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The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies

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The corporate governance system principally supports the interests of shareholders as a class. Nevertheless, corporate governance can—and to some degree must—also address the agency conflicts jeopardizing the interests of minority shareholder and non-shareholder constituencies. And herein lies the rub. To mitigate either the minority shareholder or the non-shareholder agency problems, a governance regime must necessarily constrain the power of the shareholder majority and thereby aggravate the managerial agency problem. Conversely, governance arrangements that reduce managerial agency costs by empowering the shareholder majority are likely to exacerbate the agency problems faced by minority shareholders and non-shareholders at the hands of controlling shareholders.

Minority shareholders generally lack the extra-corporate protections enjoyed by non-shareholders, including individualized contractual rights and the right to withdraw from the firm altogether.[1] Thus, in this chapter, we first address the protection of minority shareholders, and then turn to governance arrangements that protect the firm's employees—the principal non-shareholder constituency to enjoy such protections as a matter of right in some jurisdictions. Subsequently, in Chapter 5, we address the protections granted to corporate creditors.

4.1 Protecting Minority Shareholders

A growing body of empirical literature documents the private benefits of control—that is, the disproportionate returns—that dominant shareholders

[1] That is, unhappy employees can seek alternative employment and unpaid creditors can obtain liquidation of the whole firm through insolvency proceedings. See generally Oliver E. Williamson, *Corporate Governance*, 93 Yale Law Journal 1197 (1984).

receive, often at the expense of minority shareholders.[2] These benefits are impounded in the control premia charged for controlling blocks and in the price differentials that obtain between publicly traded high- and low-vote shares in the same companies. Both measures are often assumed to be rough indicators of the level of minority shareholder expropriation across our core jurisdictions.[3] The varying degrees of protection accorded to minority shareholders by differing corporate governance systems presumably explain at least some of the variation in these levels.

4.1.1 Minority shareholder appointment rights

Adjustments to shareholder appointment and decision rights can protect minority shareholders either by empowering them, or—almost equivalently—by limiting the power of controlling shareholders.

Consider appointment rights first. Company law enhances minority appointment rights by either reserving board seats for minority shareholders or over-weighting minority votes in the election of directors. An organized minority that selects only a fraction of the board can still benefit from access to information and, in some cases, the opportunity to form coalitions with independent directors.[4] Of course, even without express authorization, shareholder agreements or charters can—and sometimes do—require the appointment of minority directors for individual firms. The law can achieve a similar result on a broader scale by mandating cumulative or proportional voting rules, which allow relatively large blocks of minority shares to elect one or more directors, depending on the number of seats on the board. Moreover, lawmakers can further increase the power of minority directors by assigning them key committee roles or by permitting them to exercise veto powers over certain classes of board decisions.[5]

Significantly, however, legal rules requiring minority directors are relatively *un*common among our core jurisdictions. Only Italy mandates board

[2] See Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 Journal of Financial Economics 325, 336 (2003) (employing share price differentials for dual class firms to calculate private benefits); Alexander Dyck and Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 Journal of Finance 537, 551 (2004) (employing control premia in sales of control blocks to calculate private benefits).

[3] See *infra* note 77 and accompanying text.

[4] One study that appears to confirm the utility of minority board representation finds that minority investors are more likely to have board representation in closed corporations that are managed by controlling shareholders than in those that are not. See Morten Bennedsen, *Why do firms have boards?*, Working Paper (2002) at http://www.ssrn.com.

[5] For example, the Russian Joint-Stock Companies Law requires that major transactions, including those that implicate the interests of controlling shareholders, be unanimously approved by directors. Art. 78. Consequently, 'disinterested' minority directors can block major transactions between the company and its controlling shareholders or managers.

representation for minority shareholders in listed companies.[6] Cumulative voting is the statutory default in Japan, but it is routinely avoided by charter provision.[7] In France, the UK, and the U.S., firms may adopt a cumulative voting rule, but rarely do so;[8] and in Germany, commentators dispute whether cumulative voting is permissible at all in public firms.[9]

Legal devices that dilute the appointment powers of large shareholders to benefit small shareholders are much rarer than devices that enhance minority shareholder power. Perhaps the best known dilution device of this sort is 'vote capping', or imposing a ceiling on the control rights of large shareholders, and, correlatively, inflating the voting power of small shareholders. For example, a stipulation that no shareholder may cast more than 5% of the votes reallocates 75% of the control rights that a 20% shareholder would otherwise exercise to shareholders with stakes of less than 5%.

The UK, the U.S., and France permit publicly traded corporations to opt into voting caps by charter provision, even though today the real motivation for voting caps is more likely to be the deterrence of takeovers than the protection of minority investors. Voting caps survive today chiefly in France.[10] Germany and Italy prohibit them entirely in listed companies,[11] while listing rules and governance culture have eliminated them in the U.S. and UK.[12]

Another class of constraints on controlling shareholders limits the ways in which shareholders may exercise voting rights *in excess of* their economic stakes in their firms. As we note in Chapter 3, such limits include the regulation of dual class equity structures, circular shareholdings, and pyramidal ownership

[6] Art. 147–3 Consolidated Act on Financial Intermediation (requiring that at least one director be elected by minority shareholders).

[7] Art. 342 Companies Act.

[8] At the turn of the 20th century, cumulative voting was common in the U.S., See, e.g., Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 Columbia Law Review 124 (1994); cf. §§ 708(a) (mandatory cumulative voting) and 301.5(a) (authorizing opt-out from cumulative voting for listed companies) California Corporation Code.

[9] See Mathias Siems, Convergence in Shareholder Law 172 (2008). Even though the majority agrees that proportional voting is permissible, no important German corporation has included such a charter provision.

[10] See *supra* 3.1.2.

[11] Voting caps were banned for German publicly traded (listed) companies in 1998. See § 134 I Aktiengesetz (AktG) (as amended by KonTraG). Still, there was one important exception: Volkswagen AG, which is regulated by a special law, was subject to a 20% voting cap. The European Court of Justice ruled that the voting cap (together with other provisions of the VW Act) impeded the free movement of capital which is guaranteed by Art. 56(1) EC Treaty; see E.C.J., Case C-112/05, *Commission v. Germany*, Judgment of 23 October 2007. Italy banned voting caps in 2003. See Art. 2351 Civil Code (Italy).

[12] We know of no UK or U.S. publicly traded company with voting caps today, although caps were common at the turn of the 20th century in both Europe and the U.S. See Colleen A. Dunlavy, *Corporate Governance in the Late 19th-Century Europe and USA*, in Comparative Corporate Governance: The State of the Art and Emerging Research 5 (Klaus J. Hopt et al. (eds.), 1998).

structures.[13] Regulating these ways to leverage control rights can be viewed either as protecting shareholders as a class, if shares are measured by cash flow rights, or as protecting 'minority' shareholders, if shares are measured by voting rights.

Most jurisdictions ban some strategies for leveraging the voting rights of controlling shareholders, but no jurisdiction—as we note in Chapter 3—bars all of these strategies. Germany, Italy, and Japan go furthest by banning shares with multiple votes and capping the issuance of non-voting or limited-voting preference shares to 50% of outstanding shares.[14] Even these jurisdictions, however, do not regulate pyramidal ownership structures. French law allows corporations to award double voting rights to shareholders who have held their shares two years or more (a mechanism that enhances the power of the state as shareholder).[15] The U.S. and UK permit different classes of shares to carry any combination of cash flow and voting rights, but U.S. exchange listing rules bar recapitalizations that dilute the voting rights of outstanding shares,[16] and UK institutional investors have successfully discouraged dual class shares altogether.[17] Thus, although legal support for a one-share-one-vote norm is limited (probably for sound policy reasons[18]), all core jurisdictions, with the possible exception of the UK, regulate some ways of leveraging voting rights that are seen to be particularly harmful.

4.1.2 Minority shareholder decision rights

As in the case of appointment rights, the law sometimes protects minority shareholders by enhancing their direct decision rights or, alternatively, by diluting the decision rights of controlling shareholders.

Minority decision rights are strongest when the law entrusts individual shareholders (or a small minority of them) with the power to make a corporate

[13] See Lucian A. Bebchuk, Reinier Kraakman, and George G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in Concentrated Ownership Structures 295 (Randall W. Morck (ed.), 2000).

[14] See Art. 2351 Civil Code (Italy); §§ 12 II and 139 II Aktiengesetz AktG (Germany); Art. 108(1)(iii) and 115 Companies Act (Japan). France caps the issue of non-voting shares by listed companies at 25% of all outstanding shares. Art. L. 228–11 to L. 228–20 Code de commerce.

[15] Art. L. 225–123 Code de commerce.

[16] See Rule 313 NYSE Listed Company Manual (voting rights of existing shareholders of publicly traded common stock cannot be disparately reduced or restricted through any corporate action or issuance) and Rule 4351 NASDAQ Marketplace Rules (same). The Tokyo Stock Exchange is considering a similar rule at the time of writing: see Tokyo Stock Exchange, Listing System Improvement FY 2008 15 (2008), at http://www.tse.or.jp.

[17] See Julian Franks, Colin Mayer, and Stefano Rossi, *Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom*, in A History of Corporate Governance Around the World 581, 604 (Randall K. Morck (ed.), 2005).

[18] See *supra* 3.1.2. See also Guido Ferrarini, *One Share—One Vote: A European Rule?*, in 2 European Company and Financial Law Rev. 147 (2006); Kristian Rydkvist, *Dual-class Shares: A Review*, 8 Oxford Review of Economic Policy, Issue 3, 45, 51 (1992); Lucian A. Bebchuk, A Rent-Protection Theory of Corporate Ownership and Control (1999) (ssrn.com).

decision. Such is the case for instance when the law allows individual shareholders, or a small shareholder minority, to bring suit in the corporation's name against directors or other parties against whom the corporation may have a cause of action.[19]

Minority decision rights that are granted to a majority of minority shareholders are also an effective governance strategy. As we discuss in Chapter 7, hard law and codes of best practices sometimes impose a majority-of-the-minority approval requirement on fundamental transactions between controlling shareholders and their corporations.[20] Indeed, disinterested minority approval is necessary to legitimate all significant self-dealing transactions in some jurisdictions, while in others it has no greater power to insulate self-dealing transactions than does disinterested board approval.[21]

In addition, all of our core jurisdictions fortify minority decision rights over fundamental corporate decisions by imposing supermajority approval requirements. As we discuss in Chapter 7, the range of significant decisions subject to shareholder voting varies, as does the precise voting threshold required for approval.[22] As a practical matter, however, this threshold is always higher than the simple majority of the votes cast at a general shareholders' meeting.[23] Arguably, then, all jurisdictions use decision rights to protect large blocks of minority shares against expropriation via major transactions such as mergers. Several European jurisdictions pursue this end explicitly by awarding a sufficient percentage of minority shares (25% or more of voting shares) a statutory blocking right—to prevent the 'bare majority' from trumping the will of the 'near majority'.[24] But most U.S. states achieve a similar effect by requiring a majority of outstanding shares to approve fundamental transactions such as mergers, which implies a supermajority of the votes that are actually cast.[25] The size of the supermajority in this case depends on the percentage of shares represented at the meeting, which, in turn, reflects the salience of the transaction for minority shareholders.

[19] See *supra* 3.4 and *infra* 6.2.5.1. [20] See *infra* 7.4.2.2.

[21] See *infra* 6.2.3. [22] See *infra* 7.4 and 7.8.

[23] Germany requires a 75% vote of shares represented at the meeting to approve fundamental transactions. See e.g. § 53 II Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG) (charter amendment); §§ 50 I, 65 I Umwandlungsgesetz (UmwG) (merger); § 179 II AktG (charter amendment). Similarly, company law in the UK requires a vote of 75% of represented shares to pass 'special resolutions'; §190(1) Companies Act 2006. France requires a two-thirds majority of represented shares for charter amendments in publicly traded corporations (Art. L. 225–96 Code de commerce). In Italy, a two-thirds majority of shares represented at the meeting is required to approve special meeting resolutions of publicly traded companies (including mergers, new issues of shares, etc.) (Art. 2369 Civil Code), while for non-publicly traded companies, approval by a majority of outstanding shares is sufficient (Art. 2479–2 Civil Code). The Japanese Companies Act requires an approving vote of two-thirds of voting shares with a quorum of more than half of all voting shares (the quorum may be reduced to one-third by charter) for the approval of mergers and other basic transactions. See e.g. Art. 466 and 309(2)(xi) (charter amendment); Art. 783, 795, 804 and 309(2)(xii) (merger).

[24] See *infra* 7.2 and 7.4.

[25] See e.g. § 251 Delaware General Corporation Law (merger); § 242 (charter amendment).

Absent a conflict of interest, the costs of granting a blocking or veto power to large minority shareholders are likely to be small. A minority investor holding 25% of her company's equity is unlikely to harm it. But the benefits are limited as well for dispersed shareholders, who are too disorganized or ill-informed to muster a blocking vote without the leadership of a large minority shareholder willing to initiate a proxy fight. In most circumstances, supermajority voting, like voting caps or proportional voting, matters most today in closely held companies and in public companies dominated by coalitions of large shareholders.

4.1.3 The incentive strategy: trusteeship and equal treatment

The incentive strategy for protecting minority shareholders takes two forms. One is the familiar device of populating boards and key board committees with independent directors. As noted in Chapter 3,[26] lawmakers often view independent directors as a kind of broad-spectrum prophylactic, suitable for treating both the agency problems of minority shareholders as well as those of shareholders as a class. The second mode of protecting minority shareholders is strong enforcement of the norm of equal treatment among shares, particularly with respect to distribution and voting rights. This norm applies to both closely held and publicly traded firms, and blurs into an aspect of the constraints strategy: a fiduciary duty of loyalty to the corporation that implicitly extends to minority shareholders and perhaps to other corporate constituencies as well. We first address the role of independent directors as trustees.

4.1.3.1 The trusteeship strategy and independent directors

The addition of independent directors to the board is a popular device for protecting minority shareholders and non-shareholder constituencies alike. Lawmakers implicitly assume that independent directors—motivated by 'low-powered incentives', i.e., morality, professionalism, and personal reputation—will stand up to controlling shareholders in the interest of the enterprise as a whole, including its minority shareholders and, to varying degrees, its non-shareholder constituencies. Strong forms of trusteeship reduce the possibility of controlling the board by shareholders (or by anyone else). In the extreme case, no constituency, including shareholders, can directly appoint representatives to the company's board. This was, in fact, the core principle of the Netherlands' recently abandoned 'structure regime',[27] under which the boards of some large companies

[26] See *supra* 3.2.

[27] See e.g. Edo Groenewald, *Corporate Governance in the Netherlands: From the Verdam Report of 1964 to the Tabaksblat Code of 2003*, 6 European Business Organization Law Review 291 (2005). See also *supra* 3.2.

became self-appointing organs, much like the boards of many nonprofit corporations. Alternatively, investors themselves may contract to give one or more mutually-selected independent directors the decisive voice on the board as a governance solution to intra-shareholder opportunism. This pattern is common in venture capital financing agreements, which often provide rigorous criteria for the appointment of independent directors.[28]

In our core jurisdictions, however, most 'independent' directors are neither self-appointing nor rigorously screened for independence by savvy investors. Instead, director 'independence' typically means *financial* and familial independence from controlling shareholders (and from top corporate officers). A director qualifies as independent under such a definition even if she is vetted and approved by the company's controlling shareholder—and even if she has social ties to the controller—as long as she has no close family or financial ties, such as an employment position or a consulting relationship, with the controller. A conventional example is that an officer of an unrelated, third-party company qualifies as an independent director of the corporation, but an officer of a holding company with a controlling block of stock in the corporation does not.[29]

Finally, the most modest and basic form of a director-based trusteeship strategy abandons all pretence to independence and simply requires board approval for important company decisions. For example, the authority to initiate proposals to merge the company can be vested exclusively in the board of directors, as it is under U.S. and Italian law.[30] Alternatively, shareholders may be barred from directly making any decisions about the company's business without the board's invitation, as they are under German law.[31] These measures constrain the shareholder majority to pursue its policies through directors who, although appointed by the majority, nevertheless face different responsibilities, incentives, and potential liabilities than controlling shareholders.

Of course, how well the director-based trusteeship strategy works, even when some or most directors are financially independent of controlling shareholders, remains an open question. Our core jurisdictions give some reason for skepticism about the efficacy of these directors, at least as trustees for minority

[28] See Brian J. Broughman, *The Role of Independent Directors in VC-Backed Firms*, Working Paper (2008) at http://www.ssrn.com.

[29] Such is the case in Italy for listed companies that opt for the two-tier board system: companies controlling them may not appoint their employees as supervisory board members. See Art. 148 Consolidated Act on Financial Intermediation.

[30] See § 251 (b) Delaware General Corporation Law. See *supra* 3.4. Art. 2367 Civil Code (Italy).

[31] § 119 II AktG (shareholder may only vote on management issues if asked by the management board). But in the *Holzmüller* case the BGH held that the discretionary power of the management board, whether to ask the shareholders, converts into a duty to submit a certain matter for decision if the management board 'could not reasonably assume' that it may decide 'solely on its own authority not letting the general meeting participate'. See BGHZ 83, 122, 131.

shareholders.[32] Nevertheless, the U.S. case law provides anecdotal evidence that independent boards or committees can make a difference in cash-out mergers[33] or when controlling shareholders egregiously overreach. A classic example of both the strength and weakness of the strategy is the *Hollinger* case,[34] in which the Delaware Chancery Court backed a majority of independent directors who ousted the dominant shareholder from the board, and prevented him from disposing of his controlling stake in the company as he wished to do. The independent directors in *Hollinger* acted, however, only after the controlling shareholder's misdeeds were already under investigation by the SEC, and the controller had openly violated a contract with the board as a whole to promote the sale of the company in a fashion that would benefit all shareholders rather than the controller alone.

4.1.3.2 *The equal treatment norm*

The equal treatment of shares (and shareholders) of the same class is a fundamental norm of corporate law. Although this norm can be viewed as a rule-based constraint on corporate controllers, it can also be seen as a species of the incentive strategy. To the extent that it binds a controlling shareholder, it motivates her to act in the interests of shareholders as a class, which includes the interests of minority shareholders. As with all abstract norms, however, its functioning is subject to at least two important qualifications. The first concerns the range of corporate decisions or shareholder actions that trigger this norm. The second qualification concerns the meaning of the norm itself. For example, are two shareholders treated equally when a corporate decision has the same formal implications for each, even though it favors the distribution or the risk preferences of the controlling shareholder over those of the minority shareholder? Insofar as shareholder preferences are heterogeneous and controlling shareholders have legitimate power to shape corporate policy, some level of unequal treatment seems endemic to the corporate form.[35]

[32] See *supra* 3.2. For a broad discussion of the value of independent directors in U.S. family-controlled listed companies see Deborah A. DeMott, *Guests at the Table: Independent Directors in Family-Influenced Public Companies*, 33 Journal of Corporation Law 819 (2008).

[33] See *infra* at 7.4.2.2.

[34] See *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022 (Del. Ch. 2004). For anecdotal evidence on the positive role of independent, minority-appointed directors in Italian listed companies with a dominant shareholder, see Luca Enriques, *Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*, 38 Wake Forest Law Review 911, 928 (2003). In addition, there is systematic evidence that an independent board correlates with better performance in companies dominated by a controlling shareholder (see Ronald C. Anderson and David M. Reeb, *Board Composition: Balancing Family Influence in S&P 500 Firms*, 49 Administrative Science Quarterly 209, 224–6 (2004); Jay Dahya, Orlin Dimitrov, and John. J. McDonnell, *Dominant Shareholders, Corporate Boards and Corporate Value: A Cross-Country Analysis*, 87 Journal of Financial Economics 73 (2008)). However, better performance in companies dominated by a controlling shareholder that have independent directors may well be caused by the quality of the controlling shareholder.

[35] For an instructive U.S. example on point, see the evolution of Massachusetts close corporation case law from *Donahue v. Rodd Electrotype Co.*, 328 N.E. 2d 505 (Mass. 1975), in which the court mandates that closely held corporations must purchase shares pro rata from minority and controlling shareholders, to *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E. 2d 637 (1976), in which the court recognizes that controlling shareholders may pursue their right of 'selfish ownership' at a cost to minority shareholders as long as they have a legitimate business purpose.

Our core jurisdictions differ with respect to both qualifications of the equal treatment norm. In general, Civil Code jurisdictions—and particularly those that have been heavily influenced by German law—tend to view equal treatment as a wide-ranging source of law as such rather than as a background norm informing the actual law. For example, Japan frames the principle of equal treatment as a general statutory provision.[36] By contrast, the common law jurisdictions—the U.S. and UK—specify equal treatment by case law or statute in particular contexts, but are less inclined to embrace a general legal standard of equal treatment as distinct from constraint-like standards such as the controlling shareholder's duty to act fairly vis-à-vis minority shareholders.

These jurisdictional differences in the deference accorded to equal treatment have important consequences in a number of areas of corporate law. As we discuss in Chapter 8, respect for equal treatment makes American-style poison pills more difficult to implement in jurisdictions that discourage companies from distinguishing among shareholders in awarding benefits, including stock purchase rights.[37] Indeed, it is arguable that the U.S.—or at least Delaware—law accords the widest latitude for *un*equal treatment of identical shares among all of our core jurisdictions, though there are some isolated areas in which it enforces the equal treatment norm with exceptional vigor. Although most jurisdictions enforce the equal treatment norm most strongly in the area of corporate distributions (i.e., dividends and share repurchases) and share issues, U.S. law limits categorical enforcement only to the payment of dividends. In general, targeted share repurchases, even at prices above market, are permissible in the U.S., and companies may issue shares to third parties without providing preemption rights to incumbent shareholders.[38]

[36] Art. 109(1) Companies Act. A number of EC directives' provisions more or less broadly impose the equal treatment principle upon EU open companies as well. See Art. 42, Directive 77/91/EEC, 1977 O.J. (L 26) 1; Art. 3(1)(a) Directive 2004/25/EC, 2004 O.J. (L 345) 64; Art. 17(1) Directive 2004/109/EC, 2004 O.J. (L 390) 38; Art. 4 Directive 2007/36/EC, 2007 O.J. (L 184) 17.

[37] Given Japan's strong statutory provision enshrining the equal treatment norm, the evolving Japanese case law on warrant-based takeover defenses is particularly interesting in this regard. See *Bull-dog Sauce v. Steel Partners*, Minshu 61–5-2215 (Japan. S. Ct. 2007) (permitting a discriminatory distribution of warrants where the warrant plan was overwhelmingly approved by an informed shareholder vote and provided compensation for discriminatory treatment to the defeated tender offeror). See *infra* 8.2.3. See also Jeffrey N. Gordon, *An American Perspective on Anti-Takeover Laws in the EU: The German Example*, in Reforming Company and Takeover Law in Europe 541, 551 (Guido Ferrarini et al. (eds.), 2004) (EC directive on capital maintenance protects preemptive rights and limits discriminatory share issuance in a way that makes U.S.-style poison pills unfeasible).

[38] Where deviations from equal treatment in share repurchases are legitimate, these can be used to fend off hostile bidders, whether by selectively buying back the shares held by a potential bidder (greenmail: see *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964)) or via self-tenders

Another area in which deference to the equal treatment norm has important implications is the law of corporate groups (i.e., groups of companies under the common control of another company, often managed as a single, integrated business). As we discuss in Chapters 5 and 6, some jurisdictions provide for special regulation in this area.[39] The idea behind such regulation is that any single intra-group transaction is often part of a larger set of transactions that provides offsetting advantages and disadvantages to particular subsidiaries and to the parent company. Subjecting each individual transaction within this set to all the controls accorded to related-party transactions in general—i.e., assuring that each intra-group transaction does not advantage the group's parent or one of its subsidiaries on a deal-by-deal basis—would needlessly disrupt the group's day-to-day management.

The alternative is to permit judicial evaluation of intra-group transactions in aggregate. In Germany, where the equal treatment norm has wide-ranging application, the equal treatment norm has also been extended to aggregates of intra-group transactions: one of the core provisions of formal German group law is the duty to indemnify group subsidiaries for any losses that stem from acting in the group's interests *on a yearly basis*,[40] which can be viewed as the extrapolation of the equal treatment norm to yearly aggregates of transactions. This contrasts sharply with the U.S. approach in which any particular intra-group transaction between a parent and its partially-held subsidiaries is subject to the full panoply of self-dealing controls. At least on paper, this approach also diverges from the French and Italian approaches. As we show in Chapter 6, these two jurisdictions appear to require 'fair' treatment of minority shareholders within a group by looking at the overall set of interactions among its companies (and without specifying the time frame to be considered). Put differently, France and Italy employ a general fairness standard in group law, which leaves much to a court's discretion, while Germany relies on the more exacting equal treatment norm. However, whether this formal difference in group law among the three jurisdictions makes a real difference in practice is open to question.[41] First, whether German courts effectively enforce 'aggregate' equal treatment within groups is uncertain. Second, with specific regard to France, the indeterminacy of the fairness standard, coupled with the criminal sanction attaching to a negative finding by the courts, may deter abusive behavior by the dominant shareholders of groups even more effectively than a substantive requirement of equal treatment.

Thus, the reach of the equality norm varies greatly, both within and between jurisdictions. However, all jurisdictions rely on this device over at least some set of circumstances to align the incentives of controlling and minority shareholders.

excluding the potential bidder form participation (see *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)).

[39] See *infra* 5.2.1.3, 5.3.1.2, and 6.2.5.3.

[40] §§ 302, 311 II AktG.

[41] See *infra* 6.2.5.3.

4.1.4 Constraints and affiliation rights

We group together the remaining strategies for protecting minority shareholders because there is the least to say about them in a chapter devoted to the governance system. Legal constraints—principally in the form of standards such as the duty of loyalty, the oppression standard, and abuse of majority voting—are widely used to protect the interests of minority shareholders. In fact, these standards are often specific applications of the equal treatment norm, as when courts allow only 'fair' transactions between companies and their controllers—meaning, in effect, that controlling shareholders cannot accept unauthorized distributions from the corporate treasury at the expense of the firm's minority shareholders. We examine these standards more closely in Chapters 6 and 7, although we must stress here that they may help minority shareholders in settings involving neither a related-party transaction nor a fundamental change.[42]

Finally, the affiliation strategy in the guise of mandatory disclosure is at least as important to protecting minority shareholders as it is to protecting shareholders as a class. To the extent that disclosure, as a condition for entering and trading in the public markets, reveals controlling shareholder structures and conflicted transactions, market prices may reflect the risks of controller opportunism and penalize specific instances of it.[43] Moreover, mandatory disclosure provides the information necessary to protect minority shareholders through other mechanisms, such as voting or litigation.

By contrast, the exit strategy is sparingly used to protect minority shareholders. Permanency of investment is a hallmark of the corporate form—unlike the partnership form, in which exit rights are a default governance device. As we address in Chapters 6, 7, and 8, corporate law sometimes provides exit rights, but only upon egregious abuse of power by a controlling shareholder or at the time of a major decision that threatens to transform the enterprise. Examples of this are the possibility of appraisal rights (a mandatory buyout option) upon the occurrence of a fundamental transaction in the U.S., Japan, and elsewhere;[44] or the mandatory bid rule triggered by a sale of control.[45]

[42] See *infra* 6.2.5 and 7.4.2. For instance, a minority shareholder in a closely held firm may challenge as oppressive or abusive a controlling shareholder's decision to discharge the minority shareholder as an employee or to remove her from the board when all of the company's distributions to shareholders take the form of employee or director compensation.

[43] See Section 13D Securities Exchange Act of 1934, 15 U.S.C. § 78a (2008); Art. 9–15 Directive 2004/109/EC, 2004 O.J. (L 390) 38. Mandatory disclosure is further discussed in Chapter 9. See *infra* 9.2.1.

[44] See *infra* 7.2.2 and 7.4.1.2.

[45] See *infra* 8.2.5.4.