Higgins. He lost on the point of who, precisely, was empowered by common law to exercise the right of removal. Lincoln argued that it should only be the legislature, the governor or the Supreme Court, but not the hospital’s trustees, but the court felt the trustees too could exercise the power of amotion.
\textsuperscript{111} See ch 5(3)
\textsuperscript{112} JW Cadman, \textit{The Corporation in New Jersey: Business and Politics 1791-1875} (1949) 302, ‘The amount of attention that was given in
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Probably the most important 19th century debate centred upon having cumulative or majority voting at elections. Cumulative voting, similar to proportional representation, meant that voters would typically have as many votes as there were positions on the board. They could spread their votes or cast them as a block, and so a minority might ensure it had at least one or two seats. By contrast if there were an election for every candidate in a majority vote, the minority of voters could lose every time precisely because they were every time a minority. In 1870 the House of Representatives in Lincoln's home state, Illinois, introduced cumulative voting, and while doing so required cumulative voting in corporations. Other states followed suit, so by 1913 there were 20 states with mandatory cumulative voting, and a further 8 which permitted it.

For states with cumulative voting, the common law standard of removal by a majority vote that had been expressed by Lord Mansfield in *R v Richardson*, became problematic. If a minority appointed some directors, the majority could hardly be permitted to then remove them. This could explain why mid-19th century commentaries chose to read the pre-1776 common law cases, quite erroneously, to require a court supervised cause for removing directors. This contrasted to the position thought to exist for ordinary employees, who somewhat dubiously were said to be dismissible for any reason, any time. But commentaries were suggesting that directors were not only different, but entitled to remain in office, perhaps even for their whole term of office. The true common law principle had said that when a director breached an ordinary duty, he or she ‘can only be tried for it by the corporation.’ But as the 19th century went on, while ordinary employees had no protection in dismissal, directors could seek the assistance of a court.

In the early 20th century, the New York courts began to formalise the requirement of good cause for removing directors. New York had permitted cumulative voting in 1892. Then

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113 W Campbell, ‘The Origin and Growth of Cumulative Voting for Directors’ (1955) 10(3) Business Lawyer 3, 5-6
115 See ch 4(1)
116 eg J Kent, *Commentaries on American Law* (10th edn 1860) 373-5, referring inter alia to *R v Richardson* (1758) 97 ER 426. Also JK Angell and S Ames, *Treatise on the law of private corporations aggregate* (1861) 412. These texts referred to *Richardson* for the idea that the common law required cause for dismissal, but this was simply wrong.
117 HG Wood, *A Treatise On The Law Of Master And Servant* (1877) §136. Wood’s contention was dubious not least because he cited two cases which had held that the pay reference period determined when a dismissal could take effect: *Tatterson v Suffolk Mfg Co*, 106 Mass 56, 59 (1870) and *Franklin Mining Co v Harris*, 24 Mich 115, 116 (1871). cf *Watson v Gugino*, 204 NY 535, 98 NE 18 (1912). At that time, for example, Massachusetts, Michigan and New Jersey, followed the pay reference period for determining when a dismissal could take effect. Plainly different judges in different common law jurisdictions disagreed about what the default rule ought to be.
119 *R v Richardson* (1758) 97 ER 426, (1758) 1 Burr 517, 539.
120 cf the position for other employees, in *Watson v Gugino*, 204 NY 535 (1912) Vann J explains that New York had adopted Wood’s at-will policy in *Martin v New York Life Ins Co*, 42 NE 416 (1895). This was itself a reversal of New York’s policy from just four years prior. *Adams v Fitzpatrick*, 125 NY 124, 26 NE 143 (1891)
it was held that directors (who were certainly not ‘mere employés’) could be dismissed only for a
good reason, if indeed at all before the expiry of a term of office.  

In slight contrast in 1930, Walsh J held in *Fox v Cody* that directors could be dismissed by a majority of shareholders for a good cause, whether a corporate statute was silent or vocal. A justification for court oversight was apparently that removal should not ‘be based on whim and caprice’. In some ways this was an advance from an accountability perspective. The New York courts would now imply the right to remove directors even if a corporation’s bylaws allocated that right to the board. In a further development, in *Auer v Dressel*, Desmond J held shareholders ‘have the inherent power to remove [directors] for cause’, which meant removal was accompanied by ‘the service of specific charges, adequate notice and full opportunity of meeting the accusations’. Yet the view seemed to be that New York law invalidated the voters’ right to determine what a good cause was. The view developed widely, even among those who opposed it, that there was an inherent power of the court to second guess shareholders.

In the little state of Delaware cumulative voting had been permitted from 1917. On removal rights, its General Corporation Law was silent until 1974, though the case law was not. In 1957, in *Campbell v Loew’s Inc*, the president circulated a notice for a meeting to propose that two other directors be dismissed. He alleged they were harassing the president and damaging the company’s affairs. The Chancery Court held there was an implicit right of shareholders to remove directors, so long as they had a fair hearing. This would be the case even if directors, ousted by a majority, were elected through a cumulative vote by a minority of shareholders. The decision was greeted coldly. On the one hand, from directors’ perspective, this was a positive development because cumulative voting was already seen to threaten directors’ job security by making takeover bids more likely. On the other hand, the decision plainly undermined the

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121 *People ex rel Manic v Powell*, 201 NY 194, 94 NE 634 (1911).
122 *Fox v Cody*, 252 NYS 395 (1930) ‘Mistake or misunderstanding probably will not suffice. Substantial grounds showing breach of trust must be shown. The power of removal of directors inheres in every corporation.’
123 See also *In re Koch*, 257 NY 318 (1931) and *Abberger v Kulp*, 281 NYS 2d 373 (1935) (no without-cause removal allowed, even if inserted through a bylaw).
124 *306 NY 427*, 118 NE 2d 590, 593 (1954). Van Voorhis J dissented, arguing that there was no reason to imply such a shareholder right. cf *AG of Belize v Belize Telecom Ltd*[2009] UKPC 11.
125 *nb NYBCL §706(b) now follows MBCA §8.08 in stipulating that a charter may allow for removal without cause.
126 eg AH Travers, ‘Removal of the Corporate Director During His Term of Office’ (1967-1968) 53 Iowa Law Review 389. Note that Travers mistakes the meaning of *R v Richardson* in the same way as some previous authors, believing it to hold that a corporation’s representatives could only be dismissed for a good reason.
127 *JH Choper, JC Coffee and RH Gilson, Cases and Materials on Corporations* (Aspen 2007) 617 ff suggest that good reasons include conviction of a felony, insanity, bankruptcy, organising a competing company, harassing officers or employees, or a director selling all one’s shares. The question, however, is whether a well deliberated decision by the general meeting also counts as a good cause for removal.
129 *Del Ch 563, 134 A 2d 852* (Ch 1957).
workability of minority representation, and so calls were made for codifying removal only for cause.\footnote{eg RE Yeazel, ‘Removal of Directors for Cause’ (1958) 27 University of Cincinnati Law Review 92, 102. Note that this article misinterpreted, once again, the English common law generally, and \textit{R v Richardson} in particular.} In \textit{Essential Enterprises Corp v Automatic Steel Products, Inc} the Chancery Court appeared to change its mind.\footnote{39 Del. Ch. 93, 159 A.2d 288 (1960). Also \textit{Everett v Transnational Development Corp}, 267 A 2d 627 (Del Ch 1970) held that a bylaw can authorise removal without cause, in absence of a statute.} It held that a bylaw stipulating directors could be removed without cause was invalid, because the charter and statute provided the board could be staggered for three year terms. In 1974, the legislature responded by creating a new §141(k). The new Delaware rule was that directors could be removed without cause, unless the charter opted to create a classified board, or the company employed cumulative voting. It approved \textit{Essential} and overturned \textit{Campbell}.

What happened in Delaware law was significant because during the later 20th century, company directors typically had the initiative in charter amendments, and were generally viewed as having more influence than shareholders. On standards of accountability there was, argued William Cary, a ‘race for the bottom, with Delaware in the lead’.\footnote{W Cary, ‘Federalism and Corporate Law: Reflections on Delaware’ (1974) 83(4) Yale Law Journal 663, 703. See ch 4(3) for the origin of this idea.} Whether or not investors priced corporate governance rules into their investment choices, and this was enough to sustain an argument that it was efficient,\footnote{RK Winter, ‘State Law, Shareholder Protection, and the Theory of the Corporation’ (1977) 6 Journal of Legal Studies 251} staggered boards did become widely popular,\footnote{See JH Choper, JC Coffee and RH Gilson, \textit{Cases and Materials on Corporations} (Aspen 2007) 617.} and cumulative voting dwindled to vanishing point.\footnote{Gordon (1994) 94(1) Columbia Law Review 124, 144-160} The concomitant in Delaware’s §141(k) for a staggered board was removal for cause. But removal for cause became rare because there was uncertainty. The prospect of protracted litigation over what courts thought ‘good cause’ meant made it more appealing to simply pay the director off, or wait till the next election.\footnote{Choper, Coffee and Gilson (2007) 619, ‘removal for cause has been rare.’}

Other states followed Delaware’s standards before long. For example in 1955, the Illinois Supreme Court had held in \textit{Woolfson v Avery} that staggered boards were unconstitutional.\footnote{Woolfson v Avery, 6 Ill 2d 78, 126 NE 2d 70, (1955), 69 HLR 380. See LCB Gower, ‘Some Contrasts between British and American Corporation Law’ (1956) 69(8) HLR 1369, 1389-1390, given the very recent changes to UK law he wrote with a tinge of cheek: ‘To an English observer it seems strange that in most states the stockholders have no power to remove directors, in the absence of misconduct, until the expiration of their terms of office.’} Moreover, the Model Business Corporation Act 1955, a non-binding statute drafted by the American Bar Association and the American Law Institute to restate its view of best practice, was updated to contain an optional §36A. It recommended removal of directors without cause.\footnote{RW Jennings, ‘The Role of the States in Corporate Regulation and Investor Protection’ (1958) 23 Law & Contemporary Problems 193 argued at the time that the MBCA should have not left the provision optional, though this would in any case have been a pyrrhic victory, given the statute itself is optional.}
Small states without mandatory cumulative voting followed that guideline.\textsuperscript{140} Indeed, in the late 1950s it became an academic assumption that a majority of voters was always in charge. In 1958 AA Berle wrote confidently that ‘Fifty-one per cent of ownership of the voting stock in a single hand or compact group constitutes absolute control.’\textsuperscript{141} The idea of absolute control relied on the notion that a general meeting could remove directors at will with an ordinary majority. However by 1983, even Illinois had abandoned mandatory cumulative voting, and allowed the same choice of staggered boards as Delaware.\textsuperscript{142} Similarly the revised Model Business Corporation Act reverted so that companies in their constitutions (rather than the states) could elect whether to have with or without cause removal.\textsuperscript{143}

By the end of the 20\textsuperscript{th} century, it might have appeared that the American director enjoyed, in comparison to the UK or the German director (and probably directors in any Commonwealth, EU or OECD country) an unparalleled position of autonomy. It had not always been that way, but had become increasingly so from the mid 1970s. The rarity of for cause removal was sharpened by an absence of regulation of payments for loss of office. Among the most prominent examples, and a contemporary analogue to \textit{Shirlaw}, was \textit{In re Walt Disney Derivative Litigation}.\textsuperscript{144} Michael Ovitz was able to contract with Disney for a payout if the company terminated his contract before it ended. The board commissioned a report on his executive pay package, which did in fact say that the deal for Ovitz was ‘low risk and high return’, but the report was ignored.\textsuperscript{145} After one year Ovitz was dismissed and he received $140 million. The case itself turned on the negligence of remuneration committee members, who were all absolved by Chancellor Chandler on the basis their decisions fell within ‘business judgment’.\textsuperscript{146} This meant that US law allowed heavy financial penalties, without approval by the general meeting, to frustrate the rules on removal.

While removal rules were problematic, the position on appointments had the potential to be revitalised after the financial crisis. In the Dodd-Frank Wall Street Reform and Consumer


\textsuperscript{141} AA Berle, ‘“Control” in Corporate Law’ (1958) 58(8) Columbia Law Review 1212, 1213

\textsuperscript{142} Illinois Business Corporation Act 1983 article 8

\textsuperscript{143} RMBCA §8.08. The Official Comment, somewhat ironically, says the section ‘adopts the view that since the shareholders are the owners of the corporation, they should normally have the power to change the directors at will.’ See also, NYBCL §705(a) allows without cause removal if the bylaws allow it.

\textsuperscript{144} 825 A 2d 275 (2003)

\textsuperscript{145} This factor may have made its treatment under UK law or German law quite different, cf \textit{Re Barings plc (No 5)} [1999] 1 BCLC 433, where directors who ignored a report on separating the Singapore front and back office were found unfit for their jobs.

\textsuperscript{146} One can note, it appears more than a little disingenuous for a Nevada court to say, as in \textit{Shoen v AMERCO}, 885 F Supp 1332, 1340 (D Nev 1994) ‘one of the justifications for the business judgment rule’s insulation of directors from liability for almost all of their decisions is that unhappy shareholders can always vote the directors out of office.’

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Protection Act 2010 §971 gave the Securities and Exchange Commission authority to make rules for shareholders to propose nominees to the board. However, §971 required that the SEC issue rules only ‘in the interests of shareholders and for the protection of investors’ and consider whether it ‘disproportionately burdens small issuers’. The terms and conditions for judging these matters would in fact be set by the SEC itself. Accordingly, the SEC publicised that it would issue the rules based on cost benefit analysis and efficiency. Having done such a report, it issued a new SEC Rule 14a-11, that would have allowed shareholders to nominate candidates for director elections. But the Business Roundtable, the organisation representing the interests of directors in large companies, filed for an injunction. The DC Appeals Circuit agreed with the Business Roundtable that the SEC had acted ‘arbitrarily and capriciously’ in issuing its rules because of apparently faulty economic analysis, and so found that they were incompatible with the Dodd Frank Act 2010.\textsuperscript{147} The SEC announced it was suspending its rule drafting effort. This seems extremely peculiar, especially given that the SEC was never bound by the statute to perform any economic analysis at all.

In spite of all this, building up since the 1990s, there was a surprising change. The incidence of staggered boards went into retreat. Marcel Kahan and Edward Rock reported that out of companies listed by the Standard & Poors 100, the use of staggered boards declined from 44 companies in 2004 to 15 companies in 2009. However, 20 out of 26 companies that made an initial public offering still had staggered boards. For cumulative voting, 90 companies in 2003 used it, but by 2009 it was only ten. Without staggered boards, the way was becoming more clear in Delaware for without cause removal rights. If one took the view that majority voting was efficient, it would seem the US was ‘racing for the top’. If one viewed the unparalleled autonomy that American directors enjoyed as efficient, then this represented a race for the bottom. Either way, it seemed that changes in shareholders’ composition and power was driving the race, and the race was yet unfinished.

What led to the reversal of the 20\textsuperscript{th} century trend in director accountability? Kahan and Rock identified a range of factors, but foremost was the consistent activism of institutional investors, exploiting changes to SEC Rule 14a-3, introduced in 1992, that allowed more proxy solicitation without filing statements with the SEC.\textsuperscript{148} More particularly, it appears that certain types of institutional shareholders – notably public pension and trade union funds – were using their bargaining power on the market to change the rules. The ability of the fund to put pressure on directors for constitution changes was entirely dependent on their economic weight, and their

\textsuperscript{147} Business Roundtable v Securities and Exchange Commission, 647 F.3d 1144 (DC Cir 2011)

The lingering issue in US corporate law is what is included in the meaning of ‘cause’ for removing a director. None of the leading cases has appeared to disclaim the old common law, and indeed courts have repeatedly referenced the understanding of commentaries, which in turn lead back to *R v Richardson*. The key question is whether, if directors receive reasonable notice and a fair hearing, and then a vote is taken by shareholders, the decision of the general meeting itself counts as a good reason. On a proper reading, this seems to be the view that *Auer v Dressel* took in New York. Because *Campbell v Loew's Inc* followed *Auer*, this would represent Delaware law as well. To reconcile the difficulty met by §141(k), ‘cause’ in a company with cumulative voting would mean that a minority class of members in the general meeting who could select directors must be able to veto a dismissal. This does not mean that the court would have no role: its function would be to supervise the two main elements of the dismissal procedure: but it would be the voters’ voice that actually mattered.

Stepping back from the details, at least two key trends can be identified in the development of election rules. The first and central trend is the one that Berle and Means were most responsible for. They singled out the erosion of the traditional common law principles for small corporations, allowing simple majority removal of boards, as important for accountability. Though their work looked at the US, its most obvious implementation in the law was found in the UK’s Companies Act 1947. The UK underwent a textbook evolution, but was also followed soon by many US jurisdictions and the Model Business Corporation Act, at least in the 1950s. Second, when the law gave options, election and removal rules within companies changed according to the bargaining power of interest groups within companies. This was witnessed most graphically on German supervisory boards over the 1920s, and (in the opposite manner) in US

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149 *R v Richardson* (1758) 1 Burr 517, (1758) 97 ER 426. Lord Mansfield, 539, ‘It is necessary to the good order and government of corporate bodies, that there should be such a power [to dismiss], as much as the power to make bye-laws... But where the offence is merely against his duty as a corporator, he can only be tried for it by the corporation.’ Emphasis added.

150 *Auer v Dressel*, 306 NY 427 (1954) At 432, Desmond J said, ‘it seems to be settled law that the stockholders who are empowered to elect directors have the inherent power to remove them for cause... there must be the service of specific charges, adequate notice and full opportunity of meeting the accusations, but there is no present showing of any lack of any of those in this instance.’ It follows that ‘for cause’ referred to the requirements of notice and meetings, not to anything additional. Given those, the decision of shareholders constitutes sufficient cause. At 434, Desmond J then says that arbitrary treatment (which would be a matter of a personal contractual dispute) would be separate from the question of holding office. ‘Any director illegally removed can have his remedy in the courts (see *People ex rel. Manie v. Powell*, 201 N.Y. 194).’

151 See the MBCA 1959, §36A, ‘If less than the entire board is to be removed, no one of the directors may be removed if the votes cast against his removal would be sufficient to elect him if then cumulatively voted at an election of the entire board of directors, or, if there be classes of directors, at an election of the class of directors of which he is a part.’
over the 2000s with the decrease in staggered boards. Bargaining power could lead in any direction: directors could use their influence to insulate themselves, but US institutional shareholders were showing they could break down the obstacles to accountability.

The main conclusion, however, is that it seems very difficult to see either the political developments that led into law, or the developments on the market, as ones where welfare maximising objectives were relentlessly and successfully pursued. If accountability was important, why was there no legal enactment concerning election rights in the UK? The Higgs Report showed it was plainly a concern. In the US, *Business Roundtable v SEC*, where SEC Rule 14a-11 was struck down, demonstrated the concern once more, albeit in a very different way. Market interest groups were not pursuing their rational objectives relentlessly either. Why, for example, did UK directors before 1947 rest contentedly with 75 per cent removal rights, when German directors became considerably more creative in implementing obstacles against removal? The realistic answer is surely that political and economic actors were content to stay with what they knew, even if another course of action could be more profitable. Thus, according to the first positive thesis, progressive democracy has driven the development of director election rules, but incompletely. Following the second positive thesis, when left to the market director election rules changed with the bargaining power of economic actors, but the outcomes could be wholly arbitrary. From any point of view, both politically and economically, there was a lot to be desired.
5. Shareholder Voting Rights

Chapter 4 examined one part of the equation to bring progressive democrat ideology into corporate law. If directors were not effectively accountable to any electorate, the distribution of voting rights would be essentially irrelevant. But if directors were accountable, vote distribution became critical: who would have the loudest voice in electing or removing the board? The first positive thesis suggests that progressive democrats would seek to regulate voting rights to achieve greater equality. And indeed, Berle and Means had argued that the spread of voteless ordinary shares diminished accountability before the Great Depression.\(^1\) Total shareholder disenfranchisement seems obviously incompatible with a progressive democrat view, though it is harder to identify a single democratic conception of how votes should be distributed.\(^2\)

Historically, shareholder vote distribution ranged on a spectrum between three points: (1) one-person, all-the-votes, (2) one-share, one-vote, (3) one-person, one-vote. Before the 20\(^{th}\) century, graduated voting (ceilings on voting rights for larger shareholders) were common, and Colleen Dunlavy has characterised the development of the one-share, one-vote norm as a descent into economic ‘plutocracy’.\(^3\) But by the 1920s progressive democrats had been prepared to settle, because the more immediate threat was total disenfranchisement. Interestingly, modern institutional shareholding, to be examined in chapter 6, has involved a novel development, because participation in retirement funds usually work on a one-person, one-vote basis. Thus, while a one-share, one-vote standard prevails in the share market, and if disparities in the holdings of institutions are put aside, voting rights might appear to be becoming as egalitarian as a one-person, one-vote standard was in the days of direct shareholdings. An apparent paradox of the legal development, seen explicitly in the 1937 German law reform, but also running as a subtext in UK and US institutional investment, is that groups naturally opposed to progressive democracy were content to see the one-share, one-vote norm prevail if the ultimate contributor was in any case separated from participation.

The second positive thesis is that, left to the market, the bargaining power of economic actors would shape voting distribution, whether the outcome promoted accountability, or was wholly arbitrary. The historical reality differs drastically from the conception of the market which

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\(^2\) There are also good reasons why not only capital investors should receive all votes, when other stakeholders, particularly employees, make contributions to companies as non-adjusting investors. This is pursued elsewhere, e.g. E. McGaughey, ‘British co-determination and the Churchillian circle’ (2014) UCL Labour Rights Institute On-Line Working Papers – LRI WP 2/2014
endogenously’ enfranchises shareholders, or the idea that a one-share, one-vote standard mimics ‘the market’. In the UK, indirect judicial and regulatory pressure has been more of a theme than black letter law, and the bargaining power of institutional investors has effectively secured one vote for every ordinary share in public companies. In Germany, the very opposite occurred: company boards, with banks, had issued so many voteless or multiple voting shares in the 1920s that the mass of investors were disenfranchised. This was only reversed by law in 1937. But bargaining power in the US has pushed both ways. In the 1920s, market practice threatened total disenfranchisement, until regulation by the NYSE and SEC. The same disenfranchisement pattern recurred in the 1980s when regulation was briefly lifted, but more recently institutional shareholders have adopted and have successfully been spreading a one-share, one-vote norm. If one thing was clear, it was that the markets did not produce a pattern of shareholding voting rights that followed a consistent principle.

(1) United Kingdom: raising the regulatory brow

The UK’s earliest corporations employed voting practices, consistent with common law election rules, that were generally egalitarian. In the realm of politics, and particularly since the Bill of Rights 1689, the Whig establishment viewed the vote with high regard. In *Ashby v White*, Lord Chief Justice Holt took the view that votes in elections for Parliament were the same as rights of ‘property’. The vote was ‘a thing to be admired at by all mankind’, and it would be an actionable wrong for government officials to interfere.

The earliest companies viewed matters similarly. Company meetings often voted with a show of hands, and if a ballot was held, counted each shareholder as equal, regardless of the size of their capital investment. The basic common law principle, spelled out by Lord Hardwicke CJ, was that when no law or custom said otherwise, people stood ‘upon an equal foot’. Other companies did not treat shareholders equally as persons, but placed limits on the number of votes that could be cast by the largest shareholders. Between 1720 and 1844, around four fifths of chartered companies employed a graduated voting structure, so that as one’s shareholding increased, one had fewer votes on each share, often with an overall ceiling.

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5 *Ashby v White* (1703) 92 ER 126, 2 Ld Raym 938, 954, Lord Holt CJ was dissenting, but upheld by the House of Lords.
6 *Stoughton v Reynolds* (1735) 93 ER 1023, a case on a church corporation’s election. ‘Is the right of adjourning in the churchwardens? There is no case for that; though if there was, this is found to be the act of one only. We must therefore resort to the common right, which is in the whole assembly, where all are upon an equal foot.’
constitutions were closer to one-person, one-vote than one-pound, one-vote.

Then again, larger companies like the East India Company,8 the Greenland Company,9 and the Bank of England,10 often used graduated voting to disenfranchise the smallest shareholders altogether.11 Moreover, if there were voting ceilings large shareholders sought to evade the rules by splitting the casting of their votes among nominees. The Public Companies Act 1767 attempted to end this practice by introducing a six month qualifying period before members, and any nominees, could vote.12 Parliament’s reasons appealed to an egalitarian ethic, however elitist its context. Vote splitting was,

subversive of every Principle upon which the Establishment of such General Courts [ie company general meetings] is founded, and if suffered to become general, would leave the permanent Interest of such Companies liable at all times to be sacrificed to the partial and interested views of a few, and those perhaps temporary Proprietors....

In this opposition to the ‘partial and interested views of a few’ lay the embryonic democratic ideal.

A rough attachment to equality persisted into the enactment of the first modern company laws.13 Unless a company’s articles provided otherwise, under the Joint Stock Companies Act 1856, Table B, article 38, members carried one vote for each of their first ten shares, one vote for each five shares up to a hundred, and beyond that one vote for each ten shares.14 The presumption of equality was also manifested in corporate finance. Hutton v The Scarborough Cliff Hotel Co Ltd held a company could not issue a new class of shares with preferential dividends without the consent of all shareholders.15 Kindersley VC held that where the articles were silent, this should be construed as the implied term because ‘every shareholder has a right to insist that the original agreement between the parties was that all should stand on an equal footing so far as relates to the receipt of dividends’.16 However, an attachment to equality was about to change.

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8 S Williston, ‘History of the Law of Business Corporations before 1800. II. (Concluded)’ (1898) 2(4) Harvard Law Review 149, 156, nb voting limits were eventually put in place in the East India Company, and the usual voting practice was a show of hands.
9 Greenland Trade Act 1692 (4 Will & Mar, c 17) s 17, £500 of stock bought one vote, £1000 bought two.
10 Bank of England Act 1694 (5 & 6 Will & Mar, c 20) £500 of stock bought one vote.
11 Freeman et al (2012) 151-153, ‘In every sector except railways, larger companies were more likely to exclude their smallest shareholders from voting.’
12 Public Companies Act 1767 (7 Geo III, c 48)
13 The Companies Clauses Consolidation Act 1845 s 75, also envisaged graduated voting in statutory companies.
14 The same was found in the Companies Act 1862, Table A, art 44 (1865) 62 ER 717. On its facts the decision was overturned by Andrews v Gas Meter Company [1897] 1 Ch 361, Lindley LJ allowing preferential shares to be created if a three quarter majority existed to change the articles, given that it was a mandatory rule under CA 1862 ss 50-51.
15 See also Birch v Cropper (1889) 14 App Cas 525
Two decades after the first modern companies acts, the Court of Appeal in \textit{Pender v Lushington} effectively dismantled voting ceilings. Lord Jessel MR held that the directors of the Direct United States Cable Co Ltd, including Mr Lushington, could not refuse to count the votes cast by the nominees of John Pender, a major shareholder and competitor. Pender had split his votes to avoid the constitutional maximum of 100 votes cast at a general meeting. Although this rule was presumably in place to prevent any single member dominating the company, Lord Jessel MR avowed a shareholder’s power to say the vote was ‘a right of property belonging to my interest in this company, and if you refuse to record my vote I will institute legal proceedings against you to compel you.’\footnote{17}

This \textit{dicta} plainly echoed \textit{Ashby v White} in its rhetoric, but was very different in its effect. From a modern corporate governance viewpoint, a positive effect could be that directors would be unable to rely on a company’s articles to disperse shareholder power, and so to diminish accountability.\footnote{18} But at the same time, \textit{Pender} swept aside limits on the influence money could buy in company meetings, and transparently protected the nexus between capital investment and the vote.\footnote{19} After 1862, seventy per cent of new companies were already eschewing graduated voting structures, and by 1883 it appears that around 35 per cent of companies used a one ordinary share, one vote standard.\footnote{20} In 1906, Table A was changed to make one ordinary share, one vote the default standard.\footnote{21} Though courts had not protected the right to vote directly, it was apparent that they guarded votes for shareholders jealously where they existed.

For the next fifty years, UK law retained its rule that shares with any voting rights attaching to them could be issued, in line with whatever the company’s articles stated. The only serious look at the issue came as World War One wore to an end. Cases like \textit{Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd}, where German citizens who held shares in British companies were prevented from exercising their rights, had raised the issue of enemy shareholders voting rights.
control of corporations. Should UK law be amended to stop foreigners taking over its companies? The resulting Wrenbury Report 1918 found that in shipping, or other key industries, a simple solution could be full disclosure of real investors. A cap could be imposed on shareholders with ‘enemy’ credentials. An alternative could be to mandate vote withdrawal, but that would require further consideration. It was noteworthy that the drafters of the report viewed bearer shares, popular with continental Europeans, to be inconsistent with a policy of disclosure. Yet when administered through systems of bank deposits, they said bearer shares were transparent enough to remain, subject to a right to withdraw votes if the Board of Trade found it necessary. In the years following, the issue of voting did not seem to arise again, including in the Cohen Report of 1945. In the courts, the rights attached to shares were simply viewed as a matter of construction.

Distorted voting rights did become a public issue in 1953, during takeover battle between the board of the Savoy Hotel company group and a secret bidder. The bidder revealed himself as the owner of Selfridges, but he then gave up in favour of another bidder, the owner of Land Securities. The Land Securities owner was intent on reorganising the Berkeley Hotel in Knightsbridge. The Savoy group’s managing director, Hugh Wontner transferred the Berkeley Hotel to another company with all votes vested in six percent of the company’s shares, controlled by management. The remaining shares, which were nonvoting, were vested with the employee pension scheme. Public announcements were made on the undesirability of employee job losses, though if this was true, Wontner’s job was probably threatened most. The well known targets brought media attention, and the tactics of Wontner attracted heavy criticism. The Economist was at the forefront. It wrote that, while composing 7 per cent of the market, ‘the nonvoting ordinary share threatens to become too popular’. In 1956 the House of Fraser stirred criticism again, when it launched an initial public offering with shares carrying only 5 per cent of ordinary voting

22 [1916] 2 AC 307, the House of Lords overturned the majority of the Court of Appeal to approve the dissenting judgment of Buckley LJ (and Mr Gore-Brown’s submissions as counsel) that a company with German shareholders should be treated as having ‘enemy character’, even though incorporated in the UK. Buckley LJ subsequently became the Lord Wrenbury.

23 Report of the Company Law Amendment Committee (HMSO 1918) Cd 9138, [26] and [31].

24 Wrenbury Report (1918) Cd 9138, [36]

25 See above ch 3(1)

26 Scottish Insurance Corp Ltd v Wilsons & Clyde Coal Co Ltd [1949] AC 462, 488


28 ‘The Business World: The Battle for the Savoy’ (12 December 1953) The Economist 831-833, ‘On grounds of principle, it is difficult to find condemnation too severe for what the Savoy Hotel board have done... They have set a precedent which, if extended, could divest shareholders in any company of their legal interests, leaving them wholly at the mercy of directors over whom they would be powerless to exercise any control. They have carried to the limit the modern doctrines that “the company” is something apart from the shareholders, that directors owe a primary duty to “the company” rather than to the shareholders, and are justified in taking any steps, even to the disadvantage of the shareholders, that they conceive to be in the interests of “the company.”’

29 ‘Shares Without a Say’ (14 April 1956) The Economist 167
rights, and it used the shares to consummate a takeover bid a year later.\textsuperscript{30} The Association of British Insurers advised its members to not purchase such shares any longer.\textsuperscript{31} On 19 August 1957, the London Stock Exchange reacted by announcing it would take steps to ensure buyers were not misled into purchasing voteless shares.\textsuperscript{32} Public disapproval had risen, and with it, the stern brow of the regulator was raised.

The battle for Berkeley Hotel and the House of Fraser’s dealings were large in the news, though The City’s interests did appear firmly in control. After all, its trade associations could adopt a common policy, and threaten to remove directors with an ordinary resolution. When the Jenkins Report 1962 reviewed whether voteless shares should be abolished, it decided against.\textsuperscript{33} LCB Gower, Sir George Erskine and Leslie Brown filed a note of dissent, arguing that because, managers are looking after other people’s money it is thought that they should not be totally free from any control or supervision and the obvious persons to exercise some control are the persons whose property is being managed.

They argued that it was consistent with the Cohen Report’s policies to ensure management was under effective control. The Jenkins Report itself, they said, was largely based on the idea that increasing shareholder control was right. They warned that matters would deteriorate if no action was taken and noted that exchanges abroad had acted.\textsuperscript{34} They recommended voteless shares should not be listed and existing holders should be allowed to attend and speak at meetings.\textsuperscript{35} But the majority concluded regulation was unnecessary. The justifications for not regulating were questionable: they said the law could be evaded by issuing multiple shares, that voteless shares were an essentially private bargain warranting no interference, and it would be difficult to compensate voting shares for their dilution in power.\textsuperscript{36} However it seems the central reason proffered for not amending the law was the majority’s resolve to recommend that the Board of Trade cooperate with the London Stock Exchange to publicise the problems of voteless shares.\textsuperscript{37}

\textsuperscript{30} Discussed further in B Cheffins, Corporate Ownership and Control (OUP 2008) 30-33 and 316-317
\textsuperscript{31} ‘The Price of Votes’ (27 July 1957) The Economist, 328
\textsuperscript{34} Jenkins Report (1962) Cmd 1749, 207-210
\textsuperscript{35} RR Pennington, ‘The Report of the Company Law Committee’ (1962) 25(6) Modern Law Review 703, 706, argued even this was enough, noting at the time that ‘no other western Europe country and few of the states of the U.S.A. permit non-voting ordinary shares…”.
\textsuperscript{36} Jenkins Report (1962) Cmd 1749, 46-49, [130]-[134]. In answer to these arguments, it could be said that multiple voting is also unwarranted, that unaccountable directors harm everyone including voting shareholders with poor governance (even when management becomes the only shareholder!), and no law needs to be retroactive.
\textsuperscript{37} Jenkins Report (1962) Cmd 1749, 49, [140]
There was no express law, but there was express public disapproval, and a second stern brow of regulation had risen.

Over the next fifty years, very little changed. In 2007, a Report for the Council of Ministers was produced on the proportionality of voting rights to shares in the European Union. This found that UK companies had essentially no distortions of votes working in favour of small groups of shareholders, or no ‘control enhancing mechanisms’. The deviating UK companies either offered tiny minorities of shares with preferential dividends, or voting ceilings being used in a joint venture. Paul Davies has explained this as resulting from institutional investor opposition, and states that the ‘solution to this problem, incomplete though it is, thus turned out to be a market, rather than a legal, one in the United Kingdom.’ This is certainly accurate in the sense that UK institutional investors had used both their economic bargaining power, and social influence to achieve almost complete equality for ordinary shares. However, the law and regulation had slanted the playing field to favour shareholder enfranchisement on a one-share, one-vote model. UK shareholders had among the strongest election rights in the world. The courts vigorously policed the right to vote where it existed. The London Stock Exchange brought pressure to ensure investors had equal votes for ordinary shares. In this way, it was a market solution when institutions had significant market power, backed with regulatory support – something much more than a free market – that produced equality of voting rights in the UK. A consistent policy of the legislature, the judiciary and the City regulators enfranchised the registered shareholder, whether or not this was the ultimate investor.

(2) Germany: the paradox of despotism

The German Companies Acts are, on the question of shareholder voting, express and comprehensive compared to the UK and US, at least in black letter law. Corporations in operation before Germany’s first unification were divided in a similar way to those in England. Smaller companies, in the Hanseatic tradition, tended to be more egalitarian. Larger companies, particularly in Prussia, were more hierarchical. The Prussian Bank, for example, from the time it

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38 The term ‘control enhancing mechanism’ is said to cover any of (1) Multiple voting right shares (2) Non-voting shares (3) Non-voting preference shares (4) Pyramid structures (5) Priority shares (6) Depository certificates (7) Voting right ceilings (8) Ownership ceilings (9) Supermajority provisions (10) Golden shares (11) Partnerships limited by shares (12) Cross-shareholdings (13) Restrictive shareholder agreements. Conspicuously not listed is a two-tier board system that mandates or results in intermediated voting. There is no good reason to exclude this, since it eliminates direct accountability of the executive to the voters, just as if German citizens could only vote for their local council, which in turn elected the Bundestag.


40 P.L. Davies, Gower and Davies’ Principles of Modern Company Law (8th edn Sweet and Maxwell 2008) 827.

41 See generally O Gierke, Das Genossenschaftsrecht (1868)
allowed public investment in the 1840s, had a policy of one-person, one-vote, but only among the largest 200 shareholders.\textsuperscript{42}

In the \textit{Allgemeine Deutsche Handelsgesetzbuch 1861} (General German Commercial Code 1861) §209 Nr 9 stated that it was up to the company constitution to determine the conditions on shareholder voting rights and the form in which they were exercisable.\textsuperscript{43} But the default position under §224(2) was that every share would carry one vote.\textsuperscript{44} This was essentially the same as the UK’s Table A, attached to the Companies Act 1862, except without the default presumption of graduated voting, or other form of \textit{Höchstimmrecht} (voting cap). However, in 1884 the code was amended so that in §§221 and 190 the option of voting caps was expressly available.\textsuperscript{45} The \textit{Handelsgesetzbuch 1897}, §252(1) again started with the rule that each share would hold a vote, but said a company’s constitution could allow multiple votes, and that there could be voting ceilings.\textsuperscript{46} Voting ceilings had already been used in a number of companies before the changes of the HGB 1897, and continued at some modest level.\textsuperscript{47}

It does not appear that multiple voting rights on shares were widespread enough to raise concern until after World War One.\textsuperscript{48} Then, just as in the UK, fear of \textit{Überfremdung} (foreign takeovers) spread even though international cross-investment had become increasingly common before the war.\textsuperscript{49} Government responded less to the \textit{Überfremdung} scare than companies themselves. That said, the government never had the choice to respond in the way that the Wrenbury Report 1918 had said could be necessary (though never was) in the UK. The Treaty of Versailles 1919 article 276(d) required that Germany impose no economic restrictions on Allied nationals that did not exist before 1914, and this included the purchase of its companies.\textsuperscript{50} It is not clear whether the reality justified any action, but a mania ensued.\textsuperscript{51}

The first step was to restrict the transfer of shares.\textsuperscript{52} Then, large shareholders issued

\begin{itemize}
\item ADHGB 1869 §209 Nr 9
\item ADHGB 1869 §224
\item Amending the HGB 1869, the Gesetz, betreffend die Kommanditgesellschaften auf Aktien und die Aktiengesellschaften. Vom 18. Juli 1884, §221(2) and §190
\item HGB 1897 §252(1). See Reichsgesetzblatt (10 May 1897) 219-297.
\item W Auerbach, \textit{Das Aktionarwesen} (1873) 171-193
\item eg Gramophone and Typewriter Co Ltd v Stanley [1908] 2 KB 89. An early joint venture between Englishmen and Germans, between whom there was ‘friction and suspicion’ was in the Mines Royal, with a charter of 1568. There was four votes for each of the 24 shares, 14 owned by the English. See Select Charters of Trading Companies 1530-1707 (Selden Society 1913) 14-15.
\item This led to a law restricting the sale of colonial companies’ assets being unenforceable (RGBl 1918, 172).
\item E Jung, \textit{Maßnahmen der Aktiengesellschaft gegen Überfremdung} (1921) gives anecdotal evidence.
\item HGB 1897 §222(1) ‘Auf Namen lautende Aktien sind mit genauer Bezeichnung des Inhabers nach Namen, Wohnort und Stand in das Aktienbuch der Gesellschaft einzutragen.’ (2) ‘Sie können, soweit nicht der Gesellschaftsvertrag ein Anderes
\end{itemize}
Mehrstimmsrechtsaktien (shares with multiple votes), Verwaltungsaktien (administrative shares) which belonged to the company but whose rights would be exercised by the executive alone, or Herrschaftsaktien (golden shares) which vested an overriding power of veto in the lucky bearer. Banks got special classes of shares too. Typically, a new class of shares would be issued with an increase in capital, the new shares carrying the special voting rights. At first votes were issued with modest multiples of two or three. But as hyperinflation and hysteria accelerated, shares were issued with a thousand votes each. When the scare subsided, multiple voting shares were simply issued with the express intention of benefiting one or a group of influential shareholders.

The disenfranchisement wrought in the German share market was staggering. By September 1925, 860 out of 1595 listed companies had multiple voting. Those shares represented just 1/40 of capital, but accounted for an extraordinary 38.2 per cent of the voting rights. It was clear that the drivers, and the beneficiaries, were those who Richard Passow had called the ‘big players’: industrialist families, who wished to turn public companies back into private wealth funds, banks, and boards. They exercised their bargaining power on the market to entrench their positions, and they took advantage of the same anti-shareholder rhetoric discussed in chapter 4(2). Walter Rathenau’s theories offered respectability because he had characterised every small shareholder as irresponsible, and their rights to vote as questionable. The diminution of executive accountability is generally acknowledged as having led to faulty accounts, poor reporting, zealous share buyback schemes, and supervisory council numbers inflated with prestige-seeking friends of the executive.

These developments were effectively approved by a judiciary wedded to what it regarded as private autonomy. In 1925, the Reichsgericht (Empire Court) held that issuing shares with multiple voting rights would be allowed if it pursued a legitimate aim, and the measures were proportionate toward that aim. The issue would contravene public policy under the Civil Code §§138 and 826, but, a legitimate aim could include warding off a foreign takeover. There is no indication that anyone actually policed the authenticity of companies’ actions. In 1929, the Reichsgericht did also hold that a three quarter majority of capital, not just votes, represented at a general meeting, was necessary to increase capital. Despite directors’ conflict of interest, there

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53 FA Mann, ‘The New German Company Law and Its Background’ (1937) 19 Journal of Comparative Legislation and International Law 220, 235
55 R Müller-Erzbach, Die Entartung des deutschen Aktienwesens seit der Inflationszeit (1926) 11 ff
56 W Rathenau, Vom Aktienwesen: eine geschäftliche Betrachtung (1919) 32-33
58 RGZ 108, 327 (1925). See also RGZ 132, 149, 159 (31 March 1931) saying the same for Schutzaktien (‘safety’ shares).
59 RGZ 125, 356 (24 September 1929)
was no decision to require mandatory approval by a majority vote of the general meeting, nor to simply intervene on the basis of the external effects on the market. The most that could be said was that a measure of judicial intervention came at a time when genuine concern over misleading and coercive practices was present. But the efforts of the Reichsgericht served more to legitimise the disenfranchisement of ordinary shareholders than to effectively restrict disenfranchisement.

The German legal academy was critical. In 1931, its proposed redrafting of the companies chapter of the Handelsgesetzbuch recommended that all ordinary shares should have votes. As it was suggested in chapter 4(2) the law reform committee still operated in a democratic climate. It might therefore be regarded as surprising that, following the Nazi triumph, the one-share, one-vote recommendation was still implemented in the Aktiengesetz 1937 (Public Companies Act 1937). The Official Reasons were plainly against public empowerment, and favoured executive autonomy. Echoing Rathenau again, it said,

that the Board in the course of its administration depends to the extent hitherto known on the mass of irresponsible shareholders who mostly lack the necessary insight into the position of the business.

But if director election rules neutered accountability, then giving ‘irresponsible shareholders’ an equal vote made perfect sense. As Johannes Zahn’s ‘leadership’ and ‘bundle of contracts’ theory in chapter 4(2) had suggested, all shareholders and stakeholders were to be regarded as equal. Zahn favoured the one-share, one-vote rule. But shareholders were equal in their subordination, in their fecklessness, and need of leadership. The paradox of despotism was that the equal worth and equal rights of every individual would be proclaimed, but only as a pretext to being ‘protected’. In reality, the leader would strip away any guarantee of protection, or genuine rights. But the facade was still necessary to split opposition. The Aktiengesetz 1937 §12(1) stated that every share carried a right to vote, unless it was a lawfully issued preference share. Plural votes were invalid, unless the Reich Ministry of Economics made exceptions.

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60 FA Mann (1937) 222, fn 3
61 Official Reasons, or Amtliche Begründung, attached to the Act, cited and translated by FA Mann (1937) 229.
62 JCD Zahn, Wirtschaftsführer und Vertragsethik im neuen Aktienrecht (1934) 102-106, ironically being inspired by Ripley, discussed in ch 5(3).
63 It is also possible to view the Nazi regime as an incoherent mess of baseless ideology: empty, corrupt, and ravenous for power. See FL Neumann, Behemoth (1941). Yet its propaganda tactics were old ones. They were employed by the first Roman Emperor, who laid republican government to rest. Augustus, Res Gestae Divi Augusti (14 AD) ‘At the age of nineteen, on my own initiative and at my own expense, I raised an army by means of which I restored liberty to the republic, which had been oppressed by the tyranny of a faction.’
64 Aktiengesetz 1937 §12(1) in Reichsgesetzblatt (30 January 1937) 29-165. nb FA Mann (1937) 235-236, ‘the Official Reasons, speaking of the “situation created by the maintenance of shares with a plurality of votes,” rather suggest that a liberal use will be made of that power.’
In the post-war reforms, the *Aktiengesetz 1965* §12 followed its predecessor, but exemptions were effectively ended: up till 1988, only 19 authorisations were given to have multiple voting shares out of 2373 public companies.\(^{65}\) The legality of multiple voting and voting ceilings was ended altogether by the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich 1998* (Control and Transparency in Enterprise Act 1998) §134 for companies listed on a stock exchange.\(^{66}\) There was little left to do on paper. In law, Germany had some of the strongest protection possible for voting rights. Preferential shares could have no votes, but by their nature the financial disadvantages to issuers, and ordinary shareholders, would place an automatic check on the number of those issued.

So by 2007, according to the *Report on the Proportionality Principle in the European Union*, vanishingly few German companies had capital structures that removed votes from shareholders. Only BMW, MAN, RWE and Volkswagen were found to have nonvoting preference shares, 77 per cent of all German companies had no control enhancing mechanism at all, though 35 per cent of large companies employed one to three.\(^{67}\) This said, it is very unclear why the EU Report’s definition of ‘control enhancing mechanism’ did not include the two-tier board system. It is a control enhancing mechanism. If you elect someone directly, he or she will be more responsive to you than if you elect someone who then votes for you. But the Report’s authors probably did not wish to risk offending anyone. The irony is that mandatory removal rights for the general meeting in the UK, combined with the organisation of institutional shareholders, resulted in a more perfect guarantee of equal votes in substance, than the German law which guaranteed equal votes in form.

**(3) United States: the federal dissolution**

If the UK reached one-share, one-vote through a market led by the bargaining power of institutional shareholders, and Germany reached it through law, the US exemplified a recurring conflict between a market in disequilibrium and law reform. During the 20\(^{th}\) century, progressive democrats continually sought legal regulation, while the market continually threatened to separate

\(^{65}\) OC Brändel, *Großkommentar AG* (4th edn 1992) §12, Rz 31. Like RWE there were, however, large and prominent exceptions.


\(^{67}\) ISS, Shearman & Sterling and ECGI, *Report on the Proportionality Principle in the European Union* (12 June 2007) 47-49. 77% of German companies have no CEM, with 35% of large companies having one to three CEMs. Only four companies have nonvoting preference shares, BMW, MAN, RWE (under 10%) and Volkswagen (27%). The Porsche and Piech families own 50% of VW’s cash flow rights. VW has a 20% voting ceiling, from the Volkswagen law. There is one cross holding, with Allianz holding a 9.4% stake in Münchenner Rückversicherungs which in turn has a 5% stake in Allianz. 25% of large companies have a shareholder with over 20% of shares, compared to 65% of recently listed companies.
shareholders from votes.

In the republic’s earlier years, the democratic culture was strong enough that it appears no significant companies required a threshold investment before members acquired a vote. While the Bank of England or the Prussian Bank excluded all small, private investors from a voice, the debate over the Bank of the United States in 1790 was searching, and representative of US opinion. Larger investors were pressing for more of a voice, but there was a general public aversion to monied dominance. The Treasury Secretary, Alexander Hamilton, argued for a graduated voting system.

A vote for each share renders a combination between a few principal stockholders, to monopolize the power and benefits of the bank, too easy. An equal vote to each stockholder, however great or small his interest in the institution, allows not that degree of weight to large stockholders which it is reasonable they should have, and which, perhaps, their security and that of the bank require. A prudent mean is to be preferred.

If the federal government was finding a ‘prudent mean’, the states’ practice varied widely. Merrick Dodd’s study of Massachusetts up till 1860 suggested that a general standard of a ten vote limit prevailed in most kinds of company. John Cadman’s study of New Jersey suggested that only 15 per cent of companies between 1796 and 1867 deviated from a one-ordinary-share, one-vote standard. This was so even though the New Jersey Supreme Court had set the default principle as equal rights among shareholders. Joseph Blandi found more levelling in Maryland, with 40 per cent of charters issued between 1849 and 1852 instituting voting ceilings. Alexander Dreier found in Connecticut that 85 per cent of charters issued between 1789 and 1856 adhered to a one-ordinary-share, one-vote norm. In New York, the Manufacturing Corporation Law 1811 set the one-ordinary-share, one-vote as its standard for free incorporations.

As well as patterns within states, there were patterns within enterprise sectors. Colleen Dunlavy found that the railways, often operating across state boundaries, had more voting

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68 CA Dunlavy, ‘Corporate Governance in Late 19th Century Europe and the US: The Case of Shareholder Voting Rights’ in KJ Hopf, H Kanda, MJ Roe, E Wymeersch and S Prigge, Comparative Corporate Governance – The State of the Art and Emerging Research (OUP 1998) ch 1, 5, 24, ‘no corporate charter in the antebellum United States, to my knowledge, ever failed to give the smallest shareholder one vote.’
69 A Hamilton, Report on a National Bank, communicated to the House of Representatives (14 December 1790)
70 EM Dodd, American Business Corporations Until 1860 (1954) 203 ff
72 Taylor v Griswold, 14 NJL 223, 27 Am Dec 33 (1834) per Hornblower CJ, ‘Every corporator, every individual member of a body politic, whether public or private, is, prima facie, entitled to equal rights.’
73 JG Blandi, Maryland Business Corporations 1783-1852 (1934) 65-69
ceilings, at least in the earlier years. Henry Hansmann and Mariana Pargendler's study divided its analysis between turnpikes, bridges, canals, railroads, banks, insurance and manufacturing companies. It found that infrastructure projects tended to employ more restrictions, while in manufacturing (probably following the New York law) they were almost absent. Amidst the variety, however, it is clear that by the end of the 19th century, like in the UK, the practice of vote restrictions had eroded almost entirely. Delaware's first General Corporation Law in 1883 left it up to a company's bylaws, but its revision in 1897 provided for one-ordinary-share, one-vote.

Why did voting limits exist at all, and why did their use diminish? Dunlavy viewed the changes as symptomatic of a democratic society's descent into the plutocratic power of American capitalism. By contrast, Hansmann and Pargendler viewed the shift as responding to consumer protection needs. In earlier times, consumer protection was sparse, and so shareholder voting restrictions could be conceived as a way to ensure shareholder interests did not overpower the users of a service, who would often be the smaller investors. Modern consumer regulation and competition law made voting restrictions less necessary. Dreier characterised the shift as corresponding to the changes in the American public perception of the corporation: going from a public and political institution, to a private and an economic one. Although the risks of exploitation, and the efficient development of institutions, were also probably contributing factors, to Dreier corporations were perceived more and more as private entities, and regulation became more particularised to restrain the power of corporate insiders.

All of these views seem partially correct, but of course the biggest change was that the charters, and their terms, were simply becoming less of a political business, and more of a market. While a state based affair, the standard was closer to one-person, one-vote, and this seemed natural, as Dreier or Hansmann and Pargendler implied, when corporations were carrying out quasi-public functions in a primitive regulatory environment. But as free incorporation spread, the market pushed to one-share, one-vote not because companies stopped fulfilling public duties or the public's perception shifted decisively. 'Plutocracy' may go too far, but by the late 19th century there was an undeniable accumulation of wealth, and with it bargaining power, in

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75 Dunlavy, in Hopt et al (1998) ch 1, 5, 17-21
77 Some companies would keep their graduated voting practices. In Providence & Worcester Co v Baker, 378 A 2d 121 (Del 1977) the company's graduated voting, meant that Penn Central held 28% of shares but only 3% of voting power. It was held valid by the Delaware Supreme Court. This is an interesting contrast to Pender v Lushington.
78 Delaware General Corporation Law 1897, article 9, section 6
80 Hansmann and Pargendler (2013) 54
81 Dreier (1995) 52-54 and 77

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the hands of boards and financiers.

The detailed historical studies of shareholder voting rights usually end in the 19th century, but the ‘democracy of the dollar’ was anything but the end state. If this was ‘plutocracy’, it was about to get much worse. A common reference point is that in 1898 the International Silver Company issued ordinary stock that would have no votes until 1902, and thereafter only restricted votes. By 1925, according to a study by WHS Stevens, there had been 16 issues of nonvoting shares in 225 companies, sometimes with no votes, sometimes with the right to vote limited to set questions. This gradual drift beyond plutocracy was jolted when the Dodge Motor company, whose fraternal owners had recently deceased, was taken over by the investment bank, Dillon Read & Co. Retaining the power in management, the bank made a massive $160m share issue, every one of them nonvoting, and they were bought.

There was a swift public outcry. But if voteless shares were so bad, why were investors buying them? The plain answer is that shareholders were offered terms they could either take, or leave, but not negotiate. Small retail shareholders, who had multiplied significantly with post-war prosperity, had no bargaining power. The eventuality of bad governance would seem far away compared to the prospect of a quick boom-time buck. So people would buy voteless shares. It was clear, therefore, that one-share, one-vote was not a standard that could be accurately described as market-mimicking. Without any influence in the marketplace, people’s objections moved into politics.

Those objections were best represented by William Ripley, in a speech to the New York Academy of Political Science on 28 October 1925. Actions like those of Dillon, Read & Co ‘strike at the very tap-root of our capitalistic system’, he said, where ‘it is the fundamental principle, interwoven throughout all human relationships that power and responsibility must ever be yoked together.’ The divorcing of ownership and accountability, together with the fact of diffused shareholding among ordinary employees and consumers led to the net result.

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82 C Rohrlich, ‘Corporate Voting: Majority Control’ (1932-1933) 7 St John’s Law Review 218
83 WHS Stevens, ‘Shareholders’ Voting Rights and the Centralization of Voting Control’ (1926) 40(3) Quarterly Journal of Economics 353, 355 and 361, where a table sets out the number of companies and percentage of shares in which those companies are non voting.
84 The same Dodge brothers as appear in the notorious Dodge v Ford Motor, 204 Mich 459, 170 NW 668 (Mich 1919)
85 See ch 3/2(a)
86 William Z Ripley (1867-1941) was a complicated figure, which probably accounts for him being less well known, despite the resonance of his work today. He was an overt xenophobe, viewing both black people and women as less than competent to exercise political rights. After the Wall Street Crash, which many people credited him with predicting, Ripley suffered a series of nervous breakdowns, and retired in 1933.
of an absolute control by intermediaries - most commonly bankers, so-called - in place of the former responsibility for direction which, theoretically at least, rested upon the shoulders of the actual owners.

Ripley viewed dispersed shareholders as inert, content to give up power to boards. But the vote was still critical in his view because ‘at worst, they might always be stimulated to assert themselves’. A key objection appears to have been that shareholders were being issued with products that, although represented as shares, were in fact bonds. Ripley’s favoured plan was an interim expansion of the Federal Trade Commission’s jurisdiction, or general federal legislation. Ripley was published in the New York Times, poems were written, and he was invited by Calvin Coolidge to the White House. The shift in public opinion culminated with the New York Stock Exchange making a policy statement on 27 January 1926. They would ‘give careful thought to the matter of voting control’.

Although weak by itself, the NYSE’s reaction was not alone. AA Berle argued that collective action by shareholders was difficult, but having votes at all was necessary so that ‘there is always a latent power which can be exercised whenever the majority chooses to act.’ If new categories of shareholders were becoming disenfranchised, and effectively morphed into hyper-risk bearing bondholders, there ought to be more stringent duties accompanying the possession of ‘management shares’. They would owe duties analogous to trustees in relation to the cestui que trust: the holders of voteless shares, because they stood in charge of other people’s money.

Ripley himself went on to write Main Street and Wall Street, with an introduction by President Woodrow Wilson. Directors were said to fall under a personal responsibility for their actions, to rehabilitate the individual to its voice and place in society. Ripley’s thesis traversed all forms of companies, railway networks to public utilities. He highlighted the destructive process

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88 WHS Stevens, ‘Stockholders’ Voting Rights and the Centralization of Voting Control’ (1926) 40(3) Quarterly Journal of Economics 353, 383 made the objection that while bondholders claims to interest would be enforceable, the voteless shareholder has no enforceable right.

89 New York World, ‘On Waiting in Vain for the New Masses to Denounce Nonvoting Stocks’ (1926)

90 ‘Then you who drive the fractious nail,
And you who lay the heavy rail,
And all who bear the dinner pail
And daily punch the clock -
Shall it be said your hearts are stone?
They are your brethren and they groan!
Oh, drop a tear for those who own… nonvoting corporate stock.’ Reprinted in WZ Ripley, Main Street and Wall Street (1927) 127; also Trusts, Pools and Corporations (1916)


92 Berle (1925-1926) 39 Harvard Law Review 673, 681, ‘It has been almost universally true, since development of courts of equity, that a person having the control of property, the beneficial ownership of which belonged to another, was not permitted to exercise such control except for the benefit and with due regard to the interests of the beneficial owner.’

92 WZ Ripley, Main Street and Wall Street (Little, Brown & Co 1927)
of regulatory competition that was taking place in state corporation laws. As he soberly put it, ‘The little state of Delaware has always been forward in this chartermongering business.’

The 1920s had changed the political discourse enough so that, when the Wall Street Crash and the Great Depression unfolded, there was already a democratic consensus about the need for federal regulation. The Securities Act 1933 and the Securities and Exchange Act 1934 essentially implemented Book III of Berle and Means’ *Modern Corporation and Private Property*. This legislation did not address shareholder voting rights directly, though the 1934 Act §14 addressed the proxy process. Instead, under §19 the New York Stock Exchange was subjected to oversight by and the veto power of the Securities and Exchange Commission in amending its rules. A responsive regulator was seen as the federal solution. It provided backing for the one-share, one-vote policy.

So it was not state laws, but federal regulation that protected shareholders having votes. The line of the NYSE hardened on 7 May 1940 when in a ‘Statement of Listing Requirements as to Preferred Stock Voting Rights’ it confidently proclaimed: ‘Since 1926, The New York Stock Exchange has refused to list non-voting common stock.’ No federal legislation was passed mandating votes, although the Investment Company Act of 1940 §18 required the capital structure in investment companies to be one-share, one-vote for common stock. For the next forty years, the NYSE appeared to police voting rights. It made exceptions such as for the Ford Motor Company in 1956, which gave class B family stock 40 per cent of the votes, while holding merely 5.1 per cent of equity. Joel Seligman has criticised the NYSE’s record, because it never fully made clear what its policy actually was, rather than merely reacting to a perceived threat of legislation.

During the 1970s, a concern with deviations from share equality, and especially disproportionate influence of large shareholders went to the US Supreme Court. In *Salyer Land Co v Tulare Lake Basin Water Storage District*, it was argued that any weighted voting, in this case toward landowners, violated the Thirteenth Amendment’s equal protection clause. Justices Douglas, Brennan and Marshall supported this view, because it was a water company that performed ‘governmental functions’. ‘The weighting of votes,’ wrote Douglas J, ‘according to one’s wealth is hostile to our system of government.’ But the majority did not agree, and so the matter was suspended as a constitutional issue.

The NYSE’s ability to regulate the internal governance of listed companies was partly

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93 Ripley (1927) 30.
96 410 US 719 (1973)
dependent on it exercising a de facto network monopoly on listing services. But in the early 1980s, it was threatened with new competition from AMEX and NASDAQ. They did not require votes attached to shares. Beyond the exchanges themselves, companies across the US were being threatened by hostile takeover bidders. The jobs of both the NYSE board, and the boards of companies were at stake. Warding off takeovers by manipulating votes was perceived as necessary. In 1985 the NYSE chair, John Phelan, testified before a Congressional subcommittee on Energy and Commerce. ‘Philosophically,’ he began, ‘the Exchange continues to believe in “one share, one vote.”’ But, he said, his new competitors permitted listings on terms more to some companies’ tastes. Stocks were shifting fast.\(^\text{97}\) In 1986, the NYSE sought formal approval from the Securities and Exchange Commission to abandon one-ordinary-share, one-vote from its rules, as required by the Securities and Exchange Act 1934 §19.\(^\text{98}\) In lieu of formal amendment, the NYSE communicated that the rule ceased to be enforced. Then General Motors issued shares with half votes. By 1986, 170 of the 4886 companies on Nasdaq and Amex had dual class capital structures.\(^\text{99}\) In the next two years, 46 NYSE companies issued nonvoting shares.

Federal regulation was now in dissolution, and the market was moving toward disenfranchisement. As German courts had in the 1920s, US courts did react, but with judgments that essentially legitimised voteless shares as an exercise in private autonomy. In *Unilever Acquisition Corp v Richardson-Vicks, Inc*, the US District Court in New York granted an injunction when the management purported to create a super-voting class but no shareholder vote was taken.\(^\text{100}\) In *Lacos Land Co v Arden Group, Inc*,\(^\text{101}\) the CEO had proposed issuing ten vote shares with reduced dividends. Every shareholder could exchange their present shares, but none did. In response to the bidder filing a suit, Chancellor Allen held that while dual class capital structures were not novel (as their popularity with management grew at the start of the century),\(^\text{102}\) the plan was ‘coercive’. It was underpinned by the threat to shareholders that the CEO would oppose transactions by the company unless it was approved. It contained a veiled threat to present shareholders that they would be worse off than they were before.\(^\text{103}\) But with procedural integrity,


\(^{98}\) Securities and Exchange Act 1934 §19(c) (15 USC 78s(c))

\(^{99}\) Seligman (1986) 707

\(^{100}\) 16 F Supp 407 (1985)

\(^{101}\) 517 A 2d 271 (Del Ch 1986)

\(^{102}\) Referring to *General Investment Co v Bethlehem Steel Corp*, 87 NJ Eq 234, 100 A 347 (NJ Ch 1917) ‘thanks to its potential as an anti-takeover device, [dual class capital structures] recently emerged from the reaches of the corporation law chorus to strut its moment upon center stage where corporate drama is acted out.’

\(^{103}\) JH Choper, JC Coffee and RJ Gilson, *Cases and Materials on Corporations* (7th edn Aspen 2007) 590. Arguably this interpretation offered by the authors would be better if it recognised that the most relevant factor to the coercion here, is the position of vulnerability that a stockholder is in, relative to the management. For an analogous decision in the UK on actual undue influence (which functions in the same way as duress, or the American ‘coercion’) see *Daniel v Drew* [2005] EWCA Civ 507, regarding a threat to a trustee, who was an old lady, to reduce rent for the beneficiary or she would be taken to court.
and duress aside, the courts did nothing to restrain the substantive misuse of power that voteless shares embodied. To deal with the matter, the courts would have had to presume the practice was unfair, unless a shareholder could be regarded as having equal bargaining power with a board.

From the beginning, those like Joel Seligman argued that the issue of disproportionate voting stock was like price fixing, that it should and could be banned by the SEC. Unsurprisingly, this view was disputed. In 1988, the SEC attempted to re-regulate with a new Rule 19c-4. This barred all exchanges from listing or authorising common stock ‘with the effect of nullifying, restricting or disparately reducing the per share voting rights of an outstanding class or classes of common stock’, except when a corporation went public.

Immediately an injunction was sought, and in The Business Roundtable v SEC, the DC Appeal Circuit held it was ultra vires for the SEC to regulate voting rights. It characterised the general purpose of the securities legislation as regulating to ensure ‘investors secured enough information’ and ‘not the fairness of the issuers’ corporate structures’. This position of the DC Circuit judges seems extremely peculiar given that the Securities and Exchange Act 1934 §2 stated its purpose as being to ‘insure the maintenance of fair and honest markets’. The case might have been the end, but four years later, shortly after a change in government, and with the calming of the takeover climate, the SEC, NYSE, AMEX and NASDAQ all entered an agreement to implement Rule 19c-4. Coffee, Choper and Gilson suggest that the agreement reflected the fact that the competitor exchanges were now established, dual class voting structures had become less important to managements, and institutional investors were now actively resisting new changes.

The agreement was, however, less demanding than the NYSE policy of 1926. Despite the Listing Manual’s exhortation in §301 about the ‘Exchange’s long-standing commitment to encourage high standards of corporate democracy’, according to its statement of voting policy, ‘Voting rights of existing shareholders of publicly traded common stock registered under Section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issuance.’ The definition of ‘disparately reduced’ allowed up to ten votes per share. In 2007,

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104 Seligman (1986) 714-715.
106 The latter exception came after a submission from Ronald Gilson. It is not clear why IPOs differed, if the objection to distorted voting rights was that it hindered the accountability of directors.
107 905 F 2d 406 (DC Cir 1990) at 411-413, ‘In 1934 Congress acted on the premise that shareholder voting could work, so long as investors secured enough information and, perhaps, the benefit of other procedural protections. It did not seek to regulate the stockholders’ choices... [and] not the fairness of the issuers’ corporate structures.’ It is not clear why the court took this position, given that §2 of the SEA 1934 states its purpose, among other things, ‘to insure the maintenance of fair and honest markets’.
108 15 USC §78b.
the ISS and Shearman & Sterling Report found that 869 out of 4399 US companies had dual class shares, while 24 used voting ceilings. It may be recalled once more that the Report’s definition of ‘control enhancing mechanisms’ did not include a two-tier board and intermediated removal rights. But this aside, by 2007 it appeared that US companies had moved in front of those in every EU member state for the ability of a class of shareholders to enhance their control.¹¹⁰

There was one check on disenfranchisement. Large institutional investors, notably the public pension and trade union funds, had become active in pushing for the one-share, one-vote standard.¹¹¹ The timing and contrast to the UK is interesting because, as chapter 6(3)(b) will show, it was only by 1997 that the proportion of individual investors in the US share market dropped below 50 per cent. The UK had reached this point in 1967 when the Jenkins Report was released.¹¹² While boards and institutions might have previously sought to concentrate voting power into fewer hands, to exclude the mass of retail investors, they now held a majority interest. It could probably be expected that institutions, like they had in the UK, would find an increasingly common position favouring voting equality, at least among themselves.

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The evidence of change in shareholder voting rights strongly supports the two positive theses. First, progressive democrats, though incompletely by their own standards, drove legal reform. Most notable were Wilson, Ripley and Berle during the 1920s in the US, the German Legal Academy in 1931, and (although the case was won through regulatory pressure, not statute) LCB Gower in the minority of the Jenkins Report. Second, when specific regulation was absent, it seems plain that bargaining power became decisive, but this could lead to any outcome. In the UK it allowed institutional shareholders to perfect the policy of one-share, one-vote. In Germany, banks’ bargaining power led a disastrous concentration of economic might in the hands of insider shareholders during the 1920s. In the US, a similar result looked very likely in the 1920s, though the meltdown was restrained by uneasy settlements among federal regulators. All this said, overall, and with many qualifications (especially in the US), the results of law reform might be regarded as reasonably successful, at least if the task had been to enfranchise the registered shareholder alone.

¹¹¹ eg CalPERS, Global Principles of Accountable Corporate Governance (2010) Principle A.4
¹¹² See the charts at ch 6(1)(a) and 6(3)(b)
But the goal of voting rights regulation cannot be viewed in a 21st century environment of institutional shareholding in the same way as in 1920s or 1930s. Then, many small retail investors bought shares directly. The concern which underpinned the progressive democratic drive for one-share, one-vote was always explicitly directed, in the words of the Public Companies Act 1767, against the ‘few, and those perhaps temporary Proprietors’, against Passow’s ‘big players’, and against, as Ripley put it, ‘intermediaries - most commonly bankers’. Now, asset managers and banks have become the beneficiaries of the very one-share, one-vote policies that originally challenged their hegemony. This has fuelled the view (especially on the academic left, and not without justification) that shareholder voting rights are dangerous and what can be done with them should be limited.\(^{113}\) But now the issue cannot be confined to shareholder rights alone. Were the true contributors of capital, the ultimate investors being enfranchised as well? The two positive theses both stress that no interest group can be said to have pursued its goals in a fully rational manner. To understand just how true this is, to grasp the separation of contribution and participation in its modern form, it is necessary to look further than the shareholder, and to pierce more than the corporate veil.

\(^{113}\) Notably in the last year, LE Strine, ‘Can we do better by ordinary investors? A pragmatic reaction to duelling ideological mythologists of corporate law’ (2014) 114 Columbia LR 449 and S Deakin, ‘Against Shareholder Empowerment’ in J Williamson, C Driver and P Kenway (eds), Beyond Shareholder Value (TUC 2014)
6. PIERCING THE INSTITUTIONAL VEIL

By the late 1960s, regulation of director elections and shareholder voting had genuinely mitigated some central problems of corporate accountability, but only if people held shares directly. How would a world of institutional shareholders be shaped, if the successes of modern company law were not to be undone? As a younger man, Adolf Berle had believed that economic power could be revolutionised, and ‘labour could control’, through a system of employees owning the shares of their workplaces. At some point Berle must have realised that, because shareholders need to diversify, employee share schemes per se were not his answer. His career’s formative work shifted to shareholding generally, opposing ‘bankers’ control’, and attacking, as a third plank of unaccountable corporations, intermediaries who ran ‘voting trusts’. As he reached retirement, Berle saw at least two possibilities from the rise of pension, insurance and mutual funds. First, they might ‘remove the individual further still from connection with or impact’ on corporate management. But second, ‘the stockholder position, though having lost its ancient justification, could become a vehicle for rationalized wealth distribution’ serving the ‘ideal of a just civilization.’ Perhaps retirement savings, promoted with collective bargaining and ‘tax policy or some other device’ contained seeds of the ‘revolution’ he and progressive democrats always sought. But if it became true that more people had a stake in the corporate economy than ever before, if it became true that ordinary people’s retirement savings would form the primary contributions to corporate equity, what would happen to participation in corporate governance?

Of course, retirement savings are not the only source of institutional investment. But they have become the most important. A typical investment chain looks like this:

Employees/Individuals → Pension fund/Life insurance company/Mutual fund/Corporation → Asset manager/Bank/Broker → Custodian/Nominee → Company director

The chain starts with employees and other individuals giving money to pension, insurance, and mutual funds, or a (usually) corporate employer. Pensions are obviously for retirement, but other institutions often are too. Insurance companies mostly invest life insurance money. Mutual fund

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3 AA Berle and GC Means, The Modern Corporation and Private Property (1932) Book II, ch 1, 129-131
4 AA Berle, ‘Property, Production and Revolution’ (1965) 65 Columbia Law Review 1, 18 and 14
5 Berle (1965) 65 Columbia Law Review 1, 18
6 Berle (1965) 65 Columbia Law Review 1, 9-10 and 17
clients are often saving for old age, and are just more affluent, or they are pensions and life insurance firms. Corporate shareholders, notably in Germany and other EU countries, mostly have capital to invest because the law allows them to utilise the balance sheet surplus from self-investing their workers’ pensions. The causes of ownership structure have been intensively debated for twenty years. But it does seem very likely, as at least one author has mentioned, that state and private pension policy is intimately connected with ownership structure overall. If so, it was largely the consequence of a conscious policy to flood the market for shares with workers’ capital.

But regardless of ownership structure, how did participation rights evolve? The first positive thesis suggests progressive democrats would promote the participation rights of ultimate contributors, albeit incompletely. In practice, the incompleteness dominates because the underlying economic shifts are comparatively recent. Legal development is in its infancy. The first development, though not wholly novel, is that financial institutions have assumed the mantle of ‘stewardship’, codified in duties about their use of shareholder voting rights. A second development is the spread of legal rights of beneficiaries to vote (directly or through a union) for pension trustees. However, because pension trusts frequently delegate investment oversight to asset managers (like retail shareholders asking banks for custodial services) they give up voting to their stewards. No country has a coherent model yet, and there is disarray across pension types and economic sectors. Only recently, a third set of potential strategies has entered discussion which could unify participatory accountability throughout the investment chain. Asset managers and banks can be subjected to voting instructions, or have their stewardship role removed altogether, or be required to staff governance departments with elected representatives.

The second positive thesis is that, when left to the market, the bargaining power of economic actors shapes the outcomes, whether the results are beneficial or arbitrary. There can be very little doubt about this. The appropriation of economic power by asset managers and banks has been achieved through standard form contracts. It is true that centralisation of voting power develops economies of scale, which is probably positive in itself. But the accompanying result, that people have been quietly disenfranchised to a staggering degree, is far more difficult to rationalise. This market outcome is what has been codified in law under the guise of the

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7 See the charts at ch 6(1)(b), 6(2)(b) and 6(3)b) for the categories used by the statistical authorities. In the more minor categories of emergent shareholder, hedge funds are originally mutuals for very wealthy clients, but now often have pension funds or other asset managers as clients. ‘Sovereign wealth funds’, when they are not the natural resource hordes of authoritarian regimes, are often pensions, as in Norway or Japan.


‘stewardship’ strategy. The only counterweight has been the gradual, but ever more conscious organisation of ordinary savers, employees, and unions, to take back the power that their contributions to equity create. This has served as the main inspiration for the progressive democratic vision of the future of corporate law.

(1) United Kingdom: conservative codetermination

The development of participation rights for the ultimate contributor began in the UK long before asset managers became the stewards of corporate governance. Today the UK has one of the most collectivised shareholding structures in the world, with only around ten per cent of individual share ownership. A century ago it looked much like any other country. Although there was already significant dispersion among smaller investors, at the core it was dominated by directors and old family interests, who held controlling blocks of shares. Between 1900 and 1910, company directors probably owned over half a typical company’s shares. Outside this charmed circle, most people had no savings, let alone investments. A handful of pensions had existed in the 19th century for employees in the civil service, the waterways, the railways, shipping, banks and insurance companies. A trade union could also have set up a mutual benefit scheme, but these were fewer than might be expected since agreements with unions tended to be unenforceable. Pension money administered by employers was not always kept in a separate fund, risking the lot in insolvency. Even if a fund was separated, a perpetual risk of mismanagement by the employer or the union remained. At the turn of the century, only about

10 See below, ch 6(1)(b)
13 J Franks, C Mayer and S Rossi, ‘Ownership: Evolution and Regulation’ (2009) 22(10) Review of Financial Studies 4009, 4029-4030 and 4041 show that from a sample of 40 companies incorporated in 1900, directors owned 92.76% of shares, falling to 53.61% by 1910 and that 56% of shareholders lived within 6 miles of the city of incorporation. Obviously, if a business had only just gone public in 1900, it would take some time before the prior owners sold off their stakes.
14 Superannuation Act 1834 (c 24) eliminated the rights that civil servants had apparently acquired in their offices, to sell onto successors, and substituted a pension claim against the Treasury, which came to be two thirds of income. The Superannuation Act 1859 (c 26) benefits were fixed at 1/60 of salary per year, with up to 40 years of contributions.
15 The waterways produced the first formal pensions in the private sector, for lock-keepers on the River Lee. Deductions of 2 shillings a week provided 10 shilling a week pensions, Hannah, infra (1986) 10, citing the Minutes of the Committee of Trustees of the River Lee (8 January 1821) in PRO Rail 845/9.
16 Report of Lord Rothschild’s Committee (1898) Cmnd 8911, 151-153, union pensions that existed were based on (a) years in the union (b) 5s per week as a typical sum for those turning 55 or 60, but more for long members (c) could be contingent on the society’s vote, or incapacity to work (d) some prohibited from working while getting their pension, except perhaps light work (e) little, if anything, was available for women.
17 See Trade Union Act 1871 s 4. See also S Webb and B Webb, Industrial Democracy (1920) Part II, ch 2, 154-155
18 The Great Western Railway Enginemen and Firemen’s Mutual Assurance, Sick, and Superannuation Society was established in 1865. Enrolment was compulsory. The workers ran the scheme themselves, but by 1890 the payouts exceeded the contributions. The company was unwilling to bail out the scheme without taking more control. They employed an actuary,
5 per cent of the population had pensions.\textsuperscript{20} In 1905 around 25,000 out of 2.1 million people aged over 65 received pensions.\textsuperscript{21} Old age was impoverished, and corporate governance was much more simple, because retirement did not yet exist.

(a) Inventing retirement\textsuperscript{22}

Everything changed in a dozen years from the 1906 general election. The Old Age Pensions Act 1908 established the ‘first pillar’ of the modern retirement system.\textsuperscript{23} The state pension allowed those who had less than £31 and 10 shillings a year and were over 70 years old to collect five shillings a week (or £13 a year) from the Post Office.\textsuperscript{24} The money that funded the state pension was never set aside in a separate account of Her Majesty’s Treasury, but was paid out of general tax revenue. This meant there was no investment money that might matter for corporate governance.\textsuperscript{25} The state pension was designed as a means-tested minimum benefit. Implicitly people were expected to maintain their living standards (if they lived to retire) in other ways. The ‘third pillar’ of pensions had always existed: private savings, where a portion was destined to reach the share market by direct purchase, or through a life insurance policy or mutual fund which invested in shares on the saver’s behalf. In between was the ‘second pillar’ that became crucial for most working people. This was occupational pensions, which were highly dependent on the growing trade unions.

The Trade Disputes Act 1906 assured unions the freedom to take collective action for the purpose of a trade dispute, and so placed employees in a better position to bargain for old age benefits. But initially unions distrusted occupational pensions. Employers controlled them and threatened strikers with withdrawing benefits.\textsuperscript{26} A turning point came with the Trade Boards Act 1918. The Ministry of Labour used its power to regulate wages to make employers agree with unions to form Joint Industrial Councils, regional councils, and local work programmes. They would consult upon all workplace issues, including in pensions.\textsuperscript{27} An early example of participation in pension plan management, which served as a model, appeared in a Birmingham

\textsuperscript{20} L Hannah, \textit{Inventing Retirement: The development of occupational pensions in Britain} (CUP 1986) 13
\textsuperscript{21} LCG Money, \textit{Riches and Poverty} (1911) 266 and \textit{Old Age Pensions, Tables which have been prepared in ConneXion with the Question of Old Age Pensions with a Preliminary Memorandum} (1907) Cmnd 3618, 20
\textsuperscript{22} This heading is gratefully adopted from the leading work by L Hannah, \textit{Inventing Retirement} (CUP 1986)
\textsuperscript{23} The ‘three pillar’ classification of pensions is mirrored in the Pension Schemes Act 1993 s 1. I will call the state pension the first pillar, occupational second, and personal third, because this is the order of accessibility for most people and is in line with the common parlance in the European Union. Sometimes the numbers are different, but ‘public, social, private’ is the basic idea.
\textsuperscript{24} Old Age Pensions Act 1908 ss 1-2 and Sch 1. Those with over £21 a year had a reduced benefit.
\textsuperscript{25} A number of contemporary ‘sovereign wealth funds’ do just this.
\textsuperscript{26} Hannah (1986) 26, giving the example of pensions being withdrawn after the 1912 Port of London strikes.
\textsuperscript{27} nb ‘Joint decision making’ translates into German as ‘Mithbestimmung’, and translates back into English as ‘codetermination’.
chocolate factory. At Bournville as early as the beginning of the century Works Committees were established whose duties were largely concerned with the promotion of the employees’ welfare, and many measures were taken tentatively in extending a democratic policy which enabled the worker to take a larger share in the control of affairs. The administration of pension funds by trustees representing both sides, the recognition of the necessity of self-control by the workers of the various clubs and works societies, and the establishment of committees for frank consultation with employees in regard to new measures affecting the works as a whole - all indicate the pursuit of this policy.

Crucially, these pension funds were trusts. Equity would see workers as beneficial owners. This made it more natural to think that workers had a right over the management of ‘their’ money. A competing model, particularly from the early 1930s, came from the insurance industry. Before, individual insurance policies were sold in smaller numbers. But in 1927 the Metropolitan Life Insurance Company of New York entered the market, selling group insurance policies to employers. Its office windows at Bush House, on London’s Aldwych, were emblazoned with displays of ‘Fear of Old Age’. UK insurers copied the group plans and competed successfully. As well as picking up more employer mandates, life insurance policies were sold door to door and became very popular.

Insurance was a clean functional substitute for a pension trust. However, the formal legal analysis was that insurance was a contract. Upon the payment of policy instalments to the insurance company, proprietary title to the funds was presumed to pass.

The law did not support policyholders in pointing to the insurer's accumulated funds and saying either wholly or in part “that money is ours”. This was true even though in economic substance the policyholder might retain identical expectations to the beneficiary of a pension trust. It followed that participation in administration of funds held by an insurance company could seem slightly more problematic to the legal imagination.

28 Bournville Works, A Works Council in Being (1922) LSE Archives, HD5/118.
30 Hannah (1986) 33
31 Carter v Boehm (1766) 3 Burr 1905, per Lord Mansfield
32 Kelly v Solari (1841) 9 M&W 54, a widow was mistakenly overpaid under her late husband’s life insurance policy. She was not entitled to it because the husband failed to pay a final premium instalment, so the insurance company could recover the property in what is now recognised to be unjust enrichment.
33 cf Equitable Life Assurance Society v Hyman [2000] UKHL 39, the House of Lords held that terms would be implied into contracts to fulfil the parties' reasonable expectations, namely that the insurer's management would not use its discretion to reduce the bonuses of guaranteed annuity rate policyholders to subsidise the income of current annuity rate holders.
Pension funds organised as trusts were still more common. They were supported by the Finance Act 1921, which gave tax exemptions to trust based schemes. Actuarial advisers also preferred them. The incidence of participation in trust administration by the beneficiaries, however, appeared to follow the fortunes of the Ministry of Labour. A strong union, and a Joint Industrial Council helped. In 1931 the General Secretary of the Transport and General Workers’ Union, Ernest Bevin, organised a plan for flour mill workers. It employed Prudential, but only to insure the employer’s commitments, not to provide the benefits themselves. The pension asset managers were appointed by the union and employer through the Joint Industrial Council.

In the 1930s union attitudes swayed in favour of occupational pension plans. Between 1929 and 1931 unions failed to persuade the Labour government to improve the state pension, and they sought an independent alternative. By 1938, the numbers of people covered by occupational pensions were still relatively low, at 1.6 million employees. After the Second World War, while Ernest Bevin had been in the Cabinet, the number of people with trade union representation had grown significantly and so did occupational pensions, by around half a million a year. By 1958, there were 4.3 million people with pensions working for private sector employers, and 3.8 million people with public sector or nationalised employers.

Up to this point, pensions had not really mattered for corporate governance. The old view prevailed that company shares were financially risky investments. To comply with the trustee’s duty of care, the care ‘an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide,’ it might also be legally risky to invest in equities. The Trustee Act 1925 had listed the legitimate investments by a trustee as including securities of the British and Indian governments, and of railway companies, but little else. Individual trust deeds could always override default legal expectations, but legislation shaped the market expectation that company shares were avoided.

As occupational pensions grew more, the Trustee Investments Act 1961 changed the

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34 Finance Act 1921 s 32(3)(a)
35 Hannah (1986) 37
36 Hannah (1986) 43
37 eg National Joint Industrial Council for the Flour Milling Industry, Group Pension Scheme as Finally Approved by the Trustees (1 January 1931) LSE Archives, HD9/225. article 3, ‘The Trustees for this Pension Scheme will be appointed by the National Joint Industrial Council for the Flour Milling Industry, and will hold office during the pleasure of the Council.’
38 Hannah (1986) 43
39 Ministry of Labour, ‘Schemes for Providing for Pensions for Employees on Retirement from Work’ in The Ministry of Labour Gazette (HMSO 1938) 172-174
40 Watkinson Committee, National Advisory Committee on the Employment of Older Men and Women, First Report (1952) Cmnd 9333
41 Government Actuary's Department, Occupational Pension Schemes, A Survey by the Government Actuary (1958)
42 Re W's Trustee (1886) LR 33 Ch D 347, per Lindley J
43 Trustee Act 1925 ss 1-11, trustees could also invest in bearer securities and deposit money in banks.
44 Re Harari’s Settlement Trusts, Wordsworth v Fanshawe [1949] 1 All ER 430, a trust deed said the trustees could invest ‘in or upon such investments as to them may seem fit’. Jenkins J held that a plain meaning interpretation ought to be given, despite the ordinary rule that a strict construction should be given to investment clauses.
practice by authorising up to half a trust’s funds to be invested in equities. With trade union growth, this must be seen as one of the two key reasons why, beginning in the 1960s the share of wealth invested by pension funds in the London Stock Exchange began to boom.

The Office for National Statistics’ share ownership figures depict three major shifts. First, by the 1960s, individual ownership of UK shares was in terminal decline. Investment was becoming collectivised. Second, the relative shares held by institutional investors was unstable. From the 1960s until 1982, the rate of pension growth was marked. But growth was halted, and from 1993 pensions’ share went into decline relative to insurance companies and the various mutual fund vehicles offered for private investment by the City. Third, represented in the sharp red line, there was globalisation as the UK opened more to the European Union and the world. Changes in share ownership were important because people who owned more might buy more power. But ownership could also be quite irrelevant for who participated in corporate governance.

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45 Trustee Investments Act 1961 s 1(1) and Sch 1. The Secretary of State was able to increase the default share of equity investment to three quarters, but this was not done until The Trustee Investments (Division of Trust Fund) Order 1996 (SI 1996/845) r 2. Restrictions were dropped altogether by the Trustee Act 2000 s 3, so trustees may make any class of investments that they choose.

46 Unit trusts used to be a favoured vehicle, but grew less popular with the creation of open ended investment companies, which appear to fall under the ‘other financial institution’ category.
(b) British codetermination

By the 1960s, representation of the ultimate contributor in institutional investment was in a parlous state. There was effectively nothing in insurance, or mutuals, and pensions were dominated by employers. The number of occupational pensions had continued to grow, but the system operated informally, outside any statutory framework. From 1971, the Conservative government became attracted to reform of occupational pensions as a way to encourage the growth of private savings over public welfare. Under the Social Security Act 1973 it established a new Occupational Pensions Board, which quickly embarked on a review of existing regulations. Its report discussed ‘member nominated trustees’ in Britain and abroad, noting that in Germany, codetermination of pension and provident funds was required, but that in insurance based retirement schemes participation was excluded. The OPB recommended drafting a code of best practice to endorse parity codetermination, but no legislation.

The successor Labour government returned to the question in 1976 with a White Paper on Occupation Pension Schemes: The Role of Members in the Running of Schemes. It forthrightly endorsed parity employee codetermination of pension management, and recommended legislation. The White Paper’s rhetoric, consistent with Labour’s commitment to union nominated directors that would be found in the Bullock Report and another White Paper in the two years following, was concerned primarily with the ethic of industrial democracy. The justifications for member nominated trustees were, first, the expertise that decision-makers within the workforce could bring and, second, the educational benefits for workers taking part in financial decision making. Corporate governance was not mentioned, but union executives, at least anecdotally,

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47 L Hannah, *Inventing Retirement: The Development of Occupational Pensions in Britain* (CUP 1986) 140, ‘While early pension schemes often had up to half of the trustees representing the members, this soon became rare.’ Two publications, which cannot be located, are cited: Tony Lynes, ‘Pensions in Secret’ (16 January 1969) New Society 88-89. T Lynes, ‘Talking About Pensions’ (June 1972) Industrial Society 7. Hannah goes on to say this. ‘De facto, the great bulk of trustee boards and management committees worked in the interests of the employer. Since, as we have seen, they ultimately depended on the continuing willingness of the employer to fund the benefits, this change was perhaps natural, but that it sat uneasily with the trend to increased democratization and participation in modern society was undeniable.’

48 Government Actuary’s Department, *Occupational Pension Schemes: Third Survey by the Government Actuary* (1967) 8, Table 3, peak of 8.1m membership private, and 4.1m public, total 12.2m, so double private sector in 10 years, total income £1,745m pa, 65,000 private sector schemes.


50 SSA 1973 ss 66-68, later recast by the Pension Schemes Act 1993 Sch 1. The OPB was succeeded by the Occupational Pensions Regulatory Agency, and then reconstituted as The Pensions Regulator under the Pensions Act 2004 ss 1-106.


53 White Paper, *Occupation Pension Schemes: The Role of Members in the Running of Schemes* (1976) Cmd 6514 (1976) Cmd 6514, para 25, ‘It is necessary at the outset to distinguish between matters proper to negotiation through collective bargaining and those to be decided by participative management… investment policy and the discretionary allocation of benefits within agreed guidelines to one individual rather than another, can be the responsibility of participative management. It must be emphasized that the development of industrial democracy is complementary to collective bargaining and not intended to replace or inhibit it in any way.’

54 (1976) Cmd 6514, para 29, ‘Such a partnership gives members of the scheme more confidence in it and a greater sense of security. It can also be expected to give them a better appreciation of the extent of the claims on resources constituted by a
appeared to appreciate the influence they might have if they controlled the assets that their members’ money bought. The White Paper did not endorse direct employee votes, rather than a single channel of union nomination. In Leslie Hannah’s account, it ‘provoked an outcry, focused particularly on the proposed requirement that trade unions should control the selection of member representatives.’ It was not carried through.

But then, curiously, and without a law, major pension schemes found a renewed commitment to employee participation. Varying pension trust deeds, or corporate trusts, was simple enough if the administration was already wholly in the employer’s hands. The White Paper had begun a discussion, and many employers had found no reason to not allow more equal management of pensions. A survey and questionnaire conducted by Tom Schuller and Jeff Hyman, released in 1983, found that in their sample of 120 employers, 57 had instituted employee trustee schemes, 35 since 1976. Only 12 existed before 1970.

Why did codetermination of pensions spread? Partly, the rise between 1970 and 1976 suggests the positive effect that the OPB’s discussion and model. When Schuller and Hyman asked whether pension codetermination was introduced in anticipation of legislation, employers rejected the suggestion out of hand. It was their own initiative, said 84 per cent. Many employers may have genuinely believed themselves to have acted ‘voluntarily’, but this is doubtful. It is impossible to disentangle these developments from the fact that by 1979 union membership peaked at just over 13 million people, and many (though not all) favoured joint management. Everything happened in the shadow of trade union bargaining power.

Pension codetermination signalled a remarkable shift in the culture of the British workplace and management. In 1983, Schuller and Hyman found that pension boards functioned harmoniously, their views did not lead to conflict with advisers, and policy confrontations were few. Although the employee trustees viewed investment and fund monitoring as among their

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56 R Ellison, *Private Occupational Pension Schemes* (Oyez 1979) vol I, 3, in less than impartial viewpoint, ‘union leaders are seen to be preoccupied more with the pressing concerns of control of the massive assets of the funds and direction of investments, than with the safeguarding of their members’ rights and the improvement of benefits.’ Cites Whiteley, Builders May Strike Over Pension Issue (11 February 1974) Guardian; Elliot, Co-op Bank Employees Strike over Pensions (16 April 1974) FT
58 Variation of Trusts Act 1958 s 1
59 T Schuller and J Hyman, ‘Pensions: The Voluntary Growth of Participation’ (1983) 14(1) Industrial Relations Journal 70, 73. At 74-75, of those 57 schemes, there were 3 cases of over 50% codetermination, 16 cases of 50%, 20 cases of 40-49% and 12 of between 33-40% and 6 of under 33% the employee trustees were nominated 14% by management, 12% by management after an employee election, 16% by trade unions, 28% by all scheme members and 21% by pensions committee or consultative committee.
60 (1983) 14(1) Industrial Relations Journal 70, 76
most important tasks, it was here that trustees left detailed decisions to professional advisers most. As they put it,

Trustees operate in a highly consensual manner. This is, indeed, one of the commonly cited reasons why extensive employee participation is possible in this area: once contribution levels are settled, both company and employers have a mutual interest in pursuing the best interests of the members.

By 1991, there were 3000 private sector schemes with trustees elected by employees, and 500 with trade union nominated trustees. In 1993, of large UK occupational schemes 65 per cent had member nominated trustees, and the composition was half each in a quarter of the schemes.

By the early 1990s, union membership was in steep decline. This could have led to employers abandoning member representation, but it was then that legislation on pension participation came. In 1993 the Conservative government asked Professor Roy Goode to chair a report on Pension Law Reform. After various scandals, particularly Robert Maxwell raiding the Mirror News Group pension before falling off a yacht, it was focused on funding, fiduciary duties and plan insurance. But the Goode Report also advocated legislation for participation of scheme members. Trusts were, it said, a sound legal vehicle for ‘protecting the pension promise’. Yet trust law historically gave a general freedom to design any rules for scheme administration. A trust document could allow the employer to nominate every trustee, even in defined contribution (or money purchase) schemes where no risks lay with the employer. So the ability of employers to nominate every trustee appeared unsatisfactory in principle, because members earn their benefits by their work and their contributions. It is their scheme in a very real sense and they have a legitimate interest in its management.

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63 Pension Law Reform (1993) Cm 2342, para 4.5.23
64 G Stapledon, Institutional Shareholders and Corporate Governance (Clarendon 1996) 241. Stapledon also notes that in Australia, the Occupational Superannuation Standards Act 1987 regs 13 and 15 had already required equal member nominated trustees, or one member nominee in schemes with under 200 people.
65 Pension Law Reform (1993) Cm 2342
66 cf Armitage v Nurse [1997] EWCA Civ 1279, which suggests the modern approach is that compulsory terms exist in trusts, and that there is not a complete freedom to opt out of every duty, particularly to act in the beneficiaries interests in good faith. It seems that different kinds of duties would be standard incidents to different categories of trust.
67 (1993) Cm 2342, paras 4.5.15-4.5.18. See also, paras 4.5.19, ‘But however scrupulous the employer may be, there is no substitute for the discipline of another voice in the decision-making process, who can ensure that the employer-appointed trustees do not allow themselves, consciously or unconsciously, to be unduly influenced by the wishes and concerns of the employer.’
This spoke loudly and clearly to the legal imagination. Worker participation was legitimate because the money, in law, was theirs.

The Goode Report was cautious about condoning trustees being answerable to different classes of beneficiary, such as present contributors and pensioners, as representation of segregated interests could weaken a board’s unity. However, it did not believe the conflict concern went so far as to make member and employer nominated trustees unworkable. Many schemes already operated well. Member nominated trustees would bring to pension trust boards the discipline of another viewpoint, additional experience, and hold beneficiaries’ interests in constant view. Notably, the Report rejected the idea that pensions should simply maximise financial returns, as trustees should safeguard the social interests of beneficiaries as well. They would be better at receiving information of employees’ views because their status would be equal, and employees would ultimately be less suspicious or critical of trustee board decisions if they were involved in the decision making process.

The Goode Report symbolised consensus within the democratic mainstream of British politics. It recommended employees elect at least one third of pension boards in schemes with over 50 beneficiaries generally, and if the scheme was a money purchase scheme it favoured a right to elect two thirds of trustees. Employee trustees’ terms could be between three and six years, only be removable by the unanimous decision of other trustees, with notification to the Pensions Regulator. In the Pensions Act 1995 sections 16 to 21, the Conservative government made the revolutionary change. It was the first legislation of its kind in a UK financial institution, allowing employees as members to elect representatives to trust boards.

It was not the Goode Report’s recommendations in full, particularly because an employer could opt out of the law if it secured approval for an alternative from scheme members. This stance reflected the Conservative government’s penchant for avoiding ‘one size fits all’ corporate governance or regulation. Nevertheless, the expected position was that schemes with under 100 employees

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68 (1993) Cm 2342, para 4.5.20, ‘We do not find these arguments compelling. The fact that there are already so many schemes with member trustees indicates that the fears expressed are exaggerated. Moreover, there is an obvious potential for conflict and mistrust if employers veto the appointment of trustees selected by active members. If we define the rights of trustees more clearly employers need not fear that trustees can impose extra costs on them.’

69 (1993) Cm 2342, paras 4.9.17-4.9.18. This was made plain in *Harries v The Church Commissioners for England* [1992] 1 WLR 1241 by Donald Nicholls VC, ‘Trustees may, if they wish, accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment.’ So, for example, a trade union appointed trustee could have refused to endorse investment in apartheid South Africa, where trade union rights were suppressed. Investment there would have conflicted with the objects of the union.

70 (1993) Cm 2342, para 4.5.24

71 (1993) Cm 2342, para 4.5.40

72 (1993) Cm 2342, paras 4.5.46-4.5.49

members would have at least one codetermined trustee, there would be two trustees schemes over 100, making at least one third of the pension board’s total. The legislation cut across different forms of retirement saving to some extent, applying whether the pension was constituted as a trust or a trust corporation, but not touching insurance policies or individual pensions. Nevertheless, it was the law: the Conservative party brought codetermination to Britain.

From this point, it was perhaps just a matter of time before pension codetermination was rolled out compulsorily, although the legislative process was halting. In the Child Support, Pensions and Social Security Act 2000, the Secretary of State gained the power to end the employer opt outs in the Pensions Act 1995. But although this power was gained, it was not exercised. Instead, the legislation was simply amended by the Pensions Act 2004. Sections 241 to 243 now require all schemes to have a minimum of one third member nominated trustees, or directors of the trustee corporation. The election requirements under sections 241(2) and 242(2) must include ‘a process which involves some or all of the members’. That allowed either direct employee elections or selection through a trade union which ‘adequately represents’ members and pensioners. Under section 243 the Secretary of State can either make exemptions, or increase the proportion of member nominees to half. In 2007, the then Secretary of State Alan Johnson mooted such an extension. The Department of Work and Pensions commissioned a report on it in 2010, with the dramatic finding of favour among employees and unions, and less enthusiasm among employers. The power was not exercised yet.

(c) Voice through the investment chain

The importance for corporate governance of member representation in pensions was partly dependent on the size of the pension fund. A long running example, that became one of the UK’s more active institutional investors, was the Universities Superannuation Scheme. USS was re-established as a limited company in 1974 to manage pensions that could be taken by full time, and some part time members of staff in UK higher education. In 2014 the board had twelve people, four appointed by the universities’ management, Universities UK, three nominated by the University and College Union, one by the Higher Education Funding Council, and four ‘co-opted’ members selected by the whole board. All were subject to a veto of the Joint Negotiating

1994, and also one of the most famous ‘opt outs’ negotiated in the Working Time Directive 2003/88/EC, or the social chapter attached to the Treaty on European Union 1992. The latter ‘opt out’ was made redundant in 1997.

74 Child Support, Pensions and Social Security Act 2000 ss 43-44
75 Pensions Act 2004 ss 241-243
76 See Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 regs 2-3
78 For historical development, GR Macdonald, *Fifty years of the F.E.S.U.* (1965) LSE Archives HD7/E217
Committee which had five employer and union representatives each, plus an ‘independent’ chair that had to be agreed upon by at least three members of each side, or selected by the Minister. This presumably fulfilled the Pensions Act 2004 section 242(2), because although only a quarter of trustee company directors are nominated by the union, one or two of the co-opted directors can probably be said to come from a process that ‘involves some or all of the members’. UCU would probably also ‘adequately represent’ beneficiaries, given that over half were union members. In 2012 USS had £34.2 billion assets under management, giving it the capacity for significant influence if it chose to be active. Its internal London Investment Office managed 88 per cent of its assets directly, although the task of actually casting proxy votes was delegated to JP Morgan as an administrative custodian.

Other larger pensions, such as Railpen or the BT Pension Scheme, had a similar capacity for voting on their shares in house. However smaller plans tended to hire a manager for all investment services. In practice this came to mean giving up voting rights, for no better reason than it being part of the standard form agreement. The manager would typically be an insurance company, or mutual fund firm, or both, such as Legal & General, Prudential, BlackRock, UBS, Schroders, AXA, Henderson, Fidelity and so on. All were subject to oversight under the Financial Services and Markets Act 2000, but this had not yet been used to include a voice for clients. If these firms also conducted an insurance business, their policyholders would have, just as in the 1930s, no clear right to a say in the way their money was used.

If the asset manager ran a mutual fund business, some kinds of clients might fare better on paper. Unit holders might pass resolutions, or three quarters by value might write to request a manager’s removal, though neither resolutions nor requests would be binding. Since 1997 in Open Ended Investment Companies, or ‘oiks’, ten per cent of shareholders could by law call an extraordinary meeting to remove the oik director. But the likelihood of these rights being used was remote. In fact, individual shareholders had ended in the same position. In standard contracts with High Street banks that provided broking services, the bank would take over the role of voting on a individual shareholder’s shares, and might even insist that it had not duty to vote or take instructions. Asset managers and banks controlled almost all shareholder voting

80 USS, Reports & Accounts (2012) 7 and 39. The total number of active members was reported as 141,093, with 52,910 pensioners and 93,591 deferred members (who have stopped contributing, for instance because of leaving a job, but are not retired). The University and College Union has around 120,000 members.
81 USS, Reports & Accounts (2012) 5 and 24-26
82 See for instance, the voting policy of Fidelity in the UK, FIL Limited, Principles of Ownership (February 2011)
83 See FSMA 2000 ss 19, 22, 23, 31, Part IV and Sch 2, Pt I, as well as the FSA Principles for Business, PRIN 2.1
84 FSMA 2000 s 251 and the FSA Handbook COLL 6.5.7
85 Open-Ended Investment Company Regulations 2001/1228 (amended by SI 2005/923) r 34A
86 eg Barclays Wealth Management and Investment, Barclays Terms: Your Agreement With Us (July 2012) Section B, Part 5, 7.15 and
Could pension trustees nevertheless instruct the asset managers, to whom they delegated and entrusted the power to invest, on how to vote their shares? It was clear as a matter of principle that asset managers owed pension trusts and their beneficiaries fiduciary duties, just as they would owe fiduciary duties to contributors to a collective investment portfolio. It was irrelevant that the money might be pooled in an asset manager’s accounts. It followed that the applicable equitable principle since 1929, after a case called Kirby v Wilkins, was that beneficial owners of shares could bind their delegates to vote in accordance with their instructions. As Romer J put it where,

a shareholder holds shares as a bare trustee for a third person, he is no doubt obliged to exercise his voting power in the way that the cestui que trust desires.... He holds that voting power upon trust.

Subject to the terms on which property is entrusted, bare trustees must simply vote according to the expressed wishes of a beneficiary. This was the position assumed to exist by the City, as the Hampel Report 1998 wrote that institutional shareholders should actively vote ‘according to their own best judgement, unless a client has given contrary instructions’. Only if the agreement between an intermediary and the investor had been able to exclude the duty to follow instructions might matters be different. But even then, the Unfair Contract Terms Act 1977

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87 cf Barlow Clowes International Ltd v Vaughan [1992] 4 All ER 22, per Dillon LJ, recounting the case worked on the presumption that ‘the assets and moneys in question are trust moneys held on trust for all or some of the would-be investors... who paid moneys to BCI or associated bodies for investment, and are not general assets of BCI.’ In this case, contributors to a collective investment fund, where money was pooled, sought to determine by what proportion losses to the fund were to be shared. Because the investments were so mixed, a simple pro rata division of losses was ordered. Plainly the mixture created no doubt about the certainty of the trust.

88 See Barlow Clowes above. See also Hunter v Mass [1993] EWCA Civ 11, and Lehman Brothers International (Europe) v CRC Credit Fund Ltd [2010] EWCA Civ 917, [171]. Fawcett Properties Ltd v Buckingham County Council [1961] AC 636, 678, per Lord Denning, ‘The duty of the court is to put a fair meaning on the terms used, and not, as was said in one case, to repose on the easy pillow of saying that the whole is void for uncertainty.’

89 Kirby v Wilkins [1929] 2 Ch 444, Romer J holding a bare trustee has a duty to follow instructions from an absolutely entitled beneficiary, or vote in their best interests. Also, in Butt v Kelton [1952] Ch 197, Romer LJ held that beneficiaries can compel one to vote, and the court could exercise a power if beneficiaries were among themselves in disagreement.

90 cf Companies Act 2006 ss 324-331 allows the shareholder to delegate proxies, and s 152 facilitates the splitting of votes to be cast. Proxy voting was originally found in the Companies Act 1947 s 5, and before that left up to a company’s articles. Transfers are encouraged to be used for enfranchising beneficiaries in the EU Shareholder Rights Directive 2007/36/EC art 11. For some background discussion see Companies Bill, 2nd Reading, Sir Stafford Cripps (6 June 1947) HC vol 438 col 585-671, 585-597, which led to the first reforms so that the rule that trust interests were not entered on a share register (now CA 2006 s 126) did not interfere with corporate transparency and accountability.

91 Hampel Committee, Final Report (1998) para 5.7

would probably prevent the exclusion of fiduciary duties, which ultimately benefited pension beneficiaries, if they had no bargaining power and were given ‘take it or leave it’ terms.\textsuperscript{93}

The legal position was less problematic than the factual circumstances of most pension funds. It was implausible to imagine that small pension fund boards, let alone their beneficiaries, would cast votes upon the hundreds or thousands of company issues. However, in 2010, for the first time, a new Association of Member Nominated Trustees was formed, to organise on issues of common concern.\textsuperscript{94} By 2013 its members were collectively entrusted with over £250bn worth of assets. Even then, an organisation the size of the AMNT might not be able to monitor and vote upon every issue, but there came a genuine possibility that consistent voting policies might be devised, and that specific voting instructions could be agreed.

After all, in the typical asset management firm, corporate governance was being presided over by a very small group of people. Perhaps three or six people in each asset manager, for instance, would have \textit{ad hoc} meetings to discuss voting instructions on issues arising from the financial news. They might pass those instructions to their corporate governance department, which even in the largest firms would regularly consist of one or two people. Those corporate governance staff were not overwhelmed because they subcontracted voting to a firm like Institutional Shareholder Services. In 2013, ISS had a London staff of about 200 people, 50 of whom would work on voting. Following its mandate, and with the research it did, ISS would tell asset managers how they would want to vote on all their trillions of pounds of shares. And so the modern economy was run.

Was any of this lawful? What entitled an asset manager to exercise the votes on shares, bought with other people’s money? Back in 1929, Romer J took the view that, if no instructions were received, a trustee was entitled to cast votes ‘in the best interests of his \textit{cestui que trust}'. The question, however, was whether that demanding requirement could be fulfilled without any other form of representative mechanism.\textsuperscript{95} In \textit{Kirby} itself, the trustees were directors of a company, accountable through the vote to the shareholders, for whom they held another group of shares on trust. If an asset manager was subject to no analogous representative mechanism, it appeared very hard to see what positive guarantee there would be that votes were cast in the best interests

\textsuperscript{93} UCTA 1977 ss 3, 11 and Sch 2. Dicta to the contrary in \textit{Baker v JE Clark & Co (Transport) UK Ltd} [2006] EWCA Civ 464 are wrong in principle, and probably wrong in law. Also, the role of consent in the nature of trusts is limited by the irreducible minimum core content of fiduciary obligations: see \textit{Armitage v Nurse} [1997] EWCA Civ 1279. Arguably the duty to follow instructions forms part of this core, to show what is actually (not hypothetically) in the beneficiary’s best interests.

\textsuperscript{94} M Cobley, ‘UK’s newest pensions group gets off to a flying start’ (1 April 2011) efinancialnews.com

\textsuperscript{95} cf A Hainsworth, ‘The Shareholder Rights Directive and the challenge of re-enfranchising beneficial shareholders’ [2007] Law and Financial Markets Review 11, 14, notes that while CA 2006 s 153 allows nominee shareholders to vote shares differently to reflect different wishes of beneficiaries, there is no requirement to find out what those wishes actually are. This seems to be an overly restrictive interpretation of both the common law duty of care, and of equity.
of the *cestit que trust*. On the contrary, the better view of the law would seem to be that there would be an active conflict of interest *whenever* votes were used to support a corporate management that bought any form of retirement product from the asset manager. Conflicts of interest could not be contracted out of. The alternative would permit self-dealing on a massive scale. Just as there is a duty to actively use voting rights, the irreducible core of fiduciary duty arguably requires asset managers to gather the views of clients, and follow them, or to not vote at all.

(d) Public sector development

In the UK's public sector pensions, and quite unlike their counterparts across the Commonwealth or the United States, trustees had become heavily reliant on asset managers. Most public pensions had been constituted by a Regulation under the authority of the Superannuation Act 1972 section 7. For example, the Local Government Pension Scheme Regulations 1997 let a miscellany of officials – council treasurers, leaders, scheme actuaries, external fund managers or property advisers – form a pension plan's panel. In 2011, the Hutton Report found that 7 out of 89 local government funds allowed any voice for members. It recommended that the Pensions Act 2004 apply to the whole public sector.

The Public Service Pensions Act 2013 followed, where section 1 allowed new Regulations to be drafted but subject to the consent of the Treasury under section 30(3). Under section 4, Regulations would have to include a ‘scheme manager’, ordinarily the local authority or government department. The relationship of the manager to the requisite ‘pension board’ under section 5 were not clear, other than to be ‘assisting the scheme manager’. Regulations could go further and they would have to require ‘employer representatives and member representatives in equal numbers’. Yet this did not stop further ‘independent’ board members sitting. These would

96 Keech v Sandford (1726) 25 ER 223 developed the strict application of the no possibility of conflict principle in the wake of the world’s first stock market crash, courtesy of the South Sea Company. It should not be thought an exaggeration to say that it is ‘for the safety of mankind’, per James I J Parker v McKenna (1874) 10 Ch App 96. See further, J Getzler, ‘Rumford Market and the Genesis of Fiduciary Obligations’ in A Burrows and Lord Rodger of Earlsferry (eds) *Mapping the Law: Essays in Honour of Peter Birks* (OUP 2006) 586.

97 cf Bartlett v Barclays Bank Trust Co Ltd [1980] 1 Ch 515

98 cf Armitage v Nurse [1997] EWCA Civ 1279


100 See ch 6(3)(f)

101 Superannuation Act 1972 s 7

102 See Local Government Pension Scheme Regulations 1997 (SI 1997/1612) r 73, arrangements for administration that existed previously should remain in tact. Under SI 2007/1561 r 3, a new s 73A was inserted to require that the ‘administering authority’ had to publish a statement of how their scheme was administered, including how it was delegated or any subcommittees involved, and to keep this updated and filed with the Secretary of State. Accordingly, the default position envisaged is that the local authority’s executive will determine the structure of the pension scheme.

presumably be political appointees. The details of election rules, or the definition of what was ‘representative’, would also depend on the Regulations. Nothing in the Act explicitly required schemes to merge,\textsuperscript{104} and so local government pensions remain disunited, and often without the bargaining power to reduce asset management fees. Every scheme delegated investment services and votes to the City.

The lack of consolidation was not present, however, across all of the public sector. The Pensions Act 2008 was passed to give the right to every worker or ‘jobholder’ to enrol in a basic defined contribution pension.\textsuperscript{105} It also created a cheap public fund manager option, the National Employment Savings Trust. The board of NEST was initially appointed by the Secretary of State, and then that board would make subsequent appointments.\textsuperscript{106} This arrangement existed because the Secretary of State suspended the requirement for member nominated trustees by order under Schedule 1, paragraph 1(6).\textsuperscript{107} This meant that it was also possible, by an Order of the Secretary of State, to introduce member nominated trustees to NEST when the organisation had been deemed to be up, running and settled.\textsuperscript{108} As automatic enrolment was scheduled to phase in up till 2018,\textsuperscript{109} it was projected that up to 5 million members could join. Over time this would make it comparable to many sovereign wealth funds in scale, with the legal option that the people whose money was invested could elect those who managed it, and so participate more in corporate governance.

\textbf{(e) Conclusion}

A little more than a century after modern retirement was created, the UK could be seen to be moving slowly toward the democratisation of capital. But in 2014, it was still true that no matter what the source of corporate equity, or who appeared on the share ownership statistics, asset managers and banks dominated voting, through no better reason than their exercise of bargaining power. All the work in UK law to reduce negligence and profusion, to ensure directors were removable, and shareholders had voting rights, was threatened because it was not just directors, but also the shareholders who controlled other people’s money. A chimerical virtue was that the UK was not so different to its international counterparts. Then again, there was no comprehensive model to learn from. Germany and the US showed better arrangements in some

\begin{itemize}
\item \textsuperscript{104} Public Service Pensions Act 2013 s 1 and Sch 1 defined the sectors of public service worker and responsible Secretaries of State who would issue Regulations.
\item \textsuperscript{105} Pensions Act 2008 s 1, basic contributions of 3%.
\item \textsuperscript{106} Pensions Act 2008 Sch 1, para 1(1).
\item \textsuperscript{107} The National Employment Savings Trust (Consequential Provisions) Order 2010 (SI 2010/9) r 3.
\item \textsuperscript{108} This suggestion was politely received by the Secretary of State at the AMNT’s Summer Conference, as seen in E. McGaughey, ‘MNTs and corporate governance’ (26 June 2013).
\item \textsuperscript{109} Employers’ Duties (Implementation) Regulations 2010 (SI 2010/4) reg 4, as amended.
\end{itemize}
respects, but they were also grappling with the relatively new reality of institutional shareholding.

(2) Germany: Bismarck and Bankenmacht

Behind the institutional veil, Germany differed from the UK and US for two main reasons. First, the Bismarckian state pension was designed to replace a proportion of the income a contributor earned before they retired. The standard ‘replacement ratio’ was always over two thirds, which meant most people did not have such an urgent need for larger occupational pensions, and trade unions pressed less for them. The consequence was that by 2011 the quantity of occupational pension money in Germany, though still enormous, stood at under a quarter of that in the UK. Just as important as structure, a social ideal accompanied the Bismarckian pension system, which pierced the culture of the courts that regulated the second pillar. This was the idea that pensions were there because people needed protecting. That paternalist ethic resulted in the Germans being unusually far behind the British in the quality of pension codetermination.

Second, German banks became the custodians of shares, originally because of a quirk of private law history. Shares had to be bearer shares and consequently they needed to be safely deposited somewhere. Banks offered the service. But then, with standard form contracts (on allgemeine Geschäftsbedingungen) banks appropriated the majority of voting rights on shares. Though there were different legal origins, and different reasons for development, Bankenmacht (bank power) in Germany approximated the power of asset managers in the UK or US.

(a) Protection or participation

Participation in German pension management was always part of a general movement for economic democracy. Culturally, its roots were in the proto-democratic values of mutual

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111 Or in a real ratio, probably better said as 2:3. The Sozialgesetzbuch (Social Code) Book VI, §154 now lets the Bundestag set the replacement rate, currently at 67% of average net earnings. See W Lamping and FW Rüh, ‘From the Conservative welfare state to an ‘uncertain something else’: German pension politics in comparative perspective’ (2004) 32(2) Policy & Politics 169, 171. The Social Code, Book VI was completed in 1989, while the other books were completed from 1976 to 2005.

112 European Federation for Retirement Provision, Annual Report 2011 (2011) 48, state that in 2009, there was €430bn assets under management from occupational pensions in Germany, compared to €1,869bn in the UK.

113 nb the discourse of a three pillar pension system is sometimes viewed as having negative connotations, because it was first publicised in the English speaking world by the World Bank, Averting the Old Age Crisis (1994), a rather hyperbolic, and politicised research report which, reflecting the so called ‘Washington Consensus’ promoted a shift towards reliance on the private sector for pension provision. Despite these negative connotations, the three pillar parlance had been common in German speaking countries for some years before.

114 This section duplicates text used for the common story on employee participation in corporate governance, found in E McGaughey, ‘The codetermination bargains: the history of German corporate and labour law’ (2015 LSE Law, Society and Economy Working Papers 10/2015, part 3(1))
solidarity that guilds and unions promoted since the middle ages.\textsuperscript{115} Legally, it began with the Revolutions of March 1848, as social instability culminated in the German industrial revolution.\textsuperscript{116} Mechanised production in urban factories had outcompeted old work traditions, forcing people to search the cities for employment. Often work was scarce, and by 1847 food shortages greeted the work shortages when over 200 riots broke out across the German Länder. For example, three days of rioting at potato stalls and bakeries near Berlin University’s Law Faculty had to be quelled by the military.\textsuperscript{117} In February 1848, Germans heard news that the French had launched a revolt and in March they followed, demanding a common, elected Parliament in the Paulskirche of Frankfurt. The Fürsten, princes and despot were startled enough that they let the vote happen.

Among the new members of Parliament was a Saxon textile factory owner named Carl Degenkolb. His business was printed cloth (Kattundruck) which used the sort of machinery that had acutely affected pre-mechanical craft work. His industry had been notable before the March Revolution (or Vormärz)\textsuperscript{118} for the sprouts of participatory social institutions at work, particularly saving schemes or Kasen\textsuperscript{119} for sickness, death and occasionally old age.\textsuperscript{119} Degenkolb had come to the view that workers, who otherwise had no property to make a living, needed to participate in the functioning of the economy as much as in political activities.\textsuperscript{120} Factories should not be governed arbitrarily by an owner or employer, but by consent and law.\textsuperscript{121}

Over the Frankfurt Parliament’s short span, Degenkolb allied himself to the majority liberal faction.\textsuperscript{122} On 24 May 1848 it convened an economic committee to propose a new business law. Degenkolb’s ideas did not win majority support, but he and a minority still composed a draft, released on 12 January 1849. It would have required councils in every German business district, with representatives chosen by factory committees. Among other things, they would ‘design regulations of the factory pension schemes and their administration’.\textsuperscript{123} The factory

\textsuperscript{115} HJ Teuteberg, \textit{Geschichte der Industriellen Mitbestimmung} (1961) 118-119. Teuteberg’s work, a \textit{History of Industrial Codetermination}, remains the premier historical treatment up to the year 1916.


\textsuperscript{117} M Gailus, ‘Food Riots in Germany in the Late 1840s’ (1994) 145 Past & Present 164-167 and 184-185. The ‘potato revolution’ began at a stall in Gendarmenmarkt, after the lady who owned the stall raised her prices. She ran to seek refuge, around the back of the Berlin University’s Law Faculty, to a bakery at 44 Charlottenstrasse (now the site of the Berlin State Library) which was also subsequently attacked and demolished by the rioters.

\textsuperscript{118} My translation of ‘Kasse’ as ‘scheme’ is not completely accurate. A literal translation is ‘cache’, but this hardly sits well in English. A better word is simply ‘fund’, but in 2002 a vehicle called a \textit{Pensionsfond} was created, and its legal distinction to a \textit{Pensionskasse} means that we cannot use the word ‘fund’ twice for different things.

\textsuperscript{119} HJ Teuteberg, ‘Zur Entstehungsgeschichte der ersten betrieblichen Arbeitervertretungen in Deutschland’ (1960) 11 Soziale Welt 69-82.

\textsuperscript{120} Known as the Casino-Fraktion. The name derived from the name of their meeting hall, rather than any gambling tendencies.

\textsuperscript{121} Entwurf einer Gewerbeordnung für das deutsche Reich 1849 §45 ‘Dem Fabrikrate stehen zu... 5. die Entwerfung der Statuten
committees would be one-third elected by workers, and two-thirds the employer.\textsuperscript{124} This was part of a general plan for economic participation. Work councils were also to have powers over health care schemes, working hours, notice periods for dismissals, regulation of the number of trainees, and mediating disputes with employers. Everything was linked to a system of regional and national representation of workers in the country’s economic affairs.\textsuperscript{125} Because they only held a third of votes, workers would be outvoted on any issue, and because voice was indirect the council would always be employer controlled. Nevertheless, this was the first law ever written for economic participation in general, and participatory pensions in particular.\textsuperscript{126}

By the summer of 1849 the German aristocracy had seen the new constitution that the Paulskirche in Frankfurt wanted, with its displeasing guarantees of civil and political rights.\textsuperscript{127} It pulled parliamentary representatives back to the Länder, imprisoned or executed troublesome opponents, and had military troops break up the rest. Degenkolb returned quietly to his Saxon business, but he determined to implement his proposals personally. With three like minded industrialists in his area,\textsuperscript{128} Degenkolb agreed a business constitution, configured with only slight differences to the minority draft, which included worker representation in pension management.\textsuperscript{129} The historian Hans Jürgen Teuteberg, in his foundational study of codetermination, found no archival detail beyond the statute on how the plan played out practically, but believed it remained in force until Degenkolb passed away in 1862.\textsuperscript{130} These primeval roots of participatory pensions were very isolated in a world where only the privileged lived to retire, or have an old age pension. Many other industrialists cared for worker welfare, and were improving. Some even sympathised with worker involvement.\textsuperscript{131} But the small, slow start was far less of a problem for the world’s first general codetermination plan, than the overwhelming challenge of another ideal.

Alfred Krupp and his family best represented that challenge. The Kruppian philosophy was to sincerely display a sense of obligation to the workforce, and absolutely deny workers the right to self-determination. ‘No other great industrialist,’ wrote historian Wolf Schneider,\textsuperscript{132}

\begin{itemize}
\item \textsuperscript{124} Entwurf 1848 §42
\item \textsuperscript{125} Teuteberg (1961) 109-111 and Teuteberg (1960) 11(1-2) Soziale Welt 69, 77-78
\item \textsuperscript{126} Teuteberg (1961) 111, ‘eines der bedeutendsten Dokumente in der Geschichte der deutschen Mitbestimmung’ or ‘one of the most significant documents in the history of German codetermination.’
\item \textsuperscript{127} Paulskirchenverfassung or Verfassung des deutschen Reiches (28 March 1849)
\item \textsuperscript{128} Teuteberg (1960) 11 Soziale Welt 69, 78, the four groups of owners and businesses were Carl Degenkolb who owned Bodemer & Co.; Adolph Michael and CF Mitscherlich and Dannewberg & Sohn; Gustav Ehrenberg and Carl Richter and Ehrenberg & Richter; and Jacob Bodemer Jr and Jacob Bodemer Jr.
\item \textsuperscript{129} Teuteberg (1960) 11 Soziale Welt 69, 79 extracts the relevant provisions.
\item \textsuperscript{130} Teuteberg (1960) 11 Soziale Welt 69, 82, footnote 15. Teuteberg (1961) 212-221.
\item \textsuperscript{131} Teuteberg (1961) 199, provides a list of examples of participatory plans from the later 19th century.
\end{itemize}
‘esteemed the personal freedom of his workers so little and their material well-being so highly.’\textsuperscript{132} Krupp had provided health care by 1836, aptly evidenced by a company account entry reading ‘26 Nov 1836, 2 Talers of punishment money donated to the sickness scheme’.\textsuperscript{133} A revised scheme for illness and death benefits ran from 1853, and did include worker voice of a sort. The statute provided that there would be six worker deputies elected (no doubt after vetting) to manage the scheme, but that Krupp himself had the same number of votes as a third of the workers, and that Krupp would be the scheme president.\textsuperscript{134} He could do anything that he liked.

In these years, immediately following the March Revolution’s failure, Prussian law had led trade unions on with promises of freedom of association, but then prohibited it again in 1854.\textsuperscript{135} While the workforce could not organise and take collective action, the moral case for social welfare programmes was stronger. Krupp continued to introduce various schemes as his business expanded, with a bakery in 1858, housing from 1870, and subsidies for buying life insurance in 1877.\textsuperscript{136} But any sign of workforce dissent was punished. Already in 1848, the last of Krupp’s eight original workers had been dismissed for ‘signs of insubordination’. The company libraries prohibited literature of the \textit{Sozialdemokratische Arbeiterpartei} (Social Democrat Workers Party) and even the \textit{Zentrumspartei} (Centre Party). When strikes took place on the Ruhr in 1872, Krupp said it would be a personal affront if anyone joined, and immediately dismissed anyone tainted with social democracy.\textsuperscript{137} Everything he believed was summed up during a national election campaign on 15 March 1877, when Krupp wrote the following to his workers.

\begin{quote}
Despite repeated warnings, the spirit of social democracy seems to keep wanting to creep into a number of you. It is pernicious, and every reasonable person must attempt to fight it, the employee just as much as the employer…. That which has been earned by an industrious, thrifty family, that which a generation has honestly acquired, is what the indolent, the capricious are trying to snatch, to make the incompetent and the capable equal… I must bear the losses of the business alone, and so the profits are also rightfully mine, because I have earned them with my strength and my diligence.
\end{quote}

\textsuperscript{132} W Schneider, \textit{Essen - das Abenteuer einer Stadt} (1963) 233, British Library (1978) 233, ‘Kein anderer Anführer des Industriezeitalters hat die persönliche Freiheit seiner Arbeiter so gering- und ihr leibliches Wohl so hochgeachtet.’
\textsuperscript{133} Teuteberg (1961) 192
\textsuperscript{134} Teuteberg (1961) 193
\textsuperscript{135} Federal Decision (13 July 1854)
\textsuperscript{137} McCreary (1968) 42(1) The Business History Review 24, 47-48
\textsuperscript{138} Extracted by W Schneider, \textit{Essen - Abenteuer einer Stadt} (Econ Verlag 1963, new edn 1978), 232, ‘Trotz wiederholter Warnung scheint sich unter einem Theiler von Euch der Geist der Sozialdemokratie einschleichen zu wollen. Dieser Geist aber ist verderblich, und jeder Verständige muß ihn bekämpfen, der Arbeiter so gut wie der Arbeitgeber… Was eine fleißige sparsame Familie, was eine Generation ehlich erworben hat, soll der Faule, Liederliche sich aneignen dürfen und der Unfähige dem
Krupp thought that nobody had a right to participate in business management but the leader because the owner ‘must bear the losses’. The losses that workers might suffer when dismissed were irrelevant. Krupp’s risk and ‘diligence’ led him to believe that he alone ‘earned’ every mark of profit, and all control, absolutely.

The Kruppian view had the upper hand while workers’ bargaining power was suppressed. For example, when laws suppressing freedom of association were briefly liberalised, there was a wave of strikes. Siemens & Halske was affected, and it responded by establishing a Pensionskasse (pension scheme) in 1872. The administration included workforce representatives, though Siemens management appointed the chairman and could veto decisions. Krupp himself established a separate company scheme for retirement and pensions from 1885. It was linked to the number of years of service, and to income. But Krupp allowed no more scope for participation. Any pension money built up, under this tradition of thought, was aligned with the prevailing view of contractual benefits: workers only had rights if the employers allowed them.

Krupp’s social conservatism was ‘tainted’ with some altruism, but there was considerable self-interest in the power of social plans and pensions to promote loyalty and sanction disloyalty. Workers lost their benefits if they left the business. The idea had caught the attention of a rising politician, who in 1864 scheduled a visit to Alfred’s factory. After that, Krupp and Otto von Bismarck cultivated a personal relationship. No direct evidence exists that Bismarck modelled the new welfare state after Krupp, but when put into action from 1883 with health insurance, and from 1889 with old age and disability insurance, it bore remarkable similarities. The Age and Invalidity Act 1889 linked the statutory pension’s income in retirement to income during a contributor’s career. The amount that one received in old age was proportionate to the contributions one had made. Unlike the UK’s later scheme the German state pension was never a minimum safety net, but like an earnings related contract.

Bismarck’s political objectives were even more similar. Like Krupp’s, Bismarck’s social
programme professed some concern for workers’ welfare. But an even weightier reason for reform was that Bismarck had fully backed the Sozialistengesetze (the Socialist Acts) from 1878 to 1888, continuing the Prussian bans on trade unions and social democratic publications. Social programmes including pensions were useful to outflank the SPD, and divide social democrat supporters. ‘Whoever has a pension for his old age,’ said Bismarck in 1881,

is far more content and far easier to handle than one who has no such prospect. Look at the difference between a private servant and a servant in the chancellery or at court; the latter will put up with much more, because he has a pension to look forward to.\textsuperscript{145}

The opportune moment to enact old age welfare reform came as repeal of the Socialist Acts was forced. The appeasement of the working classes was necessary, said Bismarck in appeal to the Conservative Members of the Reichstag, to prevent their organisation. Taking after Krupp, Bismarck embodied the ethic of social conservatism. Otto Kahn-Freund, as chapter 3(1)(b) outlined, later described this ethic as placing ‘the existentially isolated, uncombined individuals of the working class under the social protection of the state’.\textsuperscript{146} But this was a state of protection without participation, where workers were seen but not heard.

(b) Development of occupational pensions

Bismarckian social conservatism – paternalist concern for material wellbeing, denial of collective action – persisted in the way companies provided pensions. Small employers usually gave a direct promise (a Direktzusage) to workers that upon retirement a pension would be paid from company funds. Employers still took contributions from workers, so that deductions showed up in people’s pay slips. Perhaps the company built up pension reserves (Pensionsrückstellungen) on its balance sheet. If so, employers used the money as if it were theirs. German private law, at least as a starting point, appeared to endorse the practice, because it gave no automatic recognition of beneficial ownership.\textsuperscript{147}

After World War One, the Social Democrats emerged as political victors. Like in the UK and the US, Germany began a programme to build industrial democracy. The inspiration came from a mass-collective agreement, signed between the federation of trade unions and the leading

\textsuperscript{145} Quoted in AJP Taylor, \textit{Bismarck: the man and the statesman} (1955) 202-203


\textsuperscript{147} Bürgerliches Gesetzbuch 1900 §§1008 ff and 941 ff, for example, on fractions of ownership and cooperative obligations for its use, could achieve identical effects to a trust, but it was a very different thing for the institution to be familiar.
employer association, known as the *Stinnes-Legien Abkommen*. But unlike the UK, which relied on the Ministry of Labour’s discretion, and the US, which similarly relied on the existence of the War Labor Board, Germany wrote worker participation rights into legislation. The Weimar Constitution 1919 enshrined the principle in article 165 that workers had a right to participate in the country’s entire field of economic development. Then, the *Betriebsrätegesetz 1920* (Work Councils Act 1920) §66 required that worker elected councils participate in a host of workplace matters, including ‘in the administration of Pensionskassen and housing as well as other company welfare facilities’.

What was a welfare ‘facility’? Some academics, notably Hueck and Nipperdey, developed the view that there was no ‘facility’ when a company made a direct promise, the Direktzusage, to workers for their pensions, and kept the money for themselves. This sat consistently with the jurisprudence in the 1920s and early 1930s of the Reichsarbeitsgericht (the Empire’s Labour Court) that gradually hollowed out the effect of codetermination laws. By contrast, Georg Flatow and Otto Kahn-Freund wrote that the law’s purpose was to ‘constrain the one-sided distribution and administration rights of the employer, and so the potential for arbitrary conduct, by giving employees the ability to participate.’ The courts themselves continued to hold that pensions could be revoked by employers from workers who left or were dismissed, approving the employer’s power to compel loyalty to the company. On the other hand, the courts passed pathbreaking decisions holding that if the substance of a contract for work involved a relationship of dependency, then the form of contract was irrelevant. This purposive commitment meant employment rights could not be avoided. In sum, in its regulation of private relations, the judiciary clutched to a paternalist tradition of worker protection, and was ever more hostile to collective voice.

If codetermination rights were only available for Pensionkassen and not when the employer paid pensions directly, the regulatory and tax framework was not favourable. After the

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148 This is often translated as the ‘Works Councils Act’, but in fact ‘works’ is a grammatically misguided translation, because the ‘s’ in ‘Betriebsrat’ denotes the genitive tense, rather than a plural of ‘Betriebe’. Another accurate, but obviously less elegant, translation could therefore be ‘Councils of Work Act’.

149 Betriebsrätegesetz 1920 (RGBl S 147) §66 ‘Der Betriebsrat hat die Aufgabe’ … nr 9, ‘an der Verwaltung von Pensionskassen und Werkswohnungen sowie sonstiger Betriebswohlfahrts einrichtungen mitzuwirken; bei letzteren jedoch nur, sofern nicht bestehende, für die Verwaltung maßgebende Satzungen oder bestehende Verfügungen von Todes wegen entgegenstehen oder eine anderweitige Vertretung der Arbeitnehmer vorsehen’.


153 Reichsarbeitsgericht Entscheidung (25 November 1929) Bensheimer Sammlung, Band 8, Nr 71, S 352

154 Reichsarbeitsgericht Entscheidung (15 February 1930) Bensheimer Sammlung, Band 8, Nr 92, S 451
Versicherungsaufsichtsgesetz 1901 (Insurance Supervision Act 1901) the Pensionskassen fell under the Insurance Supervision Authority, insofar as they created legal rights for the contributing member.\textsuperscript{[155]} The Act envisaged that a Kasse would be constituted as an Aktiengesellschaft (public company) or a Versicherungsverein auf Gegenseitigkeit (mutual assurance association) and it required licensing and prudent funding. The rules were seen as onerous by employers,\textsuperscript{[156]} and in any event they did little to prevent the post-war hyperinflation wiping away people's savings.

The incentive to establish a Kasse was temporarily increased by the Körperschaftststeuergesetz 1920 (Corporation Tax Act 1920) as §2 Nr 5 gave exemptions from corporate tax so long as money was secured for the purpose of the Kasse.\textsuperscript{[157]} The object was to shift money out of the employer's coffers, where it could be used to finance the employer, and into schemes that were worker codetermined. The policy was later halted by the DM Bilanzgesetz 1949 (Deutschmark Accounting Act 1949).\textsuperscript{[158]} With the justification of encouraging reconstruction, this allowed employers to deduct tax from pension money that they saved up and used for their own ends.\textsuperscript{[159]} The regulatory and tax incentives switched to be against employers putting money into pension schemes where workers' had codetermination rights.

Meanwhile, the inter-war decades added a third and fourth pension type. The third came in 1928 when, like to the UK, US insurance firms imported the direct insurance contract (Direktversicherung) made for employers who wanted a collective policy. It instantly received the same tax privileges as other pension plans.\textsuperscript{[160]} The fourth was introduced by the government in 1934, apparently to limit a growing problem of companies manipulating their profit figures when they held onto pension money. From the Körperschaftststeuergesetz 1934 only schemes with legal capacity, separate from the employer, could benefit from tax exemptions.\textsuperscript{[161]} The Körperschaftststeuerdurchführungsverordnung 1935 (Corporation Tax Implementation Order 1935) put this into effect.\textsuperscript{[162]} However the Insurance Supervisory Authority complained that it lacked

\textsuperscript{[155]} Versicherungsaufsichtsgesetz 1901 (12 May 1901) RGBl S 139. See M Tigges, Geschichte und Entwicklung der Versicherungsaufsicht (1985) 77-88.
\textsuperscript{[156]} H Kempees, Die betrieblich Alterversorgung in Deutschland und in der Schweiz und ihre Bedeutung für die Finanzierung von Unternehmen (Stehle 1964) 20
\textsuperscript{[157]} KStG 1920 (30 March 1920) RGBl I 1920, 393, §2 Nr 5, exempt were 'rechtsfähige Pensions-, Witwen-, Waisen-, Sterbe-, Unterstützungs- und sonstige Hilfskassen für Fälle der Not oder der Arbeitslosigkeit; das gleiche gilt für nicht rechtsfähige Kassen dieser Art, wenn die dauernde Verwendung der Einkünfte für die Zwecke der Kassen gesichert ist'. Also KStG 1922 (12 May 1922) RGBl 1922, 472, §2 and KStG 1925 (10 August 1925) RGBl I 1925, 208, §9 Abs 1 Nr 10. A Weiß, 'Begriff und Entwicklung der betrieblichen Altersversorgung' in Handbuch der betrieblichen Altersversorgung (München 1955) 17.
\textsuperscript{[158]} DM-Bilanzgesetz 1949 §29(4). See now Einkommensteuergesetz 1934 §6a, first introduced by Steuerordnungsgesetz 1954 (BStBl I 1954, 575)
\textsuperscript{[159]} G Wiedemann, Die Historische Entwicklung der Betrieblichen Altersversorgung unter Besonderer Berücksichtigung des Arbeitsrechtes (1990) 71-73
\textsuperscript{[160]} S Hubrich and T Tivig, Betriebsrenten im Altersversicherungssystem Deutschlands : eine Betrachtung aus volkswirtschaftlicher Sicht (2006) 33, fn 55, 'Die DV kam 1928 aus den USA nach Deutschland und erhielt sofort steuerliche Anerkennung; ihre konkrete gesetzliche Ausgestaltung erfolgte jedoch erst 1974 im BetrAVG.'
\textsuperscript{[161]} KStG 1934 §4 Abs 1 Nr 7 (16 October 1934) RGBl I 1934, 1031.
\textsuperscript{[162]} Körperschaftsteuerdurchführungsverordnung 1935, RGBl I 1935, 163, §§13-16.
jurisdiction over schemes where pension rights were not guaranteed. The solution, avoiding insurance supervision, was that in fourth kind of pension, the **Unterstützungskasse** (support scheme), an employer would guarantee payments to workers, rather than the scheme itself being the guarantor. A support scheme could be constituted as a civil law association (**eingetragene Verein**), a private company (**GmbH**) or a stipend (**Stiftung**). Without insurance supervision, it could also invest all the money back into the employer. By 1934, however, for member participation this had all become completely irrelevant. The Nazi dictatorship had taken over and its first act was to demolish all forms of worker voice. Pension participation and everything else was replaced with the **Deutsche Arbeitsfront** (DAF, the German Workers’ Front) the nationalised Nazi union.

After the Second World War, codetermination was successfully reintroduced but the Bismarckian ethic of pension management persisted. The **Betriebsverfassungsgesetz 1952** (Work Constitution Act 1952) and its successor in 1972 retained the language of the social ‘facility’. As occupational pensions slowly grew in size and importance, employers retained their previous practices of withdrawing pensions from resigning or dismissed employees. In principle this was endorsed by a conservative **Bundesarbeitsgericht** (Federal Labour Court), now presided over by Hans Carl Nipperdey. By the early 1970s, however, too many cases transpired where employers had arbitrarily removed workers’ pension rights. The **Betriebsrentengesetz 1974** (Work Pensions Act 1974) was passed to codify and improve the law, primarily by requiring that all pension rights vested after a certain period of service, and insuring against insolvent schemes. It also codified the four existing types of plan: the external **Pensionskasse** and **Unterstützungskasse**, and the contractual **Direktzusage** and **Direktversicherung**.

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163 This is the interpretation of events given by E Heißmann, *Betriebliche Unterstützungsunkassen* (3rd edn 1966) 4
164 The word **Unterstützungskasse** was commonly used before 1934, back to the earliest Prussian social schemes. Only with the 1934 Act did the term acquire a legal relevance.
166 Betriebsverfassungsgesetz 1972 §87 Nrs 8 and 10
167 BAGE 3, 332, 337 (14 December 1956) = 1 AZR 29/55 = DB 1957 S 192 = AP Nr 3 zu §611 BGB Fürsorgepflicht. This held that employers could cancel pension benefits of employees who left before retirement, as part of freedom of contract. It involved a former Nazi Party member being dismissed.
168 One of Nipperdey’s lasting contributions to labour law has been the horizontal application of human rights. He had supported Hans Kelsen against expulsion from Cologne University, but was also a member of the *Akademie für Deutsches Recht* since its founding in 1933, and he expound Nazi labour law through further editions of his commentaries, up to A Hueck, HC Nipperdey and R Dietz, *Gesetz zur Ordnung der nationalen Arbeit, Kommentar* (4th edn 1943). An example of his unemotional assent to human rights violations is his academic approval in RAG 21:191, for a case where an officer of a dissolved trade union was dismissed without notice because otherwise the Nazis could not realise their goals, RAG 44/34 (4 July 1934) 21:188-191 No. 37.
169 BAGE (10 March 1972) 3 AZR 278/71 = BB 1972 S 1005 = DB 1972 S 1486. This reversed the previous case law to hold that withdrawing pension benefits for long term workers would contravene the principle of good faith under BGB §242.
170 Betriebsrentengesetz 1974 §§1-1b
Immediately after the 1974 Act the Bundesarbeitsgericht, now presided over by Gerhard Müller, held that the codetermination right in the 1972 Act, §87(1) Nr 8 did not extend to pension money taken by employers, or insurance policies. The pensions forms were not enough of a ‘facility’, although the Kassen were. The court referred to two previous decisions from Nipperdey’s court in the 1950s, which concerned canteens and food prices at work, which effectively endorsed Nipperdey’s own 1930s commentary. With this, Müller managed to extrapolate a ‘consistent line of precedent’ that a facility requires ‘a certain own organisation... organisation which renders some service other than a pure payment’. Curiously, the court referred to Flatow and Kahn-Freund’s commentary from 1931 for support, but in the relevant pages Flatow and Kahn-Freund were clear there was no judgment yet on what was a facility. They viewed a facility to require some independence, but not necessarily legal, so that one off payments did not count. To them the law’s purpose to constrain arbitrary conduct by employers was the crucial factor, and so it is very doubtful that Müller’s interpretation of the law had supported the legislation’s aims. Whatever purpose the Federal Labour Court thought it was pursuing in 1975, it concluded that the Direktzusage and Direktversicherung were codetermination free, even where reserves were built up. In effect it was continuing a weak form of the social conservative ideal.

Why did trade unions not push for all pensions to be codetermined? A collective agreement could always secure pensions in the Kasse form, and even greater participation rights. The simple answer is that they were more pre-occupied with improving the state pension. Working under a relative lack of scrutiny, the Bundesarbeitsgericht added that the right of codetermination extended only to affairs concerning the savings of workers’ own money, and not to money belonging to other beneficiaries. It was creatively reasoned that if retired beneficiaries’ interests were at stake, the solution was not that those people would gain a voice,

171 The Direktzusage and Direktversicherung, or direct promise and insurance, methods fall under the Betriebsverfassungsgesetz 1972 §87(1) Nr 10, which confers a right to determine wages’ principles, but does not extend to the accumulated property in the company.
172 The German word is ‘Einrichtung’ which literally means something that is ‘set up’.
174 BAG AP Nr 5 zu §56 BetrVG [Bl 2 R, 3]; AP Nr 3... BAG 15, 136 [139] = A Nr 6 .... BAG 17, 316 [318-319]
175 G Flatow and O Kahn-Freund, Betriebsrätegesetz (Springer 1931) 348, ‘Die “Einrichtung” setzt eine gewisse (nicht rechtliche) Selbständigkeit voraus: ein für einen einmaligen vorübergehenden Zweck, z.B. ein Fest, gestifteter Betrag ist keine “Einrichtung”.
176 Flatow and Kahn-Freund (1931) 348, ‘Das Gesetz will bei allen Wohlfahrteinrichtungen “das einseitige und deshalb der Gefahr der Willkür ausgesetzte Verfügungs- und Verwaltungsrecht des Arbeitgebers durch Einräumung von Mitverwaltungsbeauftragungen an die Arbeitnehmer beschränken” (vgl. RAG v. 21.6.30, Bensh. Samml. Bd 9, 331).’
177 BAGE 27, 194 (12 June 1975) ‘Ruhegeldordnungen, deren Leistungen nicht über das Sondervermögen abgewickelt wurden, betrachtete man als mitbestimmungsfrei, und zwar auch dann, wenn für sie Rückstellungen gebildet oder Rückdeckungsversicherungen abgeschlossen wurden...’
178 Betriebsverfassungsgesetz 1972 §87(1)
179 BAGE 60,78 (25 October 1988) 3 AZR 483/86
but that current employees would lose theirs. Moreover it was said that if a multi-employer plan were established, the right to codetermination would disappear because codetermination rights only extended to the affairs of the employees' own workplace. These issues could be avoided if a Kasse were constituted as a mutual assurance association, where all contributing members would by default have a vote. But in practice, the form remained dependent on negotiation by employers and a trade union. The court's interpretation of the 1972 Act stood in opposition to the tradition that German legislation had forged. Somehow, Degenkolb's textile factory workers had more voice in their multi-employer plan of 1855 than the modern German worker in 1975.

By the late 1990s it became apparent that – although workers’ retirement savings could be appropriated through a Direktzusage – German companies lacked access to the extensive domestic share markets found in the Commonwealth and the US. If more pension money could be allocated into equity, then it was thought this situation would change. The first group of proposals, supported by pension groups and an initial government report, involved reforming the existing four occupational pension vehicles, their investment rules, or their structure. The second group of proposals, favoured by banks and investment concerns, was to encourage massive expansion in individual savings accounts. This would have ultimately meant a reduction of voice, because managers of mutual investment companies had been obliged to take on responsibility for voting themselves. More than that, under the applicable law, now found in the Kapitalanlagegesetzbuch 2013 (Capital Investment Code 2013) §94, investment companies were exempt from seeking authority from policy holders to vote on their behalf.

In the event, the ‘Riester-Rente’ reforms simply introduced a fifth pension vehicle called a Pensionsfond, or pension fund. It would still be subject to insurance supervision. It could be constituted as a mutual insurance company (VVaG), an Aktiengesellschaft (AG) or, indeed, a Societas Europaea (SE). Its hallmark would be complete freedom to invest in company shares. By 2011, 30 Pensionsfonds were established by the largest of the German companies. Curiously, all

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181 VAG 1992 §20. The general meeting of members, however, could be replaced by a representative meeting, §§ 29, 36, 53(2).
184 Bundesverband deutscher Banken, Bundesverband Deutscher Investmentgesellschaften und Deutsche Aktien-Institut, Betriebs-Pensionsfonds - Neue Impulse für die betriebliche Altersversorgung (1999)
185 Previously the Kapitalanlagegesetz 1986 §10 and the Investmentgesetz 2003 §32
186 For a thorough overview of political negotiations over the course of the early 21st century reforms, see EM Immnegut, KM Anderson and I Schulze, West European Pension Politics (OUP 2007) ch 14, 660-710, 689. Walter Riester was the Social Minister from 1998 to 2002 who led through the reform of Rente, or pensions, a member of the Sozialdemokratische Partei Deutschlands, formerly deputy chair of the union, IG Metall.
187 Betriebsrentengesetz 1974 §1b(3) and Versicherungsaufsichtsgesetz 1992 §§112-118
188 See BaFin, Gesamtliste aller zugelassenen Versicherungsunternehmen und Pensionsfonds mit Geschäftstätigkeit (18 November 2011) listing Allianz, Alte Leipzigiger, Bosch, BVW, Chemie, Deutsche Post, Deutscher, DEVK, ERGO, Generali, HDI-Gerling, HVB Trust, IBM, Lippische, LVM, MAN, Nestle, Nürnberger, PostBank, R+V Group, R+V, RWE, Siemens, Sparkassen, Swiss Life,
had opted to constitute as an AG with member representation. The consequence was important for the voice of contributing members. The Bundesarbeitsgericht held in 1978 that under the 1972 Act §87(1) Nr 8 codetermination rights would extend to a fixed list of questions, unless an agreement on organisational representation was reached.\textsuperscript{189} But if organisational representation was agreed, it was not required to be equal, or in the executive. In practice, it seemed the chairs of Pensionsfonds’ supervisory boards were management representatives. So when a supervisory board elected the executive, the voice of beneficiaries were at risk of exclusion. No new pension fund utilised the SE to have a codetermined one tier board.\textsuperscript{190} Employers participated most in investment choices about their workers’ money.

By 2008 the Direktzusage composed 57 per cent of pension assets, Direktversicherung was 12 per cent, and the other schemes where there could be codetermination stood at just over 30 per cent.\textsuperscript{191} Employers held onto pension money within the company through the Direktzusage system when they could, built up money on their balance sheets, and used the resulting liquidity for their own purposes. This risky, undiversified pension strategy had to be insured under the 1974 Act, which boosted the insurance business, and in turn necessarily increased the costs to employees in their pension savings. It all had consequences for share ownership statistics.

\textsuperscript{189} BAGE 31, 11 (13 July 1978) 3 ABR 108/77. NJW 1979, 2534.

\textsuperscript{190} See Council Regulation on the Statute for a European Company 2157/2001 art 43 and Employee Involvement Directive 2001/86/EC, which lays down no fixed rules, but instead requires negotiation to take place on the transformation to an SE between the union and the employer. \textit{nb}, it seems there would be no issue under insurance law, VAG §7a, about qualifications for the Geschäftsleiter, because the Vorstand in a collective in either an AG or an SE, \textit{cf} Aktiengesetz §77 Abs 1, Satz 1, and compare the opinion in W Blomeyer, K Otto and C Rolfs, \textit{Betriebsrentengesetz} (5th edn 2010) 372, nn 863.

\textsuperscript{191} European Federation for Retirement Provision, \textit{Annual Report 2011} (2011) 48
At least three important features stood out, particularly compared to the UK and US figures. First, while a slow decline of individually owned shares is apparent, non-financial companies (recorded as ‘other enterprises’) had long retained a dominant position, over 40 per cent of share ownership in 2004. Independent pension scheme investment (recorded as ‘insurance’) was far less. Why would German companies have had such a significant propensity to buy into the share market, when companies’ investment in the UK and US was negligible? One reason is that German companies had access to additional liquidity from pension money, and so part of the explanation must be that this facilitated and financed purchase of shares in other companies. This must be why, throughout the 1980s and 1990s the rate of new equity issues correlated closely to the increase in pension reserves. The impact on relative share ownership was only further pronounced because of the income linked state pension. This reduced the overall volume of retirement money, and so the German stock market too was smaller.

The second evident trend, since the mid-1990s and after a decline that can be attributed to unification, German share markets were globalising. Third, on the face of it German banks maintained an ownership ratio of under 10 per cent. However the true picture of banks’ participation in corporate governance is represented by the broken black line at the top of the graph.

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**At ch 6(1)(b) and ch 6(3)(e) respectively**


**H Kempkes, *Die betriebliche Altersversorgung in Deutschland und in der Schweiz und ihre Bedeutung für die Finanzierung von Unternehmungen* (Stehle 1964)**

chart. It shows the proportion of shares that are in securities deposits, with banks. This statistical survey of German share ownership was discontinued after 2004 for reasons that are unclear. Nevertheless, banks were able to decisively influence corporate governance because unless voting instructions were actively given they could appropriate the votes of almost all other shareholders.

(c) Origins of banks’ role in companies

German banks acquired their role in corporate governance through a peculiar interplay of stubborn legal doctrine, practical convenience and power. When company shares were first being issued on a large scale in the 19th century, contract law was unprepared. Shares were originally only transferable without the consent of the issuing company if the shares were in ‘name’ form (Namensaktien). This meant the share certificate stated the holder’s name. When the holder wished to assign the share to another person, people attached a note to the share certificate. After some time, it became apparent that it would be simpler for companies to issue ‘bearer’ shares (Inhaberaktien) so that the possessor or bearer of the share certificate would be the owner.

However before unification in 1871, each German state had its own rules on assignment of intangible rights. If a share was sold to a person when the seller lacked a good title (for instance, because the share was stolen) then the recipient’s title could still be open to challenge. There was no defence for the bona fide purchaser of an intangible asset, as shares were originally deemed to be. Prussia and other states had laws to protect the recipient, but many states had not. To overcome the problem for all German speaking states, the legal academic Carl von Savigny suggested that shares simply be reconceptualised as tangible assets, for which in all states a bona fide purchaser rule applied. The reasoning was simply that the Wertpapier (share certificate) was not just the share’s tangible manifestation but was the share itself (rather than a share being an intangible bundle of rights, like entitlement to dividends or the vote). But if the share certificate itself was the share, then owners needed to keep their shares safely deposited somewhere. Banks offered this service.

Once the banks began to collect people’s shares for safe keeping, the system developed a logic of its own. The hyperinflation that followed World War One led banks to pool all their deposited shares with one another. While previously banks had kept their own separate deposit facilities, and shifted share certificates at the end of the week to reflect their customers’ trades,

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197 Allgemeines Landrecht für die Preußischen Staaten 1794, Title 15, §§45-47

198 C Savigny, Das obligationenrecht als theil des heutigen römischen rechts (1853) see D Einsele, Wertpapierrecht als Schuldrecht (1995) 5; PU 1544 E 35.
this paper pushing system simply became too cumbersome and costly given the wild monetary depreciation. In 1925, the Berlin banks led the way in seeking their clients’ approval (and regretfully informing that charges might rise otherwise) for shares to be put in a central depository where trades would be effected simply by changing the banks’ own files. Like in Berlin, deposit centres were created in Dresden, Essen, Frankfurt and Stuttgart. The system’s legality was backed with the force of a specially commissioned ‘expert’ opinion.\(^{199}\) Two solicitors, Georg Opitz and Hans Schultz, assured the banking community that even though the actual owner’s share certificate had passed through the hands of, first, their bank, and second, their bank’s bank, they still maintained ‘constructive possession’ of the share, and thus were still covered by the \textit{bona fide} purchaser rule applicable to ‘tangible’ share certificates.\(^{200}\) The result was that while ‘bearer’ shares were still legally necessary, the share really needed to be borne by the bank.

\((d)\) \textit{Bankenmacht}

By the mid 1920s, with most of Germany’s shares under its supervision, the banks began to offer voting services to their customers. If their customers did not wish to vote at company meetings, the banks would do it for them. They got authority for doing it in standard form contracts, with standard business terms (\textit{allgemeine Geschäftsbedingungen}) when opening accounts. Up to this point, the courts had held consistently that a shareholder could not contract away her voting rights, primarily because it was thought that such shareholder agreements adversely affected the relative rights of other shareholders.\(^{201}\) But in 1923, the \textit{Reichsgericht} had a sudden change of heart. Just as the banks were accumulating votes on an unprecedented scale it was held that a shareholder’s position as a member of a corporation did not impede their ‘freedom of contract’ to make their votes be governed exclusively by the law of obligations: and that was so even if the obligation came in a standard form.\(^{202}\)

In 1925, the \textit{Reichsgericht} went further, adding that only damages, and not specific performance, could be awarded as a remedy for a breach of a voting agreement.\(^{203}\) The banks did

\(^{199}\) Micheler (2007) 122 LQR 251, 279, ‘Rather than reverting to a reform of the law of assignment, which would have reflected current market practice more accurately, the concept of possession was stretched to accommodate change. As a result paper documents were immobilised but not abolished.’

\(^{200}\) G Opitz and H Schultz (15 May 1925) 24 Bankarchiv, Special Issue, Nr 16

\(^{201}\) See the Reichsgericht Judgment (16 March 1904) RGZ 57, 205, 207, invalidated an agreement among the shareholders of a close GmbH because it was incompatible with public policy and the core functions of a corporation. One could not restrict freedom to vote stock through arbitrary contracts. Reichsgericht Judgment (7 June 1908) RGZ 69, 134, 137, it would restrict his ability to freely exercise his judgment according to what was in the best interests of the corporation.

\(^{202}\) RG Urteil (19 June 1923) RGZ 107, 67, 70. See also, RG Urteil (4 November 1927) RGZ 118, 330.

\(^{203}\) RG Urteil (20 November 1925) RGZ 112, 273, 279. See also, RG (10 January 1928) RGZ 119, 386, 390; RG (12 October 1940) RGZ 165, 68, 78. After the reforms in the \textit{Aktiengesetz 1965}, the Bundesgerichtshof liberalised the position, in line with the ordinary law now in the UK or the US, that specific performance may be granted as a remedy. But the BGH began
acknowledge potential public concern. In 1930 the central banking association publicised that their members had promised each other they would consult their customers on the use of votes two weeks before a general meeting involving contentious issues. The legislature’s response was to codify the practice of the banks. Was Johnannes Zahn, the German Banker Association prodigy (like the Doctor Strangelove of corporate law) lurking in the background? Who knows. But the Aktiengesetz 1937 (Public Companies Act 1937) introduced a new §114, stating the maximum period of authority was fifteen months. Also, banks were not entitled to take authority for voting through a composite standard form agreement. Authority had to be given separately. A standard form maybe, but a separate standard form.

Unlike the rules on director elections and shareholder voting, these provisions of the Aktiengesetz 1937 reflected, not just the views of Nazi apparatchiks like Zahn, but also a general persuasion of that era’s German legal academy. Subsidising Bankenmacht was thought to be tolerable, wrote Frederick Mann, because although it facilitated, the evasion of provisions aiming at a restriction or suspension of the voting rights of the owner, and it gives the banks a predominant influence, it secures the representation of a great number of shares which otherwise would not be represented and which in this country are represented by proxy.

It was acknowledged that banks routinely supported management, though this could hardly be surprising considering who was appointing the management.

Later commentators have, as with the matter of elections for directors and shareholder voting rights, vocally disputed the notion that the Aktiengesetz 1937 reflected Nazi ideology, maybe with an eye to defend the descendant provisions in today’s law. But on this issue, as with director elections, it seems irrelevant which party the ideology belonged to. Just as Walter

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204 Centralverband des deutschen Bank- und Bankiergewerbes (1930) BankA 1930-31, 116, Beschluß ‘daß die Mitglieder unseres Verbandes einander gegenüber die Verpflichtung übernehmen, an die Besitzer bei ihnen hinterlegter Aktien eine ausdrückliche Anfrage über die Art der Ausübung des Stimmrechts zu richten, wenn ihnen von einem anderen Verbandsmitglied zwei Wochen vor der Generalversammlung die Absicht einer Opposition bekanntgegeben worden war’.


Rathenau had said shareholders were ignorant and so that supervisory councils were needed, it had become a common view that bank power was desirable because banks brought prudence.208 Well informed people thought voting rights should be taken altogether from anyone who was not a ‘responsible’ and ‘entrepreneurial’ shareholder.209 They just happened to be living in a time when those views prevailed. And so even though the ideas was not cooked up in the cells of Landsberg Prison, it did not dilute the rotten ideological flavour of the age. The Aktiengesetz 1937 legitimised the practice that bankers got voting control in corporate governance, and all with other people’s money.210

Following World War Two, the Allied Occupation’s policy had been to de-concentrate economic power. It broke up the banks by region, so that a hostile government could not so easily strangle a few heads of industry, and again disrupt the peace. Once the Allies withdrew, however, the separated entities quickly recombined to create by September 1952 three big banking concerns: Deutsche Bank, Dresdner Bank, and Commerzbank.211 Possibly to reassure the public ahead of this move, the banking association made an announcement in March 1952. It promised to seek instructions from their depositors for votes on constitutional amendments, for any qualified majority vote, or if there was opposition to a vote two weeks before. Moreover if instructions were not given, promised the banks, they would exercise the votes ‘in the shareholders’ best interests’.212 The German Legal Academy was sceptical, and in its discussions on reforming company law it emphasised the danger of conflicts of interest.213 The government also appeared interested in testing alternatives, and so in the Volkswagengesetz 1960, which governed the partly public car company, with many small investors, banks were prevented from voting unless they had been given specific instructions. This led to fewer votes being cast at meetings,214 but it does not seem to have stopped the company’s global success and innovation.

When the Aktiengesetz 1965 recast company law, its practical changes were minimal. The new law essentially enacted the voluntary undertakings of banks from 1952. Under §128, now in §135(2), banks were to vote in the shareholders’ “best interests”. Quite who would sue, and for what remedy, to find out what this ‘duty’ actually means has not been answered. It probably

208 e.g. R Rosendorff, ‘The New German Company Law and the English Companies Act, 1929 - II’ (1933) 15(1) JCLIL 112, 113
209 R Müller-Erzbach, Umgestaltung der Aktiengesellschaft zur Kerngesellschaft verantwortungsvoller Großaktionäre (Berlin 1929) 20, proposed that voting stock should be reserved for “responsible” and entrepreneurial shareholders. Small shareholders should only be given non-voting stock. Referenced by J Köndgen, ‘Duties of Banks in Voting Their Clients’ Stock’ in T Baums et al, Institutional Investors and Corporate Governance (Walter de Gruyter 1994) ch 18, 531-555, 540.
210 Köndgen (1994) 552
211 T Horstmann, Die Alliierten und die deutschen Großbanken: Bankenpolitik nach dem Zweiten Weltkrieg in Westdeutschland (Bouvier 1991) ch 8, ‘Epilog: Die Großbanken kehren zurück’
212 Bundesverband des privaten Bankgewerbes, Grundzüge über die Ausübung des Depotstimmrechts (March 1952)
213 Bericht der Studienkommission des DJT, Untersuchungen zur Reform des Unternehmensrechts (1955) Teil 1, 73, ‘daß das Depotstimmrecht… die Gefahr von Interessenkollisionen in sich birgt’.
214 Schröer, Münchener Kommentar (2nd edn 2004) §135, nn 10
means nothing. Under §135, authority to vote should be renewed every 15 months, and banks should seek instructions and disclose how they would vote, with a duty to vote according to its clients’ wishes, if expressed. Despite the new sections, public concern did not disappear. In 1978, the Monopoly Commission’s third report found that in 56 companies where banks held over 5 per cent of shares, they also controlled over 50 per cent of the voting rights.215

The next major review came in 1979, chaired by Ernst Geßler. Coincidentally, as a younger man, Geßler worked on drafting the 1937 Act. Geßler’s report, entitled Fundamental Questions of the Financial System, was concerned with the general accumulation of power by banks, through a combination of direct ownership of shares, consequent representation on supervisory boards, and further acquisition of voting rights through depository services.216 It examined proposals going as far as bank nationalisation, or de-concentration,217 and it specifically considered alternatives to the depository vote. Five main options were to (a) limit banks owning shares (b) prohibit long term voting authority for banks with large stakes in companies (c) prevent banks voting on specific issues such as board elections, or ratifying breaches of duty by a bank nominated director (d) transferring responsibility for voting to a government body, and (e) requiring that banks create voting advisory bodies, elected by the depositors. The last of these appeared to be the only option that would maintain the exercise of voting power, but transfer it to those who would be most interested, namely depositors. Specifically, the suggestion was that Stimmrechtsbeiräte (voting advisory bodies) would have an ‘advisory influence on the exercise of votes by the bank’,218 in a way that the UK’s proposed ‘Independent Governance Committees’ would.

Geßler’s proposals were not enacted, though studies continued to show banks’ decisive exercise of power.219 In 1998, the general practice of board elections, under the banks’ influence, was outlined by Friedrich Kübler.

Most shareholders give their proxy to a limited number of nationally operating banks. For

216 Geßler Commission, Bundesministerium der Finanzen, Grundsatzfragen der Kreditwirtschaft - Bericht der Studienkommission (1979)
218 Gessler Commission (1979) 287, ‘Auf eine Ergänzung unter Beibehaltung es bestehenden Systems zielen auch die Vorschläge ab, Stimmrechtsbeiräte aus dem Kreise der Depotkunden zu bilden, die beratenden Einfluß auf die Stimmrechtsausübung der Kreditinstitute nehmen, sowie die Kreditinstitute zur weitergehenden Aktiengesellschaften zu verpflichten, etwa im Hinblick auf Beteiligungen oder gewährte Kredite.’
219 A Gottschalk, ‘Der Stimmrechts Einfluß der Banken in den Aktionärsversammlung von Großunternehmen’ (1988) WSI Mitteilungen 294, in a 32 firm study, except in Volkswagen, an average of 64.5% of votes were cast, and Deutsche, Dresdner and Commerzbank held 45% of votes.
the election of shareholders’ representatives to the supervisory board of the public corporation, management prepares a list of candidates which, although open to discussion with the banks, are almost certain to be accepted. This list will presumably contain the names of managers of other large publicly owned corporations including financial institutions. Thus, if there are large institutional shareholders (banks, insurance companies or industrial firms), they will be offered proportionate representation; they will delegate managers of exactly the same type which we find on management’s list. For this reason there will be very little or even no difference between the board of a purely public corporation and a company with one or several significant shareholders.220

This assessment was corroborated by statistical studies published the same year on votes actually cast.221

By 1989 the Greens,222 and in 1992 the Social Democrats,223 had adopted policies to abolish all banks’ voting, unless they had received specific instructions sent by post. Both parties were elected in coalition in the 1998 general election, but curiously the issue had been pre-empted. Six months before, the Kontrolle und Transparenz Gesetz 1998 (Control and Transparency Act 1998) was pushed through. Following an opinion by Peter Mühlbert for the German Legal Academy in 1996,224 the 1998 Act introduced a new §135(1)(iii) that forbade exercising deposit voting rights, but only if the bank’s own shares exceeded a 5 per cent block. A new §135(2)(v) required banks to inform depositors about other forms of representation, such as through a shareholder association. The SPD and Green coalition seemed to forget their proposals, and left Bankenmacht untouched.

Did the 1998 Act significantly affect banks’ control of corporate governance? Shortly before its passage, Professor Assmann wrote that whoever might be hoping, on the basis of a negative assessment of bank power, for effective constraint would be disappointed.225 But in 2010 Stefan Simon and Dirk Zetzsche argued that the control and transparency measures of the 1998

221 M Nibler, Bank Control and Corporate Performance in Germany: The Evidence (Cambridge University PhD 1998) cited and summarised by J Franks and C Mayer, ‘Ownership and control of German corporations’ (2001) 14(4) The Review of Financial Studies 943, 954. See also J Edwards and M Nibler, ‘Corporate governance in Germany: the role of banks and ownership concentration’ (2000) 15(31) Economic Policy 239, 243 and 248. Nibler’s studies looked at what votes, from bank deposits, were actually cast in company meetings, found that it was an average of 8.5% in a 156 company study. However, this is not necessarily helpful, because votes could be controlled and not cast.
222 Die Grünen, Demokratisierung der Wirtschaft: Beschränkung der Bankenmacht (18 October 1989) Bundestag Drucksache 11/5401, 3
Act had effectively ‘brought depository voting by banks to a standstill’. They also noted that more foreign investors, who are intolerant of the system, have meant more shareholders opting out of the bankers’ vote system. The difficulty is that the evidence appears to contradict this view. Official statistics on how banks actually cast the votes on depositors’ shares were discontinued in 1994. However the statistics on banks having custody of voting rights, which did continue until 2004, six years after the Act, showed no signs of ‘standstill’. Specifically, the Bundesbank statistics recorded that banks held in their custody 62.2 per cent of shares in German companies in 2004. Why would their voting practices have suddenly changed? But most importantly, whatever the 1998 Act did, it did not introduce new reasons why banks should hold any votes at all.

In March 2013, the Swiss people came to a similar conclusion. Swiss banks had acquired an identical role to German banks, controlling corporate governance by appropriating the votes on share deposit account holders. From 2005 an independent politician named Thomas Minder had been gathering signatures to stop what he delicately described as the ‘Abzockerei’, or ‘rip-off’ culture in business. When the financial crisis hit, he reached the threshold of 100,000 signatures to require Switzerland to hold a referendum. The public discussion focused on executive pay, and 72 per cent of voters supported the reforms, the second highest result historically. The law’s content related to executive pay in that it required that voters in the general meeting would have direct appointment rights over the directors on company remuneration committees. But most significantly, it required that pension funds would actively cast their votes, and it prohibited banks casting any votes at all. Klaus Hopt, a highly distinguished German academic lawyer, soon wrote that it was ‘sheer populism’. But whether the surrounding rhetoric was populist or not, the Swiss had achieved reform (mirrored by the US Dodd-Frank Act 2010 for brokers) while 80 years of German dithering had not. It suggested that the reform agenda in Germany would probably be revived.

227 Simon and Zetzsche (2010) 5 ZGR 918, 925
229 Technically the vote was a ‘people’s initiative’, being proposed by citizens, rather than a referendum, put to the people by Parliament.
230 KJ Hopt, ‘Conflict of Interest, Secrecy and Insider Information of Directors, A Comparative Analysis’ (2013) 2 ECFR 167, 181
(c) Conclusion

Behind the German institutional veil, the ultimate beneficiaries were disenfranchised to an inordinate extent. Germany was a pioneer in the experiments for a democratic economy, but trade union organisation had not yet matched the coordination and bargaining power of the banks. People’s pension money had been routinely used as a source for employers’ personal financing, and this freed up capital by which companies could buy shares in other companies. In the remaining pension schemes, where beneficiaries could codetermine the use of their savings, their voice was more symbolic. Trade unions seemed to have pressed less urgently for change because the state pension remained the foremost source of retirement income for most workers. Meanwhile, banks had appropriated most voting rights on shares through standard form contracts. And so where asset managers dominated in the UK, in Germany it was the banks.

(3) United States: laboratories of democracy

The US investment system came to resemble the UK more than Germany, because when social security was eventually implemented it was a minimum safety net, not an income linked pension. This enabled the dominance, not of banks, but asset managers. In 1862, Abraham Lincoln passed ‘An act to grant pensions’ for army personnel, but it remained limited to the disabled. In 1904, Theodore Roosevelt’s progressive era administration extended the pension to all army veterans who reached age 65. But when state legislatures attempted to follow suit, or create pensions for everyone, a judiciary hostile to socio-economic reform confronted them. In the first instance, in 1914, the Arizona Supreme Court declared its new state pension law to be unconstitutional because it was not means tested. Ross CJ said, a citizen and taxpayer ought not to be made or required to help pay pensions to those who have enough and to spare of the world’s goods. I can think of no principle of law or justice that could be invoked to sustain a law that required him to do so.

231 An act to grant pensions. July 14, 1862, ch 166 (12 Stat 566) section 1, army personnel who had since 4 March 1861 been ‘disabled by reason of any wound received or disease contracted while in the service of the United States...’ were entitled.

232 In his Second Inaugural Address (4 March 1865) Lincoln appeared to envisage an extension, but was assassinated just a month later before anything took place. He had called ‘to bind up the nation’s wounds, to care for him who shall have borne the battle and for his widow and his orphan, to do all which may achieve and cherish a just and lasting peace among ourselves and with all nations.’

233 Executive Order No 78, extending the Disability Pension Act 1890 which had recast the previous 1862 law. See P Blanck, ‘Civil War Pensions and Disability’ (2001) 62 Ohio State Law Journal 109, 124-127

234 Signalled by Lochner v New York, 198 US 45 (1905) which in turn played out the consequences of Allgeyer v Louisiana, 165 US 578 (1897)

235 State Board of Control v Buckstegge, 158 Pac 837, 842 (1916)
By 1923, public pension schemes had only survived in Montana, Nevada and Pennsylvania. The Nevada law had to be reconfigured so that counties could choose whether or not to opt in. The Pennsylvania Supreme Court struck down its state pension, because redistributing money for ‘benevolent’ purposes was found unconstitutional.\textsuperscript{236} By 1929, only Montana’s old age pension remained.

Yet many people were still becoming rapidly more affluent in the post World War One economy. The absence of any pension propelled their desire to save somehow privately. Direct investment in the stock market must have looked attractive, and so came the great separation of ownership and control from 1916 to 1919 described by Gardiner Means.\textsuperscript{237} Those many new small investors, though, were left weak compared to the companies from whom they purchased shares. As chapter 5(3) showed, they could be easily disenfranchised until the New York Stock Exchange stepped in. They were also poorly informed, and susceptible to aggressive sales practices. When the speculative bubble, and the Great Crash arrived,\textsuperscript{238} the courts undoubtedly bore much responsibility. As Brandeis J wrote in 1932 (and with even more truth than he intended) the courts had constrained whether ‘a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.’\textsuperscript{239}

(a) The Slow Deal

If state pensions were suppressed, and the stock market was on the road to ruin, what were the other options to save for retirement, and who would run them? The life insurance industry was one place to buy protection in old age, though it had acquired a record of scandal. In 1905, after Equitable Life had funded an opulent party for a policyholder, a public outcry led to the establishment of the Armstrong Commission, with Charles Evans Hughes as chief counsel.\textsuperscript{240} It uncovered patterns of bribes, mismanagement and self-dealing. But the legislative response was not to found a better old age programme, rather than limit to insurers’ rights to own shares, control banks, or invest in securities. In Massachusetts, Louis Brandeis, then developing his name

\textsuperscript{236} Busser v Snyder, 282 Pa 440 (1925) noted, in the same vein of sentiment, by IJ Williams (1927) 11 Constitutional Review 239. cf, by the Republican Governor Gifford Pinchot, ‘Old Age Assistance in Pennsylvania: Righting the Neglects of Yesterday’ (1924) 14 American Labor Legislation Review 288


\textsuperscript{238} See J Galbraith, \textit{The Great Crash} (1954) ch 10. Note that explanations of causes based on speculation can equally be taken to identify the cause as ‘absence of regulation to deter speculation’, e.g. duties of disclosure enforced in all financial transactions.

\textsuperscript{239} New State Ice Co v Liebmann, 285 US 262 (1932)

as a socially minded legal partner, attempted a different initiative. While condemning the insurance industry for ‘legalized robbery’, he promoted a voluntary, quasi-public option for buying insurance. Brandeis optimistically argued this ‘social alternative’ avoided the ‘compulsory’ nature of the German pension, and unlike National Insurance in the UK, the need to buy insurance individually would both make ‘workingmen independent’, and avoid ‘burdening general taxation’. Sadly, though Brandeis consulted 300 trade unions, the scheme failed to attract subscribers.

At the time of the Massachusetts plan there were no official statistics on the extent of old age deprivation. Yet it is plain that occupational pensions were few, and the rights allowed by employers were negligible. American Express, then engaged in rail and post, is usually thought to have introduced the first occupational pension in 1875. Its aim was to compel worker loyalty, and this was effective because the pension was said to be a gift, not a right that was earned. The courts backed this up, for instance in a New York case from 1898 where an employee, dismissed without a reason, claimed the pension money in his name belonged to him. The court rejected this because the employer ‘voluntarily’ set aside ‘a portion of its profits belonging to shareholders’ and nothing more. It was never the employee’s property, and the court refused to recognise a trust. Moreover, employers would run the fund. For instance, the Chicago and Northwestern Railway Company had five officials running its $200,000 fund, but all employer appointed.

The first exception to employer dominance coincided with the Commission on Industrial Relations. Louis Brandeis had been a witness, and urged that ‘rule by the people… involves industrial democracy as well as political democracy’. Similarly the leading report, released in

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242 LD Brandeis, Life Insurance: The Abuses and the Remedies. Address Delivered before the Commercial Club of Boston (1905)
245 WC Greenough and FP King, Pension plans and public policy (1976) 27
246 S Sass, The Promise of Private Pensions: The First 100 Years (HUP 1997) 22-24
247 A Federal court endorsed this in Menke v Thompson, 140 F2d 786 (8th Cir 1944). This view had expired by the time of ERISA 1974, see Howell v United States, 775 F2d 887 (7th Cir. 1985).
249 Commission on Industrial Relations, Final Report and Testimony (1916) vol 8, 7659-7660, LD Brandeis, The Fundamental Cause of Industrial Unrest (1916) said the following. ‘The social justice for which we are striving is an incident of our democracy, not its main end… the end for which we must strive is the attainment of rule by the people, and that involves industrial democracy as well as political democracy. That means that the problem of a trade should be no longer the problems of the employer alone… The union cannot shift upon the employer the responsibility for conditions, nor can the employer insist upon determining, according to his will, the conditions which shall exist. The problems which exist are the problems of the trade; they are the problems of employer and employee.’
1915, recommended reforms to collective bargaining to that end. One of the star guests was undoubtedly Andrew Carnegie, the Scottish rail and steel magnate. Carnegie had always fashioned himself as a progressive capitalist, propounding his view that the ‘man who dies thus rich dies disgraced’ and that ‘the millionaire will be but a trustee of the poor’. His philanthropy had led him to be a trustee of Cornell University from 1890, but it was directly after his appearance before the Commission that he acquired a particular desire to improve pensions. In his testimony, he had agreed that workers should have more say in industry, and the way forward was for workers to become shareholders, so that ‘workmen and capitalists’ were ‘pulling and owning the same boat’. But as it happened, Carnegie found pensions – not employee share schemes – to be his vehicle. During 1915, he asked Dr Henry Pritchett, president of the Carnegie Foundation for the Advancement of Teaching, to create a new plan, and one that involved ‘some form of oversight’ by the policyholders. Carnegie donated the start up capital for a new Teachers Insurance and Annuity Association, members elected a quarter of the 20 person board, albeit from nominees screened by a committee. The first board was appointed by the Carnegie Foundation, and member representation was implemented with one trustee a year from 1921 to 1926.

So with some encouragement by a federal enquiry, Carnegie was inspired to bring member nominated trustees to the US. But could the growth of occupational pensions be encouraged? University teachers were a privileged group, while most people had nothing. Federal tax policy had offered some help. The Tariff Act 1913, which re-introduced progressive income tax (but only after the Sixteenth Amendment, because the Supreme Court struck the tax down), allowed employers to deduct pension payments and deferred annuity premiums as a business expense. This meant a smaller figure of profit would be taxable.

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250 Commission on Industrial Relations, Final Report and Testimony (1915) vol 1, 92 ff lists the extensive recommendations. The key appears to be at 137, where it is suggested that the UK Trade Disputes Act 1906 be a model for US law. However, the leading report did not win majority support. The favoured approach of a majority was a system of industrial arbitration.

251 RL Hannah, ‘The control of pensions: a brief history and possibilities for the future’ (2000) 40(10) Management Decision 938, 939, notes also that Carnegie pre-funded his steel worker pensions, thus placing him at the progressive end.

252 Final Report (1916) vol 9, 8288, Andrew Carnegie. ‘When workmen were made shareholders they were sold shares in the company upon a very liberal basis and guarded against loss. I consider this the greatest of all steps forward yet taken for making workmen and capitalists fellow workmen indeed, pulling and owning the same boat. This cannot fail to prove highly profitable to both.’

253 WC Greenough, It’s My Retirement Money - Take Good Care of It: The TIAA-CREF Story (Irwin 1990) 33-37

254 In 1952, the plan was extended to buy into shares, with the College Retirement Equity Fund, making TIAA-CREF. In 1988, to register a new money market fund with the SEC, risked losing charitable status (previously exempt under the IRC, 26 USC §501(c)(3)). So instead, CREF trustees were wholly elected by policyholders, according with Investment Company Act 1940 §16, 15 USC §80a–16. See also Greenough (1988) 360-362.

255 Pollock v Farmers’ Loan & Trust Company, 157 US 429 (1895) and Brushaber v Union Pacific Railroad, 240 US 1 (1916)

256 Revenue Act 1918, further provided that employers who separately constituted funds could claim deductions. S Sass, The Promise of Private Pensions: The First 100 Years (HUP 1997) 102-103
further,\textsuperscript{259} exempting for any profit sharing or stock bonus trust used ‘for the exclusive benefit of some or all employees’.\textsuperscript{260} The Internal Revenue Service then extended the exemption to pension funds.\textsuperscript{261} When companies accumulated pension savings, they paid no tax until employees received and spent the money.

Tax breaks helped a little, but the real growth in occupational pensions came with collective bargains. Trade unions, however, took a long time to overcome their distrust, because employers had repeatedly used withdrawal of pensions as a weapon against union recruitment.\textsuperscript{262} This encouraged views like those of Samuel Gompers, president of American Federation of Labor.

Paternalism either in government or in industry is abhorrent. It takes away the initiative of the workers who should themselves prepare for old age.... Until the Government itself establishes an old age pension system, labor will insist that pension systems shall be controlled by the workers themselves, without any connection whatever with the employers.\textsuperscript{263}

This really left most people with nothing, because there were very few independent union plans. Understandably, questions of basic wages and hours preoccupied most union negotiations.\textsuperscript{264} Furthermore, many union plans failed during the Depression.\textsuperscript{265} Overall, by 1929, just 3.7 million US workers had pensions, around 10 per cent of the non-agricultural labour force. In railways, where unionisation was high, around 85 per cent of people had pensions. But again, when Wall Street crashed a substantial number were unilaterally reduced or closed.\textsuperscript{266}

The economic catastrophe crystallised the view that compulsory state pensions were necessary,\textsuperscript{267} and governments began to act, regardless of what courts might say. California, Wyoming, New York and Massachusetts introduced pensions by 1930, and almost half the states

\textsuperscript{259} The Revenue Act 1921 was primarily a tax cut initiative, led by Andrew Mellon. Mellon had inherited his father's bank, diversified into industry, acquired the position of Secretary of the Treasury, and became the third highest American taxpayer by the mid 1920s.

\textsuperscript{260} Revenue Act 1921 §219(f)

\textsuperscript{261} This was followed in the updates of the Revenue Act 1924 and 1926 § 219(f). The Revenue Act 1928 §165, as well as updates in 1932, 1934 and 1936, further allowed deductions for past accumulations, but the deduction had to be spread over 10 years.

\textsuperscript{262} L Conant, \textit{A Critical Analysis of Industrial Pension Systems} (1922) 18-49

\textsuperscript{263} Quoted in Conant (1922) 22

\textsuperscript{264} MW Latimer, \textit{Trade Union Pension Systems} (1932) 8-9

\textsuperscript{265} S Sass, \textit{The Promise of Private Pensions: The First 100 Years} (HUP 1997) 125-7

\textsuperscript{266} D Schapiro, ‘Employee Pensions in Collective Bargaining’ (1950) 59(4) Yale Law Journal 678, 680. nb Mellon's response to the crash in November 1929, according to Herbert Hoover, was to ‘liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate. It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up from less competent people.’

\textsuperscript{267} cf JR Commons, \textit{Principles of Labor Legislation} (1916) 398-403
had followed by 1933. Shortly after Franklin Delano Roosevelt’s election, the Railroad Retirement Act 1934 created a compulsory contributory scheme for railway workers, vested in the US Treasury and managed by a government board. Railroad Retirement Board v Alton Railroad Co struck it down, Roberts J holding that employers subsidising employees of other companies was ‘an unnecessarily harsh and arbitrary imposition if the plan is to be what on its face it imports -- a joint adventure with mutuality of obligation and benefit.’ But the 1934 Act was simply a prelude to the Social Security Act 1935, inventing retirement for everyone. The Supreme Court continued to strike down previous parts of the New Deal in a few more cases, until on 3 November 1936, Roosevelt won a second election with 60.8 per cent of the vote, carrying every state except Maine and Vermont. With Democrats prepared to pack the court with new judges, Roberts J made the obviously principled decision to support the New Deal. In Helvering v Davis, a shareholder of Edison Electric Illuminating Co brought a derivative claim to injunct the company from paying social security, saying it exceeded the Federal government’s power. Cardozo J, now with a majority, explained that it was lawful for Congress to spend money for ‘general welfare’, and Congress had broad discretion to determine what that meant.

Social security created a minimum income in retirement, but the National Labor Relations Act, passed on 6 July 1935, was the key to secure a fair income through collective bargaining. Although slow to come, the new policies worked quickly. Tax was reformed again by the Stabilization Act 1942 and the Revenue Act 1942. Employers had been creating pensions that were limited to top officials and thus claimed the payments were tax deductible because it was for ‘some or all employees’. From 1942, tax exemptions could only be given if 70 per cent of permanent employees were covered by a plan. Also, because of the war, wage restraints had been imposed, but pensions were exempt. Because they were among the limited fields where unions

269 295 US 330 (1935)
270 nb, at 295 US 330, 372 (1935) Hughes CJ, Brandeis J and Cardozo J dissented. The government argued that it fulfilled the requirements of due process because pensions promoted efficiency, due to their ability to improve morale and create loyalty to the company. The reply was apparently that the removal of the voluntary character of pensions necessarily ‘will eliminate all sense of loyalty and gratitude to the employer’.
271 Judicial Procedures Reform Bill 1937
272 This succeeded first with the approval of Washington’s minimum wage legislation in West Coast Hotel Co v Parrish, 300 US 379 (1937). The NLRA 1935 was approved in National Labor Relations Board v Jones & Laughlin Steel Corporation, 301 US 1 (1937)
274 National Labor Relations Act 1935 §8(a)(3)-(5) were crucial provisions, in freeing union members from discrimination, and requiring bargaining by the employer.
could make progress through collective agreements, pensions grew fast. In *Helvering*, Cardozo J had recorded that three out of four people over 65 had been wholly or partly dependent on others in old age. Social security ended this, and collective bargaining meant private sector coverage rose from 15 per cent in 1940 to over 40 per cent by 1960. And initially, unions bargained for plans where they controlled the contributions completely.

(b) From union to asset manager control

Post-World War Two, union membership stood around 35.5 per cent of non-agricultural workers. Then, employers reacted. In a wave of strikes over 1945 and 1946, unions were accused of using pensions to compensate strikers and so having an unfair advantage. Employers challenged the legal right to collectively bargain over pensions altogether. Shareholders were bringing derivative claims, arguing payments to union pensions were *ultra vires*. These were mostly unsuccessful, but the 1946 election had returned a Republican majority to Congress. A new Labor Management Relations Act 1947 §302(c)(5)(B) stipulated that no that money could be paid by an employer to any employee fund, unless it was jointly managed with an employer, with a neutral umpire or a court determining disputes in case of deadlock. While Carnegie had guaranteed American workers a voice in the use of their pension money, the new Congress guaranteed a voice for employers.

The Act’s main proponent, Senator Robert Taft, had in fact wanted to prohibit involvement of employees altogether. This was reflected in the House of Representatives’ proposal. He singled out the United Mine Workers pension fund, where the union leader, John Lewis, had been demanding a solely union administered fund from the government. Taft wanted to keep pensions for the use of employers, while Lewis saw sole pension control as to

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277 Editor, ‘Legal Status of Private Industrial Plans’ (1940) 53 Harvard Law Review 1375
278 M Shearon and Social Security Board, *Economic insecurity in old age: social and economic factors contributing to old-age dependency* (GPO 1937) 15
280 *Inland Steel Co. v NLRB*, 77 NLRB 1, enforced, 170 F 2d 247 (7th Cir 1948), cert. denied, 336 US 960 (1949)
281 FH O’Neal, ‘Stockholder attacks on corporate pension systems’ (1948-1949) 2 Vanderbilt Law Review 351
282 Labor Management Relations Act 1947 §302(c)(5)(B) (*29 USC §186*)
284 See HR Rep No 245, 80th Cong, 1st Sess 29-30 (1947); Also, ‘House set to compromise on Labor Bill in order to obtain measure on which veto could be beaten’ (10 May 1947) Wall Street Journal, 3
285 R Blodgett, ‘Union Pension Fund Asset Management’ in * Abuse on Wall Street* (Quorum 1980) 320, 321
286 This led to *United States v United Mine Workers of America*, 330 US 258 (1947) where the US Supreme Court declared Truman’s attempted nationalisation of the mining industry unconstitutional. The union controlled, employer funded pension was a post-strike settlement.
287 J Rifkin and R Barber, *The North Will Rise Again: Pensions, Politics and Power in the 1980s* (1978) 101-2, ‘Senator Claude Pepper of Florida... suggest[ed] that Taft and his business friends, when they fretted over possible union abuses of the funds, were really fretting over the possibility that they might lose control of the potential pool of capital that pension funds represented. Pepper was right, but despite the fact, or probably because of it, the vote went against labor.’
the advantage of unions. The miners’ dispute itself was resolved by the federal government getting an agreement to jointly administer the fund. This collective agreement became the model for §302. President Harry Truman used his veto twice, but enough Democrats supported the Taft-Hartley Act 1947 measures for it to pass.

Although the Taft-Hartley Act 1947 limited employee involvement on its face, it tacitly promoted the joint management model. As post war union membership remained strong the number of codetermined pensions, ironically named ‘Taft-Hartley’ plans, grew. On top of the single employer pensions, by 1960 multi-employer plans covered 3.3 million workers, rising to 9.7 million workers in 1988. Ever more, this money was invested into shares. But employers did avoid employee involvement if they could. Early on in 1950, and flaunted as a victory for both sides, General Motors initiated a sole-employer pension as part of a five year collective agreement. The General Motors pension was confined to investing a maximum of 0.75 per cent in any company’s stock, and managers were also instructed to be inactive in corporate governance. Here, as it happened, it was not Roe’s ‘populist’ politicians which limited pension funds holding blocks – leading to his example, seen in chapter 3(1)(a), of no shareholder having more than 1 per cent of General Motors – but a strategy of corporate boards like General Motors itself.

Aside from the lack of voice for contributors, significant problems were that, first, employees could not move pensions if they moved jobs. Similarly many plans still did not vest, or allow the worker their money if their job terminated. Second, while the employer might accumulate the savings on the company’s books, it did not actually set aside money. There were no minimum funding requirements. Pensions crashed with employers. Following a popular NBC documentary entitled Pensions: The Broken Promise, Congress acted with the Employee

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288 Louis Stark, ‘New strike looms, coal official says’ (12 February 1947) NY Times, 5, quoting the hostile view of Forney Johnston of the National Coal Association, that the Union of Mine Worker proposed funds ‘are now on the agenda of every central union in a program of sweeping encroachment on the earnings and on the functions of ownership and management, with no limitation whatever except the consciences of the union dynasty.’


290 HR Bartell Jr and ET Simpson, Pension Funds of Multiemployer Industrial Groups, Unions, and Nonprofit Organizations, occasional paper 105 (National Bureau of Economic Research, 1968)

291 Rep. Peter Visclosky, 135 Congressional Record H5984–05, H6233 (1989) citing a study by the ME Segal consulting firm.


294 NBC, Pensions: The Broken Promise (12 September 1972). The documentary won a Peabody Award, and sufficiently outraged the Richard Nixon government to bring an action, through the Federal Communications Commission, for breaching the then ‘fairness doctrine’, that programming had to be duly impartial. After the Nixon controlled FCC found that NBC was in breach, the Federal Court of Appeal overturned the ruling to find no breach in National Broadcasting Company, Inc v Federal Communications Commission, 516 F 2d 1110 (1974). The fairness doctrine was later abolished by the Reagan administration, so that broadcasting needs not to make any semblance of fairness, due impartiality or accuracy. Equivalent laws persist for all television in the UK under the Communications Act 2003 s 319, and in Germany see the Rundfunkstaatsvertrag 2013 §11.

ERISA 1974 required everybody be entitled to their pension money after one year's work. Defined benefit pensions needed to have minimum funding. This was insured through the state Pension Benefit Guaranty Corporation. Trustee duties, including to take care, diversify, report, and avoid conflicts, were codified and made mandatory. ERISA 1974 required no particular form of pension governance, but did encourage outsourcing to asset managers. Under §402(a) the plan structure had to be outlined in a written instrument, §403(a) required assets to be held by trustees, and §408(c)(3) stated trustees could include the company’s own officers or employees. §408(c)(3) effectively immunised the employer against charges of breach of duty, if its plan management was tainted with its own interests rather than those of its employees. Moreover, §402(d)(1) precluded liability for negligence if the trustee delegated investment to an external manager, and §404(c)(1) immunised the sponsor from claims if a plan permitted the beneficiary to exercise control over the account assets. So if the employer managed the pension, there could be no liability for conflicts of interest, but risk of a negligence action. This meant the employer had the incentive, if they provided pensions at all, to give employees some token control (e.g. a choice of investment classes) and otherwise outsource asset management.

The regulatory incentives of ERISA 1974 encouraged a shift toward asset manager control of pension plans. Tax provisions went further, encouraging individual accounts over collectivised entities. Originally the Self-Employed Individuals Tax Retirement Act 1962 had allowed self-employed people to establish tax deferred saving accounts, called Keogh plans, for themselves or their workers. ERISA 1974 extended tax deferment to a maximum of $2000 a year in Individual Retirement Accounts (IRAs) to everyone, including those covered already by employer, union, government or Keogh plans. IRAs would often be held by banks.

In 1978 there was still demand for people to place additional funds in tax deferred accounts, so the Internal Revenue Code §401(k) allowed it. Employers often matched contributions. As more employees were sent plan details, the tax section became the popular name for the pension type. In a ‘401(k)’, employers outsourced investment work to managers of mutual firms. The employee would choose from among a range of funds within the fund family. Investment in 401(k) plans was essential for the growth in assets managed by mutual funds, rising from just 2 per cent of US household assets in 1979 to 21 per cent in 2009.


the Tax Reform Act 1986, a cap was placed on tax deferment in IRAs, so more people were encouraged to shift their assets to mutual funds altogether.\textsuperscript{298} This was the decisive step to change the trends in share ownership.

![Graph of US share ownership 1965-2009](image)

In this chart, derived from the Federal Reserve's official corporate equity statistics,\textsuperscript{299} the first important trend, like in the UK, is the ongoing collectivisation of shareholding in institutions since the 1960s. This is what Berle had identified in his later years. It was consistent with the growth of pensions achieved by collective bargaining. But, second, there was a very large change in the fortunes of private pensions from 1986. The ‘private pension’ figures included both defined benefit and defined contribution plans when they invested in shares, but only if it was managed independently or through a custodial bank. If money was placed into an open-ended investment company – run by an asset manager – it would show up under the mutual fund figures.\textsuperscript{300} After 1986, employers forced the switch in pension type to individual accounts, and so more contributions went under mutual fund heading: overtaking private pensions in 1996, and fully replacing their position by 2009.

\textsuperscript{298} ‘Mutual Funds, Brokers Taking A Bigger Slice of the IRA Pie’ (10 March 1986) American Banker
\textsuperscript{299} The Federal Reserve’s statistical set (L.213) shows raw figures, from which the author has calculated percentages, and merged some of the categories.
\textsuperscript{300} Federal Reserve, Flow of Funds Accounts of the United States: Annual Flows and Outstandings 2005-2010 (2011) 23 and 25 (in F.118 and F.121), which are the concepts used at 85 (L.213).
How did the asset management takeover affect corporate governance? If beneficiaries had individual pension accounts collective action was already hard. But if their money went to a mutual firm, it was next to impossible. Mutuals would be regulated under the Investment Company Act 1940 §16. This required that policy holders would have a vote for the board of the investment company according to their stake. But nobody was told about the voting, or when it took place. One account of the voting process in mutuals in general from 1982 ran accordingly.

In a recent election for board members of the Prudential, four vacancies were to be filled. Vying for these four spots were a total of four candidates, nominated by the board itself. Eligible to vote were 18.4 million policyholders. Of these, 323 did - virtually all of them employees of Prudential. Later in the same year, policyholders of the Equitable were called upon to choose among a field of 11 nominees to fill 11 board seats. An estimated 3,250,000 policyholders were eligible to vote but were not informed of the election; 6,400, mostly Equitable employees, voted by mail. Seven showed up at the election to vote in person.

The investment companies, where a 401(k)’s assets were placed, would usually be established by an investment adviser, working as part of a large fund family. The adviser would be regulated by the Investment Advisers Act 1940, but had no particular obligations in this respect. The adviser would select the first board of directors of the investment company and then promptly delegate the investment work back to the advisers. In the end, advisers from fund families assumed control over voting in corporate governance. Any scope for collective or individual negotiation had vanished. Invariably mutual firms would delegate the actual work of voting, as in the UK, to a proxy advice firm such as Institutional Shareholder Services. The priorities of proxy advice firms, their recommendations, and their voting, would be set by asset managers.

Why did progressive democrats not push to ensure that there was a voice for the ultimate investor, and control over asset managers? The answer, though it is intensively unsatisfying, is that when ERISA 1974 was passed very few people had thought about it. Of course, Taft-Hartley pensions, and their governance, could still be collectively bargained with an employer by a

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301 A Tobias, Invisible Bankers: Everything the Insurance Industry Never Wanted You to Know (Washington Square 1982) ch 3, 35-36
303 See ch 6(1)(c)
union. But after 1980, union membership was falling sharply in the private sector, and so this became more and more unlikely. It was then that the diminishing scope of beneficiary voice caught attention, with a 1989 House of Representatives Sub-committee hearing on leveraged buyouts. Trustees of single-employer pension plans were allegedly investing in junk bonds and terminating plans prematurely to make takeovers more attractive. Moreover, company directors were using votes on employees' pension money to defend against takeovers of friendly colleagues on other boards, or simply pursuing a pro-management policies. In 1989, Representative Peter Visclosky introduced legislation to insert a new §403(a)(2) in ERISA 1974, so that for single-employer plans employee associations would have half the seats on pension plan boards. It was rejected. In 1999 another bill sponsored by Bernard Sanders, entitled the Workplace Democracy Act 1999, was rejected. A further bill, sponsored again by Peter Visclosky entitled the Employees' Pension Security Act 2008, met the same fate. Unlike the UK or German laws, which left the form of employee representation as a matter of choice, these Bills would have required that trade union representatives took pension board seats. But it seems they would not have affected pensions organised individually. Union and codetermined pensions were becoming more active, but their declining numbers was leading their collective influence to dwindle.

(c) Broker votes

As mutual funds and asset managers dominated the stock market, they replaced banks, or broker dealers. Given America's extraordinarily high number of household investors, banks might have acquired same role as German banks, except that for they were more numerous and more disorganised. Roe's regulatory analysis provides many reasons for US banks becoming smaller, but they were actually disabled in corporate governance for a different reason. On top of the campaign against ‘banker control’ led by Ripley, if banks had wanted to use standard form
contracts to get the vote, they had been constrained after 1937. Under the Securities and Exchange Act 1934 §14b, the Securities and Exchange Commission had power to regulate proxy voting. It pressured the New York Stock Exchange to introduce Rule 452, whereby brokers could not vote on their depositors’ shares without instructions either on mergers or when it might ‘affect substantially the rights or privileges or privileges of such stock’. This was materially identical to the provisions of the German Aktiengesetz 1937 regarding instructions, but it had also included outright prohibitions. Yet the SEC had allowed voting upon certain ‘routine’ matters, which included an uncontested election for the board of directors. Authority for further rule making by the SEC was given in 1964, but nothing was done immediately. Broker voting was not so widespread, though when used it usually supported an incumbent management.

In 2006, the NYSE made a request to the SEC to change Rule 452, because of a public campaign against Disney’s Michael Eisner. Following the negligence case surrounding Ovitz’s $100m golden parachute that was described in chapter 4(3), Eisner had been singled out for dismissal. Only broker support had allowed him to remain in office. Institutional investors wanted a ban on broker voting, and the SEC condoned the change in 2009. Brokers were prohibited from voting on any election for directors, whether contested or not, unless they were registered as advisers under the Investment Company Act. But soon, the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 went further. Under §957, a new §6(b)(10) was inserted in the Securities Exchange Act 1934 to prohibit brokers from exercising any voting rights attached to shares that the Commission determined to be ‘significant’ without express instruction from their customers. Conclusively deemed significant were votes relating to director elections and executive compensation. What was said in Germany to not be possible, or sheer populism, was done in the US for brokers. Banks could not vote with other people’s money, though asset managers could.

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314 R Maidman, ‘Voting Rights of After-Record-Date Shareholders: A Skeleton in a Wall Street Closet’ (1962) 71(7) Yale Law Journal 1205, 1215
316 15 USC §78n(b) (Supp 1965)
318 The background is summarised briefly by EB Walter, ‘Regulating Broker–Dealers and Investment Advisers: Demarcation or Harmonization?’ (2009) 35(1) Journal of Corporation Law 1
319 Report and Recommendations of the Proxy Working Group to the New York Stock Exchange (5 June 2006) 9
321 NYSE Rule 452,11(19) Giving Proxies by Member Organization
322 Dodd-Frank Act 2010 §957
(d) Public sector pensions

Although private pensions had, since 1974 become re-individualised and outsourced to asset managers, public pension plans had not entirely. Originally pensions for public sector workers followed the model set by the Civil Service Retirement Act 1920. By default, employers (in this case governments) would usually choose the pension trustees just like the private sector. As ERISA 1974 was passed, only a handful of plans in Connecticut, California and Nebraska and the Ohio Teachers plan had beneficiary representatives, and Ohio’s representation for teachers began in 1973. The Wisconsin State Teachers Retirement System, unusually, had a wholly employee elected board, although a separate State of Wisconsin Investment Board managed investments, and were appointed. The California Government Code required that the pension board had beneficiary representation, and the 2010 version required seven members appointed by the employer (i.e. government), but six elected by beneficiaries. The composition of the board, however, aroused little interest until after 1967 when CalPERS was first able to invest up to 25 per cent of its assets in shares. In 1984, the limit was removed altogether. With other public pension funds, their share of votes in corporations climbed, and they made use of it.

The position by 1993 was that 45 from 50 states had beneficiary representatives on pension boards, but most were still appointed, rather than elected. By this time a succession of scandals were tarnishing their reputation, as employers used pensions to plug budget deficits by directing them to buy sub-prime government bonds. This changed with the Uniform Management of Public Employee Retirement Systems Act 1997 §17(c)(3). It did little more than require each plan disclose how its trustees were selected. But by shining a light on good practice, by 1998, out of 2670 public retirement systems there was an average of 36 per cent elected trustees, 15 per cent ex officio trustees and 44 per cent appointed trustees.

While reform took place in 1997, public pensions kept their outdated reputation among some. For instance, in 2007, Marcel Kahan and Edward Rock, relied on a hostile article from 1993 by Roberta Romano, to assert that generally ‘trustees consist of gubernatorial appointees,
elected politicians who serve *ex officio*, officials elected by fund beneficiaries, or some combination of these groups' and quickly concluded that it 'should be evident, public pension fund trustees lack significant financial incentives to maximize fund performance.'\textsuperscript{331} The contrasting view, also represented in 1993 by Mark Roe was this:

The high activism of public pension plans - pensions run for state employees - contrasts sharply with the relative passivity of private pensions. Public pensions persistently propose charter amendments, prod managers, and establish lobbying groups. Some of their actions may be political posturing, but I believe many are not. They are acting, roughly and imprecisely, the way owners would tend to act. They lack the managerial command structure that private pensions have.\textsuperscript{332}

Whatever the case in 1993, it seemed that public pensions remained no more dominated after 1997 by their employers’ values (whether pro-democratic or pro-corporate management) than private pension funds. On the contrary, they were quite ahead, and far beyond the total absence of ‘financial incentives to maximize fund performance’ found among asset managers.

Public pensions’ size meant their beneficiaries could take collective action, and the increasing presence of beneficiary voice ensured that they were leading in pushing for the classic understanding of better governance standards.\textsuperscript{333} Precisely because of their challenge to incumbent interests, public pensions became political targets. In 2005 Governor Arnold Schwarzenegger attempted to terminate the Californian plan and resurrect it as a form of 401(k) operation, but the attempt was defeated by protests.\textsuperscript{334} It has since become a consistent strategy, essentially among Republican governors, to individualise and outsource state employee retirement funds. This is driven by the Supreme Court’s decisions on election finance,\textsuperscript{335} which increases the political influence of corporate boards. Public pensions funds are targetted precisely because they have become responsive to their beneficiaries, and active. They are leading experimentation in the laboratories of corporate governance.

\textsuperscript{333} CalPERS Global Principles of Accountable Corporate Governance (2010) requiring, for instance, under B6.1 removal of directors without cause and under A4, one share one vote.
\textsuperscript{334} J Wasserman, ‘CA: Governor ousts CalSTRS appointees who oppose his pension plan’ (11 February 2005) Free Republic
(c) Conclusion

More than the UK or Germany, US corporate governance today is being pulled in two very different directions. Its tradition of worker and beneficiary codetermination in pensions is as long any, and public pension funds were leaders in governance activism. But along with the temporal decline in the American labour movement’s membership, ERISA 1974 and the 1986 tax changes were remarkably successful at re-individualising pension investment. Mutual fund corporations benefitted, and unlike the banks who brokered direct share purchases before, they had been left free to exercise other people’s voting rights on their own account. Asset managers acquired decisive influence, and all through standard form agreements. There was nothing rational about this. It was the raw consequence of unfettered bargaining power. Only public pension funds could compete, but they were still at a disadvantage. The voice of the ultimate contributor was very precarious indeed.

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Behind the institutional veil, three of the most different systems of modern corporate law begin to look very similar. Asset managers dominate corporate governance in the UK and the US, while banks dominate in Germany. But although asset managers and banks acquire their economic influence through different business channels, this does nothing to detract from the remarkable functional convergence that has been achieved: the ultimate contributors to corporate equity have been cut out, and financial institutions rule. Why has this happened?

The same themes remain consistent in institutional investment as they did for director elections and shareholder voting. The evidence follows the first positive thesis, in that progressive democrats have consistently sought to expand the domain of participation rights through all institutions. In the UK, this came from the policies in the Trade Boards Act 1918 to spread Joint Industrial Councils, the trade unions during the war who preferred trust to insurance based schemes, and a consensus between mainstream Conservatives and Labour, from the Occupational Pensions Board, to the Goode Report, to the Pensions Act 2004. In Germany, it began with Degenkolb in the 1848 revolutions, it was continued by the Social Democrats in the early Weimar Republic, but was met with stiff resistance at all times from the social conservatives, the courts, and the fascists. The US forged the expansion of voice through investment most consciously, from the New Deal unions, to the Taft-Hartley plans, to modern state pension funds, particularly after 1997. But this consistent pattern in the development of participation rights has
been left very incomplete.

The economic patterns are even more clear. The second positive thesis emphasises the irrationality of power. Standard form contracts have the same character everywhere. They serve a function of administrative efficiency, but the gains mainly go to the party who writes them. Life insurance was held back as an alternative to pensions by union bargaining power in the UK and US during the 1930s and 1940s. But from the 1980s, asset managers succeeded in appropriating voting rights, especially through the growth of 401(k) plans, with standard agreements. Without an active push back by their unions, German workers lost the voice in most of their pensions to corporate employers and in life insurance forms of pension. New regulation may come soon in some form: the cancellation of banker voting is more likely than ever in Germany after the Dodd-Frank Act and the Swiss referendum, while ‘Independent Governance Committees’ in the UK, once established in principle, could lead to many innovations. But as matters stand, what rationality is there behind the accumulation of power by asset managers and banks? It has happened through private market transactions – markets involving parties of unequal bargaining power. How can the outcomes be justified, any more than the unaccountable assumption of power by boards of directors could be?

These questions are all the more pressing because institutional investment is global. Since the fall of the Berlin Wall, in each country, the proportion of foreign share ownership has risen dramatically (tripling in the UK, doubling in Germany and the US), and will probably continue to do so. What happens behind institutional veils abroad now matters more than ever at home. If a similar culture of financial institutions controlling companies is present in each country, it has global consequences.

The statistics do not yet make clear who ‘foreign ownership’ means. It would also include a few percentage points for foreign governments’ wealth funds. But with this exception, a workable hypothesis is that the breakdown of foreign investors would resemble the

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336 The Office for National Statistics, the Bundesbank and the Federal Reserve say they have no further information.

337 Sometimes pension funds are conflated with purely government controlled savings accounts. The lack of democratic accountability appears to be the appropriate dividing line. cf RJ Gilson and CJ Milhaupt, ‘Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism’ (2007-2008) 60 Stanford Law Review 1345
average composition of domestic investors in each country. In the UK, countries in Europe and the Americas counted for 92 per cent of foreign direct investment in 2009.\textsuperscript{338} In the US, the top sources for foreign direct investment were Canada with 22 per cent, Germany with 16 per cent, France 15 percent, Switzerland 11 per cent, the UK 10 per cent, Netherlands 7 per cent, and the rest of the world 22 per cent.\textsuperscript{339} Direct investment differs from portfolio investment, but the national breakdown is unlikely to differ widely. Regulation of financial intermediaries in any jurisdiction will have consequences – whether positive or negative – for its neighbours.

The promising fact, and a reason for hope, is that the evolution is still primitive. If it were true that the functional convergence in corporate governance had reached an ‘end’, with shareholders as asset managers and banks becoming supreme, then modern corporate governance, from the progressive democrat view, might be seen as a failure – a stupefying and ruinous failure. Yet the cause for optimism, in the progressive democrat’s eyes, is still strong. There is no end. How might, and how should, corporate governance develop in future? It is to this question that Part III turns.

\textsuperscript{338} Office for National Statistics, \textit{Statistical Bulletin: Foreign Direct Investment (2009)} 4
\textsuperscript{339} Organization for International Investment, \textit{Foreign Direct Investment in the United States (18 March 2010)} 2
PART III. IMPLICATIONS
7. One normative thesis: symmetry of contribution and participation

Part I posed the question, why do some people participate in corporate governance more than others? Chapter 2 contended that the focus should shift (and maybe it already has) from ‘ownership and control’ to the separation of contribution and participation. Chapter 3 elaborated two positive theses, namely that participation rights in law have been driven by a progressive democratic movement, but incompletely compared to its social ideas. When participation was left to the market (when the law did not contain specific rights) the relative bargaining power of different groups drove results. Neither the political, nor economic development of participation in corporate governance can be regarded as principled in process, or outcome. Part II has provided the historical evidence to support these positive theses in the UK, Germany and the US, and suggested that alternative political and economic theories are not as convincing in their accounts of the causal drivers of participation rights. But if all this is true, does it matter?

This chapter makes the case that the separation of contribution and participation is a significant concern and it threatens to undo the successes of modern corporate law. Sometimes it is argued that legal history and tradition is irrelevant for justifying today’s institutions. Whether or not this is true, legal history can certainly show why today’s institutions are unjustified. It can prompt us to say, “if that’s how it happened, it can’t be right.” Precisely because political developments have followed no principle fully, and because economic evolution has an arbitrary tendency, there is a strong normative implication favouring reform. In short, participation in corporate governance is unprincipled, and it should change.

Section (1) discusses the different ways of looking at the goals of corporate law, against which a ‘good’ principle might be judged. Productive efficiency is often a central goal in corporate governance. It is argued that an economic focus is generally sound, because economic productivity serves the larger aim of social welfare and justice. If the separation of people who make the ultimate contributions to corporations continues, or grows, economic productivity is threatened because institutional intermediaries will tend to the ‘negligence and profusion’ that Adam Smith feared from company directors.

Section (2) suggests the best way to ensure that corporations function productively is to maintain the principle of a symmetry between contribution and participation. People who provide the ultimate contributions to equity should have a proportionate right to vote – direct or

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intermediated, but unbroken through the investment chain – over whoever uses their
contributions. The tension between accountability and efficiency is often exaggerated, especially
since accountable management is one of the guarantees of expertise. The market mechanism
cannot provide the necessary accountability alone because the risks of inefficient behaviour
remain whenever there are imbalances in bargaining power. This would be true even in a
hypothetical world without transaction costs. Legal duties can only create minimum standards.
Thus, the symmetry of contribution and participation rights embodies an irreplaceable principle.
If shareholding institutions can become accountable they will be, not a threat to systemic
stability, but a productive force for good. Section (3) proposes three policy options to carry the
symmetry principle into effect.

(1) Goals of corporate law

One of the difficulties of normative argument is that, as people’s values and objectives differ, so
will their proposals. In democratic discussion, obfuscation is often a way of overcoming
disagreements.\(^2\) If policies are framed at a higher level of generality, then short term political
consensus is more likely, and the details can slowly play out later. The technique is deployed when
drafting bills of rights, constitutions, international treaties, and in media discourse. In corporate
law, values such as economic productivity, social responsibility, social efficiency, democracy,
accountability, legitimacy, and expertise, are frequently used as overarching justifications for laws
or proposals, and rightly so. Precisely because they are general, many people can support them in
principle. Yet – and though it may seem obvious – it is historically profound that law should be
justified with reasons, even vague ones. Reasons serve a process of social communication. They
open the law to critical reflection by people who frequently have opposing interests, but offer a
route to resolution. They allow deliberative discussion. Human institutions can be shaped
through a slow, reflexive dialogue, which may determine whether the means being used are
proportionate to pursue a stated goal.

What should be the goal (if any) that corporate law pursues? The trouble with those
general goals just listed is that none can be truly said to be ‘good’ in unlimited quantity all of the
time. Like almost any pursuit, each can potentially be viewed as good or bad depending on the

\(^2\) cf Lord Sumption, ‘The Limits of Law’ (20 November 2013) 27\(^{th}\) Sultan Azlan Shah Lecture, Kuala Lumpur, page 13,
referring to democratic discourse. Lord Sumption does appear to neglect that opaqueley worded treaties or constitutional
documents can themselves be a product of the same democratic deliberation. For the view that there is no single ‘right’
balance see Lord Hoffmann, Matadeen v Pointu [1999] 1 AC 98, 109-113
relation in which one stands.³ Productivity and thus increased wealth might be usually thought of as good unless, to take one simple example, people found they preferred less work and more leisure. Efficiency, whether economic or social, is properly speaking a means in pursuit of a goal (an efficient way to do what?) and as such is not a substantive objective.⁴ But if the goal is maximisation of production, or some other good, then efficiency, like productivity, only has relative, not absolute worth. The perception that people in power hold legitimacy is plainly important, unless despite the perception the reality is one of exploitation. What might determine objective legitimacy? Expertise could be important unless, for example, the experts’ interests diverge substantially from those they are meant to serve, and they further their own ends. And so on. The philosophy of relativity is not the only point of view: it could be said that there are objective goods, which are identifiable through introspective reflection.⁵ However, it seems more plausible to admit that in almost all goods that one could identify, there must be exceptions and trade-offs some of the time and this negates any possibility to objectively identify a list of goods.

Because this thesis centres upon participation rights, it is worth expanding on the goal of ‘democracy’ and its associate ‘accountability’. Democracy and accountability are usually important values, but it is also true that ‘too much’ might lead to lack of expedient decision-making, poor decisions, or any of the problems discussed in chapter 2(3)(c). Often analogies are drawn between voting in democratic politics, and in economic organisations like the corporation, and from this analogy it is concluded that corporations ought to be democratised.⁶ Assuming ‘democratic corporations’ do conjure up a desirable image, it is not at all clear the analogy is useful.⁷ The main reason seems to be that people make different contributions to corporations, and so people are not clearly justified in being on an equal foot. People might make different investments, engage more or less, and so on. On the other hand, it might be argued that the differences in contribution that people often make, for instance today through pension funds, are usually so negligible that it would hardly be worthwhile to deviate from a one-person, one-vote standard. This may partly explain why 18th and 19th century companies employed flatter shareholder voting structures. The debate will probably continue today. Meanwhile, in political entities there are very well established reasons for believing everyone should count equally,

³ B Spinoza, On the Improvement of the Understanding (1677) §§1-10
⁴ cf R Posner, Economic Analysis of Law (2011) 37, ‘A second meaning of justice, perhaps the most common, is – efficiency.... Even the principle of unjust enrichment can be derived from the concept of efficiency... And with a little reflection, it will come as no surprise that in a world of scarce resources waste should be regarded as immoral.’ Here it can be seen that Posner has subtly redefined efficiency as maximisation of resources.
⁵ eg J Finnis, Natural Law and Natural Rights (1974) chs 3-4
⁷ eg HG Manne, ‘Some Theoretical Aspects of Share Voting’ (1964) 64(8) CLR 1427, 1445, suggesting that in fact the issues tend to be simpler in corporations.
regardless of wealth, education, gender, race, or other status, because we tend to view the relevant ‘contribution’ to society as an equal human potential. This cannot persuasively be multiplied or divided in an economic equation. But in the sphere of economics itself, differential inputs are generally seen as morally relevant, at least as matters stand today. It follows that in relation to corporations, the values of democracy and accountability cannot be regarded as absolute. Justifying a goal in corporate law cannot simply take a logical shortcut from existing political structures, but must find justifications in its own terms.

This said, there is a consistent line of thinking in post-enlightenment philosophy that there is one goal that is indeed always a worthy objective in life. This has variously been described as seeking, together with others, a better content of our ‘character’, to bring forward everyone’s ‘capacity’, the ‘utmost possible development of faculty in the individual human being’, or to ensure that ‘the opportunity to develop individuality becomes fully actualized’. It is difficult to conceive of a reason why trying to improve ourselves as people, and build institutions to deliver the same improvement socially, could not be regarded as something inherently good in itself. In economic thought, John Stuart Mill promoted ‘utility’ in a very similar (and possibly indistinguishable) manner, while the modern economics of ‘welfare’, ‘human freedom’, or ‘human development’ is viewed in the same way as key to the idea of justice. These can all be regarded as different synonyms for ‘social justice’. Social justice is hardly an eternal moral value, because it is hard to believe that such values exist outside of the human society which shapes its own morals. Instead it is an argument that depends on its persuasive power to be accepted.

8 For this view, see T Paine, The Rights of Man (1792) Part II, ch 3
9 B Spinoza, On the Improvement of the Understanding (1677) §§13-14, ‘man conceives a human character much more stable than his own, and sees that there is no reason why he should not himself acquire such a character... This, then, is the end for which I strive, to attain to such a character myself, and to endeavor that many should attain to it with me. In other words, it is part of my happiness to lend a helping hand...’
10 T Paine, The Rights of Man (1792) Part II, ch 3, ‘There is existing in man, a mass of sense lying in a dormant state, and which, unless something excites it to action, will descend with him, in that condition, to the grave. As it is to the advantage of society that the whole of its faculties should be employed, the construction of government ought to be such as to bring forward, by a quiet and regular operation, all that extent of capacity which never fails to appear in revolutions.’
11 S Webb and B Webb, Industrial Democracy (9th edn 1926) Part IV, ch 4, 847-849, ‘We ourselves understand by the words “Liberty” or “Freedom,” not any quantum of natural or inalienable rights, but such conditions of existence in the community as do, in practice, result in the utmost possible development of faculty in the individual human being...’
15 This is not to say that with a particular will, significant differences in emphasis cannot be found, and debated endlessly.
16 It is not, therefore natural law. See F Kessler, ‘Natural Law, Justice and Democracy – Some Reflections on Three Types of Thinking about Law and Justice’ (1944) 19 Tulane LR 32, 54-55

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Individual justice is often said to concern people getting what they are due. If the idea is persuasive that we owe a moral duty to ourselves to be better people, social justice means creating the institutions to realise that duty for each other. Rather than people’s goals and free will being subordinated to society, the role of all social institutions is to be subordinated to the purpose of serving people. Social justice is the true aim toward which all law and human institutions, inside corporate governance and out, should strive.

Matching this higher abstraction with real law presents the challenge of arranging hierarchies and sub-categories of objective. Economic productivity and efficiency is certainly one of the most important sub-categories of the general objective of social justice. This is because with economic growth and efficiency, people in society have more resources. It means that individually and collectively they may hold more property. In turn, the best justification for property is that it represents one method for people to express and develop their personalities.

A useful proxy to measure a country’s success in social improvement is the United Nations’ inequality-adjusted Human Development Index. It aggregates countries’ gross domestic product, years in education, and life expectancy, and adjusts the outcome according to how many people substantially share the average position. Although it is an incomplete measure, and is yet to be defined more precisely, it gives a rough indication of social justice at a national level. Because money, property, and GDP are part of the larger social aim, it follows that ‘economic’ aims may sometimes have to concede to the general social goal. However the reverse cannot be true: social goals must never concede to the economic.

All this means that most of the time, corporate law can indeed focus on goals of economic development, productivity, and efficiency, unless there is an obvious clash with the general values of social justice. Such a clash might arise, for example, when corporations...
perpetuate social exclusion of under-represented groups or harm the environment. This invites public regulation to confine how otherwise autonomous associations could act, perhaps in spite of foreseeably negative economic outcomes: and ultimately to ‘let justice be done whatever be the consequence’. Otherwise, institutional structures must be justified economically. It could be argued that emphasis on economic considerations is often excessive, but it should also be seen why such a charge cannot stand if the economic focus serves the social objective. The most difficult debate when it comes to participation rights concerns, not just their direct social value, but their economic value – and without understanding this, the social merits will always remain inconclusive. So do the benefits of the separation of contribution and participation outweigh the costs? To answer, the arguments may rightly speak in terms of economic consequences.

(2) From separation to symmetry

(a) Expertise and shareholding

Does the separation of contribution and participation matter? The first potential answer is to see the results of the present law, and developments on the market to be largely justifiable. It could be rejected that there is any market ‘failure’ as such, even if it is admitted that the results come largely from unequal bargaining power of financial institutions. To the extent that corporate laws underwrite votes for shareholders, and some ability to elect or remove directors, but go little further, this could be viewed as a way of maintaining economic stability and dynamism. The best possible reason that could be offered would seem to be one based on expertise and the division of labour. Asset managers and banks do have unequal bargaining power, but they are given money precisely because they offer a specialist’s service. Those which maintain the larger corporate governance departments are able to combine their unique knowledge and macro-oversight of the markets with their governance functions, or they can pay other specialists, particularly proxy advice organisations, to make the right governance recommendations.

Moreover, this argument could go, specialisation means the average person saving for retirement does not need to become an expert in the complex technicalities of economic management. Such a person certainly has little time to do so. But he or she may still enjoy the advantages of secure investments. One does not have to be impressed with the proto-fascist arguments deployed in 1920 and 1930s Germany about the ‘irresponsibility’ of small investors, and should not be repelled by the fascist heritage of director primacy theory and the ‘nexus of

24 Somerset v Stewart (1772) 98 ER 499, 509, per Lord Mansfield. This case affirmed slavery was unlawful at common law.
25 See chs 4(2) and 5(2)
contracts", before seeing that the present state of affairs represents a wise balance between securing expertise and accountability. As Jensen and Meckling wrote, it is reasonable to presume that when all parties have made voluntary choices – and fundamentally (if by nothing else then by choosing their job) people do choose their retirement plans, their life insurance policies, managed fund investments, or whether to directly buy shares – the results will be economically efficient. Delegation of voting rights to asset managers and banks is rational. The alternative, to intervene and engineer some ‘socially optimal’ outcome would probably have unintended consequences for the stability of corporate governance. Here the same arguments go for spreading participation rights among the ultimate contributors as they go for shareholder rights. Indeed it is arguable that some countries’ laws on shareholder rights have already gone too far. It may also be that some institutions are over-protected, particularly German banks, because market penetration and competition from asset managers is hindered. All active shareholders divert attention and resources from the business of management. At worst, spreading participation in corporate governance could, this view might suggest, lead to special interest groups such as trade unions and ‘political entrepreneurs’ devaluing and stagnating the economy. This would risk damaging security in retirement for the very people who were supposedly meant to be ‘protected’.

One difficulty with such an argument is that while it can be agreed that expertise is an important goal, it does not follow that financial institutions have it where they are unaccountable. It is plain that directors, asset managers or bankers mostly have their jobs because of a demonstrated aptitude for results in their way of enterprise, but it is also true that nobody has a monopoly on expertise. So far as agency costs go in terms of negligence, centralisation of authority carries with it a concomitant concentration of risk of poor decision making. This means that the idea of an antonymous trade-off between expertise and accountability through the vote is misplaced, because representative voting is itself part of the guarantee of expertise, and has no ‘substitute’. ‘The more people who ultimately have a vote for representatives, the less risk of persistently socially detrimental decision making. Representative voting (not direct participation) is a mechanism for aggregating the preferences of many people efficiently, and thus the risk of any single person making a poor appointment is diversified because those who vote usually have an advantage in knowing what is best for them. This is not always true, but it probably is true


27 Or ‘authority and responsibility’ as put in different circumstances by K Arrow, The Limits of Organization (1974)

28 See SM Bainbridge, ‘The Case for Limited Shareholder Rights’ (2005-2006) 53 UCLA Law Review 601, with the notable conclusion that ‘The director primacy-based system of U.S. corporate governance has served investors and society well. John Micklethwait and Adrian Wooldridge, for example, recently opined that the company is “the basis of the prosperity of the West and the best hope for the future of the rest of the world.”’

most of the time that accountability through the vote instils a culture of professionalism and better practice. Moreover, when the issue is the risk of profusion, it takes very little specialist or expert knowledge to see that an agent is paying itself excessively. Just because negligence and profusion can both be called agency costs, it does not follow that expertise will counteract both.

A further significant difficulty is that the evidence which usually is called on to support the ‘director-centered Delaware way’ was the supposed vitality of the American economy. But no sooner than this triumph of logic was revealed, the global economy was crashed, again. It is true that (no matter how much one may wish to never waste a good crisis) the insolvencies of Northern Rock, Bear Stearns, and Lehman Brothers, were not directly related to corporate participation rights. The direct causes were different. They included the absence of regulation for unfair contract terms in the US mortgage market, rating agencies being paid by the businesses whose products they rated, and no enforcement of disclosure obligations in vast swathes of the derivatives that monetised people’s homes. Zealous triumphalism, and likewise condemnation, of one country’s economic institutions in fleeting moments of history is unwise. But it can be said that the latest economic catastrophe took place on the watch of a system where asset managers and banks dominated. The centralisation of authority, and concentration of risk that accountability mechanisms failed was an exacerbating factor.

Since the financial crisis unfolded, a series of studies have suggested that a shareholder oriented model of corporate governance was a factor contributing to the collapse. This position ought to be taken seriously as it has been found, to take just one example, that there is a significant positive correlation between the banks taking less money from the Troubled Asset Relief Programme in the US, and its managements being more insulated from shareholders.

The basic responses to this charge – that shareholder empowerment links with systemic risk – range from, first, saying that shareholder rights ought to be limited. Here some of those who can fairly be described as being on the political left of corporate law, and on its political right, find a

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30 eg M Lipton and W Savitt, ‘The Many Myths of Lucian Bebchuk’ (May 2007) 93(3) Virginia Law Review 733
31 eg B Cheffins, ‘Did Corporate Governance “Fail” During the 2008 Stock Market Meltdown? The Case of the S&P 500’ (2009) 65(1) Business Lawyer 1
33 See J Taub, Other People’s Houses: How Decades of Bailouts, Captive Regulators, and Tooie Bankers Made Home Mortgages a Thrilling Business (2014)
34 For example, the major shareholders of Bear Stearns in December 2007 were Barrow Hanley Mewhinney & Strauss – 9.73%, Joseph C Lewis – 9.36%. Morgan Stanley – 5.37%, James Cayne – 4.94%, Legg Mason Capital Management – 4.84%, Private Capital Management – 4.49%, Barclays Global Investors – 3.10%, State Street 3.01%, Vanguard Group – 2.67%, Janus Capital Management – 2.34%.
way to shake hands. Those on the left see a diminution of shareholder rights as being desirable, because it is thought that this will lead to a space where other stakeholders can be protected by enlightened directors. Those on the right see increasing managerial authority as a value in itself. A second response is to suggest that bank governance does, and ought to differ from the general patterns of corporate governance because the public interest is uniquely engaged, possibly drawing an analogy to network enterprises or other natural monopolies like water, electricity or railways. The answer, however, lies in closer regulatory control, including more intrusive public oversight of capital maintenance, not least through the (invariably public) central banking authorities.

A third approach could acknowledge that shareholder power is not inevitably positive, and that bank governance does and plainly ought to differ from the general regulation of enterprise. But instead of limiting shareholder rights, or leaving shareholders alone, the better approach is to look at who shareholders actually are. Shareholder voice is not the problem per se, if shareholders can be converted into, not a destructive, but a positive force in corporate governance.

(b) Making shareholders safe for corporate governance?

A second potential answer to the main question is that the separation of contribution and participation is a concern and should be addressed. It embodies a defective system of social organisation, but with a particular view of the extent of the defects. Transaction costs and the costs of taking collective action could be seen as the issues which make the market for institutional investment, like corporate governance, sub-optimal. In principle, markets work unless shown otherwise, so deviation from laissez faire is justifiable but only to the extent of resolving the particular market failures. Here, Ronald Coase’s axiom, as discussed in chapter 3(2) (a), points the way. We may presume that in a world without transaction costs, including the costs of taking collective action, the ultimate contributors to companies, like smaller shareholders, would be capable of organising to ensure that their interests are properly represented. But in the real world, such costs prevent an optimal outcome. So it is legitimate for the law to achieve what people themselves would want to do.

37 eg S Bainbridge, ‘Director Primacy and Shareholder Disempowerment’ (2006) 119 HLR 1735
38 eg K Hopt, ‘Corporate Governance of Banks after the Financial Crisis’ in E Wymeersch, KJ Hopt, G Ferrarini (eds) Financial Regulation and Supervision, A post-crisis analysis (OUP 2012) 337
39 cf S Deakin, ‘Against Shareholder Empowerment’ in J Williamson, Ciaran Driver and P Kenway (eds), Beyond Shareholder Value (TUC 2014)
40 This was the famous presumption of JS Mill, Principles of Political Economy (1848) Book V, Ch XI
41 R Coase, ‘The Problem of Social Cost’ (1960) 3 JLE 1, 40
The problem so defined, different policy solutions could follow, with the **caveat** that the task is to interfere only as strictly necessary to make the markets work like the hypothetical model. The most prominent attempt recently is embodied by the UK Stewardship Code, which has inspired many similar proposals, including revisions to the EU Shareholder Rights Directive.\(^42\)

The essence of this approach is to place some form of legal duty on institutional shareholders to do what it is presumed the market does not do already: with varying degrees of specificity, this is to act in the best interests of the ultimate contributor. This resembles the fiduciary duties of a trustee to beneficiaries, which also, incidentally, may resemble the direction of development of implied terms in insurance agreements in the UK, namely to live up to the parties’ ‘reasonable expectations’.\(^43\) In form, it resembles the duties of a director to promote the success of the company, or to act in shareholders’ and stakeholders’ interests. As chapter 6(2)(d) explained, a similar regime was essentially developed by German banks in the 1920s in relation to their depositors, and codified from the *Aktiengesetz 1937* up to today. In the UK Lord Myners himself took direct inspiration for the stewardship initiative from the US Department of Labor rules regarding pension funds,\(^44\) which was mirrored by the Securities and Exchange Commission regarding mutual funds. The innovation, and the difference to the German law (though probably not to the modern English law of trusts\(^45\)) is that minimum standards of voting activism and engagement are made explicit, as part of the umbrella notion of acting in the client’s interests.

The positive aspect of the stewardship model is that all asset managers have now been recognised as owing the same duties to all clients,\(^46\) and thus the formalist distinction between proprietary and personal transactions has been abandoned. We are now past ownership, and focused on contribution. Asset managers holding pension money, insurance money and mutual fund money are all being treated alike. The risk, however, is that the stewardship movement may tacitly recognise not merely responsibilities, but also presume a right of asset managers to vote using other people’s money. Moreover, it seems that reforms based on legal duties underestimate the issue’s nature. If the quantity of activism were really the issue, legal duties can indeed effect minimum standards. Either a soft-law system (as in the UK or the EU proposals) or a compulsory system (as in the US or Germany) will probably work, at least in terms of votes cast (and leaving the issues of international enforcement aside\(^47\)).

\(^{42}\) Proposed Directive COM(2014) 213 final, articles 3f and 3g. Note the ambiguity of article 3c, facilitating indirect shareholder rights.

\(^{43}\) *Equitable Life Assurance Society v Hyman* [2000] UKHL 39


\(^{45}\) eg *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 Ch 515

\(^{46}\) Stewardship Code 2012, Principle 1, ‘The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.’

\(^{47}\) B Cheffins, ‘The Stewardship Code’s Achilles Heel’ (2010) 73(6) MLR 985
But the issue is not the quantity, rather than the quality of activism. The stewardship model is anything but new: it is a soft law replication of the duties of German banks to vote on their clients’ behalf that was first codified by the Aktiengesetz 1937. As chapter 2(3)(b) explained, legal duties are best viewed as functionally incapable of doing more than make minimum standards. The most active, well resourced judiciary or regulator cannot feasibly substitute its judgment for the judgment of the bearer of the duty on a continuing basis. Such duties carry no guarantee of qualitative change by financial institutions to act in anything but their own private definition of their clients’ interests.

A different way of responding to collective action problems might be for government to attempt to better organise the market at the bottom end, for instance by consolidating retirement saving plans, or even promoting the collective organisation of the workforce. There is some evidence in the UK of this strategy, notably in proposals to merge local government pensions. It does seem, however, and among other sources of opposition, that the asset management industry is less than enthusiastic if this meant a single local government pension fund could take investment management in house. If the issue were one of the path to rational legal reform, then it would seem an obvious cost saving measure to achieve economies of scale. A consolidated UK Local Government Pension Service would rival CalPERS, which as chapter 6(3)(f) described, was almost terminated and turned into individual accounts by the Schwarzenegger administration in 2005. The interests behind Schwarzenegger’s proposals probably explain the absence of enthusiasm to promote multi-employer collectively bargained pension schemes generally. This suggests that relying on government to collectively organise social partners is vulnerable to the varying motives of those in government. The nature of the obstacles suggests that viewing the issue purely as one of collective action problems is not enough.

(c) Addressing market incapacity

In chapter 2(3)(a) the general concept of bargaining power was seen to include the problems of information, taking collective action, and at its most basic, inequality in wealth and resources. This last element delivered the ability to hold out longer in negotiations so that general inequality will persist into inequality of transaction terms, though for some economic actors inequality will matter less than information and collective action. The second positive thesis made bargaining

48 Department for Communities and Local Government, LGPS Structure Analysis (March 2014) and S Johnson, ‘Local UK pensions driven into ‘blind alley’” (4 May 2014) Financial Times.

49 It is fair to mention that the conclusion of the argument about to be made on the basis of unequal bargaining power could be derived from viewing the relevant problem as one of collective action. However it is suggested that this basis nevertheless leaves too much ambiguity.
power central to understanding the development of participation rights. Actors who were relatively well organised could win participation in absence of compulsory legal rights. But generally, and otherwise, the separation of contribution and participation tended to grow. As a positive issue, then, bargaining power had to be regarded as relevant for the way that participation rights developed. But did unequal bargaining power have any efficiency consequences, so as to be normatively relevant? At the heart of the matter is whether Coase’s axiom can be defended: that absent transaction costs people come to efficient agreements regardless of the distribution of legal rights. Does the distribution of legal rights per se have no effect on economic efficiency?

The third potential answer to whether the separation of contribution and participation is detrimental is both that it is, and that it cannot be resolved just through a minimalist imposition of legal duties, or by encouraging better collective action on the market. This is because inequality of bargaining power, especially where it flows from inequality of wealth, always leaves the weaker parties one step behind. It precludes market transactions as tools for economic efficiency, and so merely tackling the issues of transaction costs is not enough. This can be logically demonstrated even in a transaction cost free world that lay at the heart of the Coasean construct that law and economics theory has followed since. Coase often spoke of economically efficient results in general terms, but it is clear he was concerned both with allocative and productive efficiency.

It was probably already shown in 1990 that Coase’s axiom was both logically and evidentially unsound in regard to allocative efficiency. Would people trade rights to the party who would value them the most in a transaction cost free world? In just one example, Daniel Kahneman, Jack Knetsch and Richard Thaler set up a simple experiment where students were either given tokens or Cornell University mugs, and were then asked to trade.\(^50\) It was found that when people were given things, like the mugs, they were more inclined to hold onto them than they were the money. In essence people become attached to the things they are initially ‘endowed’ with. This endowment effect is pervasive throughout human interactions, and it stops efficient allocation of resources. It follows that it is simply inaccurate to say that people will always trade rights to the person that values them the most in a world without transaction costs. The evidence sits at odds with Coase’s argument. When the issue is participation rights, those who hold them at the moment are likely to ask for an inefficient premium before they give them up. There is more to market failure than transaction costs. It makes it unlikely that economic power can be easily or efficiently bought.

What about productive efficiency? In a transaction cost free world, are people inclined to maximise their productive capacities regardless of the initial distribution of rights? The answer must be a clear ‘no’ because distribution of rights affects the human motivation to work. To take one example, a study from 2011 by Alain Cohn, Ernst Fehr, Benedikt Hermann and Frédéric Schneider looked at the effect on wage changes among 96 temporary workers, handing out nightclub entry cards on a German high street. Working in pairs, their productivity was measured according to how many cards they sold for €5, or alternatively how many they gave out for free in return for the customer’s personal information. A first group of worker pairs was paid consistently at €12 per hour. The second group of worker pairs was, shortly into their first shift, told their wage would be cut to €9 per hour, pursuant to a contractual flexibility clause. The third group of workers, shortly into their first shift, was told this: ‘Worker 1 continues to earn €12 per hour while worker 2 receives €9 instead of €12 per hour. This was the manager’s decision.’

The results were that, compared to the first group, the second group of workers’ productivity dropped by 30 per cent (15 per cent for each worker on average). But in the third group, the average productivity drop was 34 per cent, all attributable to the drop of worker 2. In other words, it was even more damaging to have unfair pay with an overall €3 pay cut, than it was to have an overall €6 pay cut that was equal. The conclusion of the authors was that the social comparisons that people make cause changes in effort and thus productivity. In this way the distribution of rights is relevant for productive efficiency. Again, Coase was mistaken that the most efficient result would ‘always’ transpire in absence of transaction costs. Again, this simply sits at odds with the evidence. But the idea that Coase’s axiom might be unsound can hardly be regarded as surprising because this is what Alfred Marshall in 1890, and Adam Smith in 1776, had already found. Distribution affects motivation to work, and thus productive efficiency.

For corporate law, the question goes further. Is the reverse of the German nightclub card studies’ findings true? Being underpaid demotivates and damages productive efficiency, but does it harm productive efficiency if people are overpaid? There do not seem to be empirical studies yet, but quintessential corporate governance suggests it does. Profusion, unjust enrichment, is half the sum of agency costs. As Berle and Means wrote, if left unaccountable, company directors could ‘serve their own pockets better by profiting at the expense of the company than by making

52 For further discussion, see E McGaughey, ‘Behavioural economics and labour law’ (2014) LSE Working Paper Series No. 20/2014
54 Smith (1776) Book I, ch 8, §§43 and 47
profits for it.”\textsuperscript{55} If this hypothesis is sound this means that, if inequality of bargaining power perpetuates a mal-distribution of participation rights, and if in turn this leads to directors or institutional intermediaries being able to unjustly profit from their office at others’ expense, productive efficiency will be damaged. Directors, asset managers and banks spend more time lining their own pockets than working.

If inequality of bargaining power tends to preclude an economically productive system of participation rights, then stronger reforms are needed to resolve the problems of institutional shareholding, than if only transaction costs and collective action problems are identified as issues. Because it begins with inequality in wealth, it follows that a different distribution of resources, or rights, is a necessary remedy. One method to do this would be to redistribute ownership of assets or money. Socialisation of the means of production may be necessary in specific enterprises, but after the last century of nationalisations and privatisations, it is doubtful that a \textit{unified} theory of enterprise can prevail, any more than it has in contract. If instead wealth were re-distributed, for instance through the tax system, the difficulty would be that it could lack sustainability: periodical redistribution drives could become necessary if wealth has a tendency to concentrate. Wealth inequality is an underlying cause of unequal bargaining power,\textsuperscript{56} but it is also symptomatic of the deeper cause: inequality of power within the corporation.

When people form associations, as chapter 2\textit{(3)(c)} urged, those in power will usually follow the interests of those to whom they owe their jobs. Asset managers, banks and directors can disregard the interests of the people whose contributions create their positions if the ultimate contributor has no right to participation. If the goal is productive social organisation, the most logical remedy is to ensure people have the right to vote for representatives who decide how their investments are used: a symmetry between contribution and participation. Throughout the investment chain, there must also be an unbroken voting chain, from the ultimate contributor up to the board of directors. The ‘symmetry principle’ might not be sufficient to ensure perfect accountability, but it is necessary. Representatives on corporate boards, and financial institutions that use other people’s contributions, if ultimately subject to votes of those whose contributions they use, will be more impelled to act according to the contributors’ interests, less prone to negligence and profusion. This will protect economic productivity, as a route to social justice.

\begin{footnotes}
\item[55] AA Berle and GC Means, \textit{The Modern Corporation and Private Property} (1932) 114, ‘the owners most emphatically will not be served by a profit-seeking controlling group. In the operation of the corporation the controlling group even if they own a large block of stock, can serve their own pockets better by profiting at the expense of the company than by making profits for it.’

\item[56] On which, now famously, T Piketty, \textit{Capital in the Twenty-First Century} (2014) ch 10, discussing capital ownership, though lacking in specifics. It contrasts to this thesis in its focus on ownership, not power.
\end{footnotes}
(3) Principles and policy options

So far, section (2) has established the reasons for the symmetry thesis. The principle of symmetry is necessary to achieve the goal of efficient production, as a path to social justice. It does this by ensuring that people’s contributions are not used in a way that is unaccountable, and allowing ‘negligence and profusion’. In a world of unequal wealth, market mechanisms cannot be a full answer. But if the principle of symmetry between contribution and participation is accepted, there is no necessary ‘right’ way to achieve it. Within reason, there could be legitimately different views on the relative value of a ‘contribution’ (one-person, one-vote, as in pension trusts? Or one-pound, one-vote, as with shares?). Within reason, there can also be legitimately different views on the desirability of intermediated participation (are unitary boards so much better than two-tier boards? Is trade union nomination of pension trustees worse than direct elections?). Also, while the symmetry principle requires that people have participation rights throughout the investment chain, there can be legitimately different views about implementation methods. Three will be offered as illustrations, namely a ‘self-organisation’ model, a ‘disability’ model, and a ‘positive rights’ model, and how they would apply in the UK, Germany and the US.

(a) The self-organisation model

First, it is conceivably possible for people to reorganise corporate governance, even as matters stand today, with barely any legal reform. Regarding directors and shareholders, it is conceivable that in the US the drive continues toward dismantling staggered boards, and spreading the one-share, one-vote standard, on the (perhaps optimistic) assumption that political action is not successful in dismantling those pension funds. The public and union pension funds which have pushed the reform so far could produce a system which does through bargaining what the UK did through law and regulation in 1947 and 1962, coupled with the power of its own institutional shareholders. In Germany, there are different views about the supervisory board, and some people will probably continue to value it because they regard it as having unique merits. If, however, the German supervisory board’s purpose is seen again in a more historically accurate light – as an outlet for Prussian authoritarianism and banker dominance over small shareholders – then perceptions might shift. There is no particular reason why large companies might not convert to a Societas Europea, and dismantle supervisory boards on the grounds that they serve an unwarranted management insulation function. The challenge here would be to reach a sufficient accommodation with trade unions about a post-supervisory board codetermination
model. It could be suggested that somewhere between one-third and one-half of a unitary board could achieve the same or better result from a worker viewpoint.\textsuperscript{57}

What about asset managers? In the UK, developments in 2013-2014 suggested that highly significant changes could be in motion, partly as a result of an ongoing regulatory discourse. Concern about excessive fees being charged to pension funds, and the threat of regulation, led the Association of British Insurers to propose an agreement with the Office of Fair Trading to institute ‘Independent Governance Committees’ in asset managers.\textsuperscript{58} The most recent Department for Work and Pensions consultation paper envisaged that the IGCs would have a list of functions relating to oversight of investment policy, and would be partly composed of representatives elected by the asset manager’s clients or beneficiaries.\textsuperscript{59} The issue of control over governance policy has not been proposed, but this would nevertheless represent a logical next step, once IGCs are in place. Participation in the way votes are cast would, in effect, be an avenue for the genesis of the proposal in the Geßler Report for German banks in 1979 to have elected governance committees controlling the votes on deposited shares. There is a distinct possibility that self-organisation of pension funds could achieve such an objective simply through applying market pressure as clients. This said, the other side of the industry was consolidating in 2014, as the Association of British Insurers merged with the Investment Management Association to make the ‘Investment Association’. US pension funds which had the same habit of delegating investment management to investment advisers could attempt the same strategy. If it worked, if elected governance committees were in place, the voting function of investment management could be decoupled from the registered shareholder, and re-coupled with the ultimate investor.

For German banks, the situation is complicated by the nature of the retirement savings legislation. Trade unions would need to push for a switch in types of pension plan, away from direct promise and insured pensions toward the codetermined models. Those funds could then conceivably bargain with banks to implement the Geßler proposals. The difficulty is that employers have strong incentives to maintain direct promise pensions, because they can use the balance sheet surplus to self-invest. Because direct promise pensions have to be insured against the risk of the employer’s insolvency, the insurance industry also has a strong incentive to use its influence to maintain that option. Insurance companies, like Allianz, can use their weight as shareholders to do this. To the extent that major shareholders in Allianz or other German

\textsuperscript{57} It may be noted that Swedish employee representatives holding a third of the seats on a unitary board seem to have more influence, and success, than their German counterparts, although much also depends on labour law more generally.

\textsuperscript{58} Otto Thoresen, Director General of the Association of British Insurers, \textit{Letter to Clive Maxwell, Chief Executive, Office of Fair Trading} (30 August 2013)

\textsuperscript{59} DWP, \textit{Better workplace pensions: Further measures for savers} (March 2014) Cm 8840, 104, Annex B
insurers are banks,\textsuperscript{60} this means that banks have a strong incentive also to use the voting rights they hold to forestall a different result. Employers, insurers, and banks thus have incentives to maintain a mutually reinforcing profit structure, even when their interests deviate from people who save for retirement. In the UK and the US, there are analogous problems but the difference is the relatively low concentration of the asset management sector, compared to Germany’s banks and insurance corporations. It is certainly not impossible, but it is questionable whether the German system is so easily shifted, in absence of an open social discussion. A social discussion would, in any case, probably supersede self-organisation with legal reform.

If all asset managers and banks had to have governance committees that were elected (either completely or substantially) by the ultimate contributors, there would be a very significant new control on agency costs. Asset managers would no longer be able to deploy voting power within companies to influence the kinds of retirement contracts that companies bought from them, it is doubtful that the tendency for supporting rising director remuneration packages would continue, and it is probable that a host of other issues regarding social and environmental responsibility would adjust in line with the preferences of the median retirement saver. However, in order for this self-organisation model to work, clients of financial institutions who have bargaining power (essentially large codetermined pension funds) must necessarily strike agreements which have ‘positive externalities’ in favour of all ultimate contributors: including the isolated holders of life insurance policies, or mutual fund investors that could otherwise be left vulnerable. Ultimately the organisation of retirement savings connects with the solidarity of larger social movements, which includes trade unions, and their solidarity with the interests of all people saving through the investment system.

(b) The disability model

A second way to achieve symmetry between contribution and participation is to follow the ‘disability’ model. As seen in chapter 6, this is what has already been deployed in the US Dodd-Frank Act 2010 for brokers, and more comprehensively in Switzerland for banks. Here the strategy is to remove the influence of the institutional intermediary altogether from corporate governance, because it is seen as illegitimate, giving way to the ultimate contributor to exercise its voice independently. Chapter 6(2)(d) showed how such ideas have been debated in Germany since the 1930s, but opinion has been divided because it is feared that very few votes will be cast

\footnote{Major shareholders are disclosed under the Wertpapierhandelsgesetz 1994 §§25-26 when changes above or below certain thresholds are made. In 2014, for example, Commerzbank held a fluctuating block of up to 8% of Allianz’s equity, while other major holders included JP Morgan, Credit Suisse, Morgan Stanley and Société Générale. Disclosures are on allianz.com}
in company meetings. Switzerland’s implementation of the plan could indicate whether this concern is real or not. More fully, the concern is that when institutional intermediaries cease to vote, a tiny number of potentially erratic voters (the stereotypical activist who causes a fuss at Annual General Meetings) will be in the corporate governance driving seat. Of course, the Swiss initiative took measures against this possibility by placing a duty (somewhat like the UK Stewardship Code, or the US Department of Labor interpretive bulletin) on pension funds to be active in casting their votes. The potential drawback is that a form dependent system is created: banks can be banned from voting, but pension funds might still delegate investments to a new class of asset managers, and a pension funds’ management, or indeed insurance companies and mutual funds, may not be effectively accountable to its ultimate contributors.

The disability model, in order to meet its critics, is therefore necessarily accompanied by avenues to ensure that after institutional intermediaries are eliminated from the voting equation, other parties are capable of taking up the engagement slack. In this respect, UK law is illustrative. Chapter 6(1)(c) outlined how equity recognises a right, through any fiduciary relationship, to give instructions over the exercise of voting power, or in lieu of instructions for the fiduciary to cast votes in the beneficiaries’ best interests. It is no doubt open to litigation, but the weight of authority suggests that every asset manager stands in a fiduciary relation to its clients, whether money is mixed in a pooled fund or not, and indeed this principle has been codified in the Stewardship Code. It suggests pension trustees can pass through voting instructions, and asset managers are obliged to follow them by default.

The developing view of fiduciary duties, although the precise conceptualisation is contested, is that they function in the same way as terms that are implied in contracts: they are construed to reflect the reasonable expectations of the parties. There is very little reason against, and there is legal authority for, saying that when the functional relationship of an asset manager to a client is the same, the duties which arise regarding voting for purchasers of pension or mutual fund services are the same toward insurance policyholders. This can be explained within the terms of precedent through the language of fiduciary duty in equity, or through the language of the reasonable expectations of the parties at common law. Both can do the same work. It would follow that a basic right would be available to pass instructions to an institutional

62 It would then be questionable whether an exclusion or limitation clause on this equitable default is possible under the Unfair Contract Terms Act 1977 s 3(2)(b). Schedule 2 requires that the relative bargaining power of the parties is taken into account.
64 Attorney General of Belize v Belize Telecom Ltd [2009] UKPC 10
65 cf Equitable Life Assurance Society v Hyman [2000] UKHL 39
intermediary to cast votes in respect of the particular share. An objection that this would create technical difficulties is probably unsound, though facilitation of online voting fora, a public good, could be desirable from a government's viewpoint.\(^\text{66}\)

**(c) The positive rights model**

A third option in pursuit of the symmetry principle is to follow a ‘positive rights’ model: participation rights written into law from the bottom to the top of the investment chain. In the UK, immediate reforms could be made by the Secretary of State, by issuing a statutory instrument to increase the number of member nominated trustees from one-third to one-half, and to remove the exception to require MNTs in the National Employment Savings Trust.\(^\text{67}\) The local government pension schemes could be consolidated into a single plan, and the managers could be majority elected, and hold full control over investment policy, so as to subtract the risk of political interference by the government employers. The proposals for IGCs could make clear that a majority of representatives are elected by their ultimate clients (all clients, including insurance policyholders and mutual fund investors), that they are not merely consultative bodies but make binding decisions over the voting rights held by the asset manager, and those rights could be written into the Financial Services and Markets Act 2000. To give an example from the typical pension scenario, this would mean that the beneficiary voted for (1) the pension trustee,\(^\text{68}\) which in turn elects (2) the IGC representative, which then (3) exercises shareholder rights over company boards. In principle a multi-level voting structure is undesirable, because it can be appreciated that with every step the representative’s representative becomes a little more distant from the ultimate contributor. The solution would be to acknowledge that a contributor has direct voting rights for his or her aliquot share of an investment pool (a matter of long division, not outside the boundaries of standard investment software) but in recognition of the advantages of coordination, by default the voting right is delegated to the relevant representative.

In Germany, a positive rights model would begin by considering reform of the board structure. One option would view intermediated election and removal of directors as generally benign, maybe even useful to separate management and oversight, and leave it untouched. A second option would simply be to eliminate the *Vorstand*, on the ground that a division of competences among directors does not require division of accountability between boards. This would see the argument for retaining two-tier boards as largely undermined by other countries’


\(^{67}\) Pensions Act 2004 s 243

\(^{68}\) Many pension trustees are also intermediated by the staff’s trade union, as for instance, with the Universities’ Superannuation Scheme.
systems (with and without codetermination) working amicably in practice, and by its origins: two-tier boards were not put in place to promote accountability or expertise, but to create a managerial class beholden to Prussian banks. A third option is to retain the supervisory board, but to restore the pre-fascist position where the company general meeting is given direct removal rights over the *Vorstand*, not intermediated by the supervisory board. To be compatible with codetermination some share of votes in the general meeting, for instance one-third to one-half, would need to be allocated to employees. Furthermore, a positive rights model would implement reforms along the lines of the Geßler Commission’s proposals, and have elected governance committees in banks. It would extend that same model to all financial intermediaries, particularly insurance concerns, as an effects based law. It would overturn the problematic jurisprudence that precludes codetermination rights for direct promise and insurance based pension funds. This would mean German workers’ retirement savings could not be used to subsidise the insurance industry or fund a system of interlocking corporate block ownership.

In the US, a positive rights model could best be pursued at state level (where legislation is possible), rather than the federal government (where political ossification may continue). It would seem that neither the Employee Retirement Income Security Act 1974, nor the Investment Companies Act 1940, the Investment Advisers Act 1940, nor the Securities and Exchange Act 1934 pre-empt state laws providing more protective rights than the minimum federal standards, especially since participatory investment already runs in Taft-Hartley multi-employer pension plans. It is open for states to adapt the Democrat proposals explained in chapter 6(3)(d) for private pension plan representation in their own states. Mutual funds in each state could be required to have elected Independent Governance Committees. Naturally, if reforms are seen as desirable regarding director or shareholder rights, the state of incorporation must also make the relevant changes. The essential standard is merely to do what union and public pension funds have already been pushing: abolition of non-voting or multiple voting shares, and retrenchment of for-cause removal boards. It is not entirely clear that the governing Democrats in Massachusetts, or Delaware, or elsewhere, would be naturally opposed to reform, and it may be emphasised that there is no single ‘correct’ model of rules. States would need to test whatever works for them, and again become the laboratories of democracy.

Whichever set of options might be taken, whether that is something closer to the ‘self-organisation’, ‘disability’, or ‘positive rights’ model, or a combination, or something else, reform will recognise the principle of symmetry of contribution and participation. This is a principle that will create a more productive and just system of corporate law.
8. CONCLUSIONS

Over the last seven chapters, there have been three main theses, two positive and one normative. The first positive thesis is that a progressive democratic movement has spread participation rights in law, regarding who elects the board, which shareholders have votes, and for accountability through the vote behind shareholding institutions. But the social ideal of the movement has not been pursued to an optimal extent. The second positive thesis is that where participation rights are not fixed by law, the resulting patterns of participation tend to reflect the bargaining power of different actors. Power has an arbitrary tendency, and the people who made the contributions to company investments became separated from participation in corporate governance for no ultimately justifiable reason. The third, and one normative thesis, was that particularly given the absence of a principled framework for participation in corporate governance, reform should pursue a way for the ultimate contributors to equity to vote for representatives down the investment chain: a symmetry of contribution and participation. This will ensure the successes of modern corporate law are not undone. Establishing the principle of symmetry is necessary to forestall negligence and profusion among directors, asset managers and banks, and so promote a productive and just system of corporate governance.

The two positive theses were substantiated primarily through an appeal to the historical evidence of corporate development in the UK, Germany and the US. It was suggested that alternative theories, particularly ones which looked to rational choice and incentives for answers, were not as good at explaining the unfolding of history as a contextual form of reasoning. People are conscious decision makers, not incentive-driven automatons. In politics, it has been a conscious plan (but not one fully pursued) from Wilson and Brandeis, to Berle and Means, to the post-war Labour Party, the mainstream of the Conservative Party, German Social, Christian and Free Democrats and Greens, to 21st century American Democrats, to push for the dispersal of participation rights from the top to the bottom of corporate governance. They sought to socialise, not ownership, but power, and sought to extend democracy from the political sphere to the economy. In the economy, the relative bargaining power of small shareholders, financial institutions, occupational pension trustees, life insurance policy holders, and trade unions, have all shaped the direction of participation rights when there was an absence of specific regulation. However, there remains a significant risk that the interests which wished to see a growing separation of contribution and participation will succeed.
Where should corporate governance go in the next ten or twenty years? If its development so far is not seen as the outcome of a politically or economically rational strategy, then this implies that there is room for reform. There is increasingly little doubt about the need for a change among those people who saw the effects of the global financial crisis up close. For those people there are constantly painful reminders of social fragility, and instability, which make it impossible to be agnostic about the salient issues in corporate governance. It is hard to think of a more salient issue than the economic pre-eminence of asset managers and banks, and the economic disenfranchisement of ordinary people. Ironically, many financial institutions would seem to be all too glad to rid themselves of the responsibility for stewardship. Their lack of engagement could very well indicate that they are much more content to concentrate on their specialism of trading.

Another less charitable view that is developing is that corporate and financial power, which has wrecked the global economy twice and, while being bailed out, is continuing to wreck developed society, needs to be broken before it compromises humanity’s future. As this view persists and becomes more vocal, in outspoken protests like the Occupy Movement, it could be perceived by some financial and corporate interests that, to maintain their position, democratic government needs to be ‘shutdown’ first, or perhaps undergo ‘structural adjustment’. The more extreme the situation becomes, the more fear there is, the more likely that radical, and potentially dangerous answers meet the perceptions of danger. A modest path of reform is available and waiting: to build on the better side of corporate governance, evident throughout modern history. This is the side that would favour the principle of symmetry of contribution and participation, in a corporate law that is more sustainable and just.
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