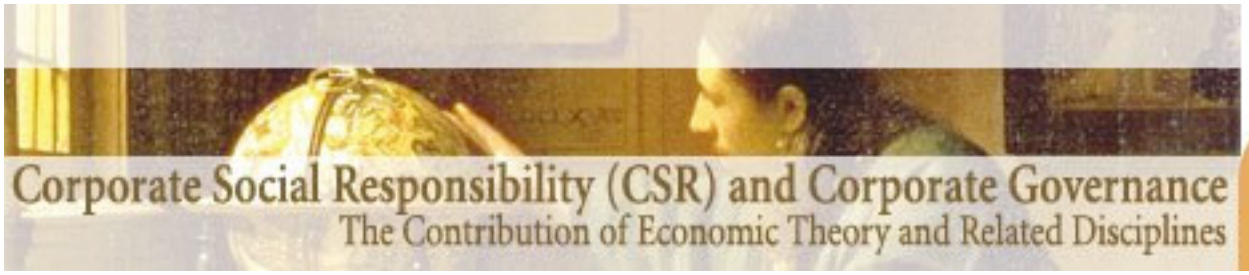

Francesco Denozza

Empowering v Protecting Stakeholders:

A partially sympathetic critique of

LYNN STOUT (WITH MARGARET BLAIR)

"Specific Investment And Corporate Law"

Three main variables

Three main variables define the range over which corporate managers can operate effectively:

--Who has the power (to appoint and above all) to remove them;

-- Nature and "quantity" of the specific duties they have to comply with;

--The definition of the interest whose care shall steer and limit their discretionary power

Agency/shareholder value Theory

- Appointment/ Removal

- Specific Duties

--- in corporate law

---outside of corporate law

- Discretionary Power

- Shareholders

--Only Shareholders and Creditors

--External constraints other Stakeholders are able to gain (by dealing with the corporation, by lobbying MPs, by forming trade unions, etc.)

- Shareholder Value

Team production/Specific investment

v

Agency/Shareholder Value

- AGENCY stakeholders interests are (and must be) protected only by specific duties, mostly established by the government in its rule-setting function, outside of corporate law.
- TEAM external constraints are unable to prevent opportunism

Team production/Specific investement

v

AGENCY

Appointment/Removal	Shareholders	Perpetuation by co-opting
Specific Duties	Other Stakeholders	Unable to prevent opportunism
Discretionary Power	Shareholder Value	Directors as mediating hierarchs

De jure condito (the law as it is) I

Appointment/Removal: under almost all European laws, shareholders have the power to appoint and to remove directors (British, Italian and French law gives the shareholder majority a non- waivable right to remove directors without cause).

- The controlling shareholder can therefore compel the directors to do everything not prohibited by the law (e.g. to distribute whole or part of the surplus to the company's legal capital; note that in most jurisdictions shareholders decide about dividend distribution -as f.e. in Germany§119 AktG, Spain, Art.213L. Soc. An., and in Italy, art. 2433 Cod. Civ.- or must approve dividend decisions of board of directors).

De jure condito II

Specific Duties: no duty towards stakeholders, other than shareholders and creditors, is usually present in corporate law;

Discretionary Power :shareholders can sue directors under all corporate laws (and as long as the company is solvent only shareholders can sue) thereby causing a judicial scrutiny of board decisions (in fact, to my knowledge, no director has ever been held liable for having used her discretionary power in favor of shareholders and to the detriment of other stakeholders)

De jure condito III
the agency theory

- I think that the problems with the agency theory underlined by professors Stout and Blair, arise from the fact that often (in fact, not so often in Europe) we are confronted with a "collective" principal, consisting of a multitude of dispersed individuals; "collective" principals always face big problems in controlling their agents (the Public Administration is probably the most important example of this enormous agency problem).
- But this result is a matter of ownership structure rather than a matter of law.

De jure condito IV

- Where a dominating individual emerges as “main” principal, or where a coalition of organized principals arises, we come immediately close to the classical model of the principal- agent relationship (the shareholder activism of financiers and coalesced hedge funds provides a lot of examples).
- In conclusion, I think that agency theory provides a description of the existing law that is rather (even not completely) correct.
- Its main defect is that the “typical” shareholder is depicted, and conceived of, as an economic abstraction, thereby hiding all conflicts of interests that in fact exist among different groups of shareholders.

De jure condendo I
(law as it should be)

- Discretionary Power providing directors with a wider range of discretion seems to me:

- Excessive: dealing with opportunism is the legitimate domain of the courts in their normal activity of interpretation of rules and contracts. One could maintain that, here as elsewhere, no special remedy is needed.

De jure condendo II

- Dangerous: directors who are able to protect non-shareholder interests are also able to protect their own interest. Risk of sheltering managers' misuse of their power from any scrutiny (given that courts would find very difficult to adjudicate "fiduciary"duties running to non-shareholder - as also professors Stout and Blair state - directors could easily justify almost every decision by invoking, in turn, the shareholders' interest or the interest of other stakeholders).

De jure condendo III

- Specific Duties corporate law should protect the interests of "atypical" shareholders (long term investors, socially responsible investors) and of other constituencies:
- Nonfinancial disclosure (mandatory social, environmental or sustainability reports)
- Risk management system ensuring that the risk preferences of all corporate constituencies are reflected in corporate decision-making (§91 II AktG ?)
- Duty to specify ex ante (at the moment the relevant board decisions are taken) the consideration given to the "social interests" that are usually mentioned ex post in social reports

De jure condendo IV

- Appointment/Removal mandating the appointment of outside directors independent even from the controlling shareholder:
- Mitbestimmung Germany is the best example
- Minority shareholders right to appoint one or a few directors (Russia, Spain-art.137 L Soc. An- : cumulative voting; now under Italian law in all listed companies, at least one of the nominees for the board must be chosen from a minority slate).

What should be changed, according to the team production theory, in the present law and in the current dominant theory?

Appointment/Removal no change needed: shareholders are already destitute of any significant power

Specific Duties no change needed

Discretionary Power change needed: from agents to mediating hierarchs

- Change is needed: to reduce the shareholder majority's power
- Change is needed: corporate law should protect "atypical" minority shareholders' and other constituencies' interests
- Change on this point without having changed the previous two, may produce unpleasant results especially in terms of increasing uncontrolled power of directors