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The Nature of Shareholding and Regulating Shareholders' Duties

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CHAPTER 2

The Nature of Shareholding and Regulating Shareholders' Duties

Alfonso Martínez-Echevarría

§2.01 INTRODUCTION

Some authors use the term 'owner' when referring to a 'shareholder'. This suggests that a shareholder has proprietary rights over the company's assets, but this is contrary to the foundations of company law and private law.

The European Union intends to open up a new front in company law and to regulate the duties of shareholders.[1] This means that now is a good time to reconsider the nature of shareholdership, since the distortions resulting from considering shareholders as owners will increase if they are given the same status when discussing their rights and duties.

To this end, this study starts with a brief review of the evolution of companies, examining the roles of shareholders and managers within the company, and their relations to the corporate assets.[2] While there are differences between legal cultures, there are some common principles and in recent years there has been some convergence caused by the globalization of the markets. The harmonization brought about by EU company law directives and by the Statute for a European Company[3] has also led to greater understanding of different legal cultures.[4]

1. Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (COM/2014/0213 final).
2. *See* ss §§2.02 [A]-2.02 [E] *infra*.
3. Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European Company (SE), and Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees.
4. *See* s. §2.02 [F] *infra*.

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Some of the theories and opinions that have shaped the corporate governance rules have blurred the concept of a 'shareholder'. There is no doubt that the principles of corporate governance have given a special vitality to company law, helping to establish or re-establish a balance of power between the different stakeholders in a company. However, it is wrong to equate ownership of shares with ownership of the company or its assets and to attribute to shareholders a legal position that does not correspond to that conferred by legislation or legal doctrine.[5]

The differences between civil law and common law jurisdictions do not explain how some common law authors have developed a number of doctrines which treat the 'shareholder' as 'owner'. To a greater or lesser degree, both legal traditions have their roots in Roman law, and in their legislation, case law and doctrines a distinction is made between property rights (*ius in rem*) and personal rights (*ius in personam*).[6]

The external dimension of a share, its status as financial instrument, gives the shareholder property rights over the share; but the internal dimension of a share, the bundle of rights of the shareholder, prevents attribution to the shareholder of any ownership rights over the company's assets.[7]

The corporate legal person holds the property rights over the company's assets, but the diverse legal titles by which a company acquires goods and adds to its assets mean that sometimes it is also wrong to consider it the owner of every single element of the corporate assets.[8]

§2.02 THE EVOLUTION OF THE COMPANY AND THE RELATION OF SHAREHOLDERS AND MANAGERS TO CORPORATE ASSETS

[A] Non-trading Forms of Corporations Before the Late Middle Ages

Commercial corporations are known to date back to the Late Middle Ages. Anything prior to that will date back to the remote predecessors of trading associations and issues that fall under the general doctrines of private law. These are some of the seeds from which business structures have evolved. A variety of corporate forms have been used by cities, guilds and colonies since the time of classical Rome, and by universities, religious orders and other charitable foundations since the Early Middle Ages.[9]

[B] Early Business Structures and the Involvement of Their Members in Their Management

The first business structures arose from the need of individual entrepreneurs for a legal instrument that would allow them to manage their trading activities when they exceeded the physical abilities of a single person.

5. *See* s. §2.03 *infra.*
6. *See* s. §2.03[A][1] *infra.*
7. *See* s. §2.03[C] *infra.*
8. *See* s. §2.03[D] *infra.*
9. *See* John L. Colley, Jr., et al., *Corporate Governance*, 9 (McGraw Hill 2003).

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The members of these first companies were members of the same family – a father and his children – or people bound by a close and loyal relationship. The word 'company' may be derived from the Latin *cum panis*, referring to people who came together to share bread.

It was normal for the members of a corporation to be directly involved in the management of the business. This, and the small number of members involved, made the creation of a corporate legal entity almost irrelevant. The members acted as a single entrepreneur and there was almost no separation between 'ownership' and 'management'.

[C] The Creation of Chartered Companies in the Sixteenth Century

In the sixteenth century, particularly following the discovery of America, there were large business projects that required financing which exceeded what could be obtained through a partnership, which was then a simple form of business structure. This led to the emergence of the chartered joint-stock company as an instrument to allow merchants to raise large amounts of capital, with the division of the equity capital into shares subscribed to by a larger number of investors.

The first chartered company, the Muscovy Company of London, was given its charter in 1555 in the reign of Queen Mary I, followed by the Spanish Company in 1557 and the English East India Company in 1600.[10] They were followed by, among others, the Dutch East India Company in 1602, the Virginia Company of London in 1606, and the Dutch West India Company in 1612.[11] Spain, under the initiative of the Count-Duke of Olivares, and France also set up similar companies.[12]

These first corporations took very different forms than today's corporations. They were created by sovereigns by a government decree called an *octroi*. They enjoyed monopoly privileges, had the power to build fortifications, and flew their own flags on their ships. They could also sign commercial treaties and declare war.[13] Because of these privileges and their creation by royal decree they are also known as 'privileged companies'.[14]

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10. *See* Jack J. Beatty (ed.), *Colossus: How the Corporation Changed America*, 6 (Broadway Books 2000).
11. *See* John L. Colley, et al., n. 9, 9; and Rodrigo Uría, *Derecho Mercantil*, 223-224 (Marcial Pons 2002).
12. *See* Santiago Hierro, *El origen de la compañía anónima en España* (Tecnos 1988).
13. *See* Fernando Sánchez Calero, *La sociedad cotizada en Bolsa en la evolución del Derecho de Sociedades*, 40 (Real Academia de Jurisprudencia y Legislación 2001); and Uría, n. 11, at 223-224.
14. *See* José Girón, *Las grandes empresas. Problemas jurídicos actuales de tipología empresarial. La gran S.A., los grupos de sociedades*, 31 (Universidad Nacional Autónoma de México, México/Publicaciones de los Seminarios de la Facultad de Derecho 1965).

[D] Increasing Flexibility and Democratization of Companies in the Nineteenth Century

The regimes of privileged companies were modified in the nineteenth century, when they were codified and brought more into line with modern corporations. Under Article 33 of the French Commercial Code of 1807, the system of setting up companies by royal charter was replaced by a system of administrative authorization. The Spanish Commercial Code of 1829, considered one of the best of its day, was even more flexible. Instead of administrative authorization, it provided that the deed of incorporation and the regulations of the company should be examined by a commercial court (Article 293).[15]

At this stage, in common law the company law regime was undergoing major changes which would lead to a confrontation between two competing theories of incorporation: the contractual theory and the regulatory theory.[16] A leading case in this respect was the 1819 judgment of the Supreme Court of the United States in *Trustees of Dartmouth College v. Woodward,*[17] one of the first major cases on corporations in the United States (US).

This period also saw the 'democratization' of the public limited company in several countries. Public limited companies were governed internally by the will of shareholders who had equal rights.[18] It is this characteristic, which is ingrained in the modern corporate regime, which suggests the metaphor of democracy.[19] Thus, by analogy, in a corporation, 'popular sovereignty' lies with the shareholders in the general meeting, and executive power lies with the board of directors.

In civil law jurisdictions liberalism and interventionism alternated in the evolution of the regulation of public limited companies, similarly to the alternating political trends of the nineteenth century.[20]

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15. *See* Sánchez Calero, n. 13, 41-42.
16. *See* Henry N. Butler & Larry E. Ribstein, *The Corporation and the Constitution*, 1 et seq. and 18 et seq. (American Enterprise Institute Press 1995).
17. 17 U.S. (4 Wheat.) 518 (1819).
18. *See* Uría, n. 11, 224.
19. *See*, in this book, Mathias Siems, *Ideal and Real Types of Shareholders: Rights and Duties*.
20. In the case of Spain, financial scandals involving forward transactions on the Stock Exchange led to the enactment of the Law of 28 January 1848 on trading stock companies, introducing a regime with a greater degree of intervention than that in the Code of 1829. This calmed the popular outcry caused by what even Sainz de Andino, the author of the Code, called the 'immoral, illicit' behaviour of the managers of such companies; *see* Sánchez Calero, n. 13, 42. Quite a lot of the regulatory elements in this measure and its implementing regulation were found to be so useful that they re-emerged, not just in the Code of Commerce of 1885, but in the commercial laws of the twentieth century which regulate the public limited companies in western countries; *see* Jesús Rubio, *Introducción al Derecho Mercantil*, 327 (Ediciones Nauta 1969). On the subsequent regulation of public limited companies in the Law of 19 October 1969 and in the Code of Commerce of 1885, *see* Joaquín Garrigues, *Nuevos hechos, nuevo Derecho de sociedades anónimas*, 19 (Editorial Revista De Derecho Privado 1933); Luis Sánchez Agesta, *Historia del constitucionalismo español*, 330 (3rd ed., Instituto de Estudios Políticos 1974); Fernando Sánchez Calero, *Las operaciones a plazo en la Historia del Derecho Bursátil (1831-1936)* in *El mercado a plazo en las Bolsas Españolas,* 32-34 (Instituto de Estudios Bancarios y Bursátiles, Facultad de Ciencias Económicas y Empresariales, Universidad de Bilbao 1977).On

[E] Company Law in the Twentieth Century and the Emergence of Corporate Governance

The twentieth century introduced a phase of de-codification of company law. A number of European countries removed company law from their codes and enacted special laws for the regulation of companies. Legislators framed such companies legislation with a clear understanding of the complexity of the interests involved in companies, as is evidenced by the regulations and their attempt to strike a balance between freedom and intervention.[21]

Corporate governance doctrine emerged during this latest period of the history of company law. Since then the evolution of company law has been influenced by two main aspects of the doctrine. First, the thinking behind the principles of corporate governance have helped draw attention to the need to provide specific regimes for large corporations, since it does not make sense to apply the same rules to both public and private companies.[22] Second, some corporate governance rules have been incorporated in the legislation on the structures of large companies, turning corporate governance rules, which had hitherto been soft law rules, into hard law regulations.[23]

[F] The Harmonization of European Company Law and the Concept of the Corporation

Recent decades have seen some stability or consolidation of the core principles of company law in civil law jurisdictions, especially those in the EU where, since the end of the 1960s, the company law directives and the legislation on the European Company (Societas Europaea),[24] the European Private Company (Societas Privata Europaea) and the European Cooperative Society, have directed the evolution of company law. This evolution has not been without difficulty but it has been in a more or less fixed direction. The principles in these directives and statutes, and their transposition to the

the issues raised during this period in France and Germany, *see* Philippe Merle, *Droit commercial. Sociétés commerciales*, 633 (6th ed., Edition Dalloz 1998).

21. In Spain two regulations were enacted: the Law of 17 July 1951, on the Legal Regime of Public Limited Companies and, on joining the current European Union, Royal Legislative Decree 1564/1989 of 22 December, approving the New Text of the Company Law.

    While introducing some new developments, Royal Legislative Decree 1/2010 of 2 July approving the Companies Act has considerable continuity with the public limited company regime of the preceding century.

22. However, it is well known that some small and medium-sized companies voluntarily use corporate governance rules as guidance.

23. *See* s. §2.04 *infra*.

24. Proposed for the first time by Pieter Sanders in 1959; *see* Pieter Sanders, *Vers une société anonyme européenne?,* November-December Rivista delle Societá 1163 (1959).The long preparatory process (from 1970 to 2001) and agreement of the Statute for the European Company required the approximation of the company law cultures of the different EU Member States. Among its goals, the Action Plan 'European Company Law and Corporate Governance' (COM(2012) 740 final) includes fostering knowledge and use of the Statute for the European Company, without any intention to modify it.

legal systems of the Member States, may be considered as continuing the evolution of the preceding company law.

In contrast, in common law different doctrines propose alternative concepts of the corporation.[25] In 1976, Jensen and Meckling offered an innovative conception of a corporation as a nexus of contracts.[26] While there are some positive aspects in Jensen and Meckling's work, this conception of the corporation as just a group of contracts has been strongly criticized since it first appeared.[27]

§2.03 DO SHAREHOLDERS *OWN* THE COMPANY OR THE CORPORATE ASSETS?

[A] Referring to Shareholders as 'Owners' by Some Common Law Writers and Its Influence in Other Jurisdictions

There has always been a temptation to identify shareholders as owners or co-owners of the company's assets. This mistaken usage is more excusable in practice than in theory, and is more understandable in those who do not approach the issue from a legal perspective.

In companies with few shareholders who are also involved in the management of the company, it is easy to forget that the formation of the company has created a legal entity different from the shareholders, and that such entity holds all the rights and obligations stemming from the company's business activity.[28] For some authors in the common law countries it has been natural to consider that the shareholders are actually the owners.[29] Chandler referred to the confusion of the roles of shareholders, managers and title-holders of corporate assets that existed at the beginning of the nineteenth century, saying that 'owners managed and managers owned'.[30]

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25. Due to their special influence, the following should be highlighted: Adolf A. Berle, Jr., & Gardiner C. Means, *The Modern Corporation and Private Property* (The Macmillan Company 1932); and Ronald H. Coase, *The Nature of the Firm*, 4, 16 Economica 386 (1937).

    There is a long systematic list of the leading authors and doctrinal trends on this topic in Daniel J. H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, revisited*, 69 S. Cal. L. Rev. 1021, 1023 (1996).
26. *See* Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).
27. *See* Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts and the Dual Nature of the Firm*, 24 J. Corp. L. 819, 819, note 2 (1998), which includes a list of authors who are critical of this idea. Eisenberg disagrees with the theory of a *nexus of contracts* and considers that the concept of the *dual nature of the corporation* is more suitable (*ibid.*, 836).

    See also, in this book, Jennifer Payne, *Contractual Aspects of Shareholders' Duties*, Ch. 6 s. §6.02 'Nexus of Contracts Theory'.
28. From the factual or functional point of view, it is possible to establish certain parallels between this kind of company and earlier kinds (s. §2.02[B]); in both cases there is no doubt that the legal person is the owner of the company's assets.
29. *See* Paddy Ireland, *Company Law and the Myth of Shareholder Ownership*, 62 Modern L. Rev. 32 (1999); Margaret M. Blair, *Corporate 'Ownership': A Misleading Word Muddies the Corporate Debate*, Winter 13/1 The Brookings Rev. 16 (1995).
30. *See* Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business*, 9 (Harvard University Press 1977).

The development of large corporations at the beginning of the twentieth century made it common for companies to have large numbers of shareholders whose views were no longer relevant to shaping the management of the company, and such shareholders were less likely to feel they were owners of the company's assets. The Supreme Court of Michigan gave judgment in *Dodge v. Ford Motor Co.*,[31] ruling in favour of the Dodge brothers who considered that Henry Ford should not retain USD 58 million in the company but should instead distribute part of the money as dividends. Some authors consider this judgment to be one of the main foundations of the 'property conception of the corporation'.[32]

While the law does not support the idea that shareholders have property rights over the corporate assets, the use of the term 'owner' synonymously with 'shareholder' or 'stockholder' has become widespread in some sectors of the common law writing. However, this usage is not unanimous and other writers deny that shareholders have the status of owners.[33]

[1] The Distinction Between Property Rights and Personal Rights in Civil Law and Common Law

The influence of Roman law on civil law has led to civil law clearly distinguishing between property rights and personal rights. These are two different categories, each with its own internal logic and general principles.[34]

In Roman law, the distinction between the two categories is clear, due to the different actions used to uphold each type of right: an *actio in rem* to demand a right over a thing, and an *actio in personam*, to enforce an obligation.[35] These Roman law procedures have been transmitted and enriched over the centuries, among other

31. 204 Mich. 459, 170 N.W. 668 (1919).
32. *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 Cardozo L. Rev. 261 (1992).
33. Followers of the concept of a company as a *nexus of contracts* deny that shareholders are owners, since a mere collection of contracts cannot be subject to ownership. And authors who adopt other doctrines are also opposed to considering the *shareholder* as *owner*; *see* Paddy Ireland, n. 29; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999); and Blair, n. 29.
34. With property rights, it is right to note the protection of the link between a person and a thing, and the enforceability *erga omnes* of the recognized rights over a thing – *ubi rem meam invenio, ibi vindico*; however, with personal rights the focus is on the relations between two people whose rights are enforceable *inter partes*.
35. D. 44.7.25 pr (Ulp. *l. sing. reg.*): '*Actionum genera sunt duo in rem, quae dicitur vindicatio, et in personam, quae condictio appellatur. In rem actio est, per quam rem nostram, quae ab alio possidetur, petimus; et semper adversus eum est, qui rem possidet. In personam actio est, qua cum eo agimus, qui obligatus est nobis ad faciendum aliquid vel dandum; et semper adversus eundem locum habet*'.For his part, Paulus defines an obligation not just by focusing on its essence but also distinguishing it from rights over things: '*Obligationum substantia non in eo consistit, ut aliquod corpus nostrum aut servitutem nostram faciat, sed ut alium nobis obstringat ad dandum aliquid vel faciendum vel prestandum*' – D. 44.7.3 pr (*Paulus II institutionum*).The author is grateful to Juan Manuel Blanch, Professor of Roman Law and author of Locuciones latinas y argumentación jurídica (Una revisión a la luz del Derecho romano y del Derecho actual). Pro iure romano et lingua latina, (pro manuscrito), from which the quotations in this note have been taken.

channels by the *Corpus Iuris Civilis* and the works of medieval legal commentators. The codification processes in continental Europe during the eighteenth and nineteenth centuries consolidated this systematic Roman distinction, and this is explicitly reflected in the structure and titles of the headings of the civil codes.[36] Both the rules which are part of private law and the legal doctrine are guided by this *summa divisio*. The works of authors such as Savigny[37] and, closer to the last period of codification, Windscheid[38] are remarkable. Today, this is not an area of dispute in private law doctrine and it constitutes one of the basic foundations of legal reasoning.[39]

Anglo-Saxon law or common law developed independently of Roman law, though there are major points of similarity between the legal traditions.[40] In particular, the concepts and terms 'property rights' (*ius in rem*) and 'personal rights' (*ius in personam*) are not alien to the common law system. In both its doctrine and jurisprudence common law clearly distinguishes between a real right over property and a personal right of an obligational nature.[41] However, regardless of the possibility of linking the common law to categories rooted in the Roman tradition, the common law itself makes it possible to identify and define the extent and the content of 'ownership' and 'property rights'[42] without there being any confusion with the 'personal rights'.

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36. The current Spanish Civil Code of 24 July 1889 is a clear example of this process, as may be deduced from the wording in sections of its 2nd, 3rd & 4th Books: '*De los bienes, de la propiedad y de sus modificaciones*', '*De los diferentes modos de adquirir la propiedad*' and '*De las obligaciones y contratos*'.
37. *See Friedrich K. v. Savigny*, *System des heutigen römischen Rechts*, erster (-achter) Band (Berlin, 1840-1849).
38. *See* Bernhard Windscheid, *Lehrbuch des Pandektenrechts*, erster Band (9th ed., Literarische Anstalt Rütten & Loening 1906), 166, on '*Dingliche und persönliche Rechte*', 193, on '*Actio in rem* und *actio in personam*'.
39. For guidance on the non-adversarial nature of this issue, e.g., in the Spanish doctrine, *see*: Luis Díez-Picazo & Antonio Gullón, *Sistema de Derecho Civil*, vol. III, *Derecho de cosas y Derecho inmobiliario registral*, 31 (7th ed., Tecnos 2002), where a distinction is made between property rights and credit or personal rights; and José L. Lacruz, Francisco A. Sancho, Agustín Luna, Jesús Delgado, Francisco Rivero & Joaquín Rams, *Elementos de Derecho Civil,* II *Derecho de obligaciones*, vol. I *Parte general. Teoría General del contrato*, 7-9 (3rd ed., Dykinson 2003), where there are some explicit references to the Roman law tradition.
40. '[A]lthough the common law developed as a system independently from the influence of the *Corpus Iuris Civilis* and thus English law does not belong to the *ius civile* tradition it, nevertheless, seems to share many of methodological characteristics of classical Roman Law'; *see* Geoffrey Samuel, *Law of Obligations and Legal Remedies*, 99 (2nd ed., Cavendish Publishing Limited 2001).
41. In the judgment in *Manchester Airport plc v. Dutton* ([2000] 1 QB 1333) it became evident that 'the *ius* in issue was one that was *in rem* rather than *in personam*' and, as a consequence, the success of this case is the result of clearly establishing the differences between the nature of 'a *proprietary* right and not just one that was *obligational* and which did not attach directly to the *res*'; *Ibid.,* 110.

    'Legal scholars assert that property is *in rem* as opposed to *in personam* … but to many of them the characteristics that define property are still as ambiguous as a Rorschach inkblot'; *see* O. Lee Reed, *What Is 'property'?*, 41 Am. Bus. L. J. 459, esp. 462 (2004).
42. *See* Alison Clarke & Paul Kohler, *Property Law. Commentary and Materials*, 26 (Cambridge University Press 2005).

Such a distinction between property rights and personal rights is found in both the common law system and its practice.[43]

Thus, as it will be explained later, there is no justification for the incorrect use of the term 'owner' to refer to a 'shareholder' by some economists and lawyers from countries with a common law tradition. There is even less justification when the same mistake is made, mimetically, in countries with a civil law tradition.[44]

[2] Economic Analysis of Law? Yes, but of Law

The property conception of the corporation and the use of the term 'owner' as equivalent to 'shareholder' have been especially associated with the Chicago school of economics in its analysis of law. In this school of thought both this terminology and this idea of the corporation have taken root and have been developed.[45] In this school of thought, there has been particular emphasis on the idea that a corporation's assets are the property of its shareholders and that the company's managers must act as agents of the shareholders.

The economic analysis of law may originate with Bentham and utilitarianism.[46] Since the 1960s this has found a special resonance and has been developed by authors such as Coase,[47] Becker,[48] Calabresi[49] and Posner.[50]

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43. Eisenberg expressed a clear position on this issue: 'Both law and social practice draw sharp distinctions between *ownership or property rights on the one hand, and contract rights on the other*' (emphasis added); *see* Eisenberg, n. 27, 825.
44. This happens, for example, in the Spanish legal system. In Art. 540.4.a) of the Companies Act 2010, the wording used is '*estructura de propiedad de la sociedad*' (company property structure) when referring to the structure of the *shareholders*. Likewise, in the three Codes of Corporate Governance published in Spain, the expression '*consejero dominical*' (proprietary director) is used, referring to the Latin term *dominus, proprietor*, to designate a director who is a member of the board by virtue of a corporate stake or having a significant interest as a shareholder; Code of Corporate Governance, of 26 February 1998, II.2.2 (p. 22), Recommendation 3 (p. 64) and passim; Report of the Special Commission to Foster Transparency and Safety in Markets and listed Companies of 8 January 2003, IV.2.1.b (p. 34) and passim; Unified Code of Corporate Governance of the listed companies, of 19 May 2006 (version of June 2013), Recommendation 10 (p. 16) and passim. Two of the codes use the expression *property*, when referring to the shareholders, and *structure of the property*, when referring to the *structure of shareholders*; Code of Corporate Governance of 26 February 1998, I.2 (p. 6) and passim; Report of the Special Commission to Foster Transparency and Safety in Markets and listed Companies of 8 January 2003, I.6 (p. 12) and passim.

    When the term *consejero dominical* (proprietary director) was used in the first Code, it was considered appropriate to draw attention to the inaccuracy of the term and it was stated, almost apologetically: 'those that we can designate, with a *terminology more graphic than accurate*, proprietary directors' (emphasis added); Code of Corporate Governance of 26 February 1998, II.2.2 (p. 22).
45. *See* Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance in the Twenty-First Century*, 210 (The Brookings Institution 1995).
46. *See* Louis Kaplow & Steven Shavell, *Economic Analysis of Law*, Working Paper No 6960 National Bureau of Economic Research 1 (1999).
47. *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J. Law & Econ. 1 (1960).
48. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968).
49. *See* Guido Calabresi, *The Costs of Accidents* (Yale University Press 1970).
50. *See* Richard A. Posner, *Economic Analysis of Law* (Little, Brown and Company 1972).

Approaches to the economic analysis of law have been debated and frequently refuted.[51] Nevertheless, provided the economic analysis respects some fundamental premises, it can make a valuable contribution to the adoption of decisions of legal nature, particularly in the field of commercial law, company law and financial market law, where the economic consequences of such decisions are obvious and measurable.[52] There are two basic premises which, if complied with, enable the economic analysis of law to fulfil the instrumental function proposed.

The first premise is that the ultimate purpose – and touchstone – of the economic analysis of a legal decision (or institution) is to determine whether or not the decision complies with justice, rather than to evaluate its economic efficiency. The economic efficiency of a legal decision or institution is important, but it is not the priority of legal reasoning. Obviously, it is not a problem to subject a decision to simultaneous analysis from the perspectives of justice and economics. The classic definition of justice is open to this dual perspective, as the essence of justice is 'giving to each his due' (*suum cuique tribuere*). For this, there is no doubt that evaluating issues in economic terms helps.

The second premise is both important and undemanding. It is that the meanings of legal terminology should not be altered when used in the economic analysis of law. The use of the term 'owner' (which refers to possession of a property right) to refer to

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51. The economic analysis of law has been criticized from a variety of perspectives, e.g., from positive, normative and logical-semantic perspectives.

    From the positive or behavioural perspective, some authors have argued that individuals and firms do not always respond to legal rules as rational maximizers of their welfare. *See* Jonathan Baron, *Thinking and Deciding* (4th ed., Cambridge University Press 2008); Christine Jolls, Cass R. Sunstein & Richard H. Thaler, *A Behavioral Approach to Law and Economics*, 50 Stan. L. Rev. 1471 (1998); Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. Polit. Econ. 1325 (1990); and Matthew Rabin, *Psychology and Economics*, 36 J. Econ. Lit. 11 (1998).

    From the normative or moral perspective, the main criticisms of the economic analysis of law have related to its focus on efficiency and the effects of legal rules on behaviour, rather than on fairness or achieving certain moral standards other than a utilitarian approach to issues such as victim compensation, redistribution of income, the purposes of punishment or the justification of consideration in contracts. Among others, *see* A. Mitchell Polinsky & Steven Shavell, *Contribution and Claim Reduction among Antitrust Defendants: An Economic Analysis*, 33 Stan. L. Rev. 447-471 (1981); and Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. Leg. Stud. 667 (1994). Amartya Sen & Bernard Williams, *Utilitarianism and Beyond* (Cambridge University Press 1982) is also a good general reference, showing representative views of leading economists and philosophers on normative analysis.

    A third criticism, with arguments based on normative criticism, reaches a different conclusion. This is the semantic and logical argument. It seems that the economic analysis of law originally deliberately excluded the normative perspective, based on the assumption that concepts of fairness, justice and rights would not necessarily be efficient. However, it is argued here that efficiency is part of the fairness of a procedure and the exclusion of efficiency should not be assumed. The present author's view is that it is good that economic standards should serve economic goals, but it is not appropriate that economic standards should be used at the same time as new legal paradigms or definitions. The same criticism is applied to intellectual property rights in Andreas Rahmatian, *International Intellectual Property Scholars Series: A Fundamental Critique of the Law-and-Economics Analysis of Intellectual Property Rights*, 17 Marq. Int'l. Prop. L. Rev. 191 (2013).
52. This is what happens with share value creation, *see* s. §2.04[B].

a 'shareholder' (who does not have a property right, but rather a bundle of obligational rights) is a good example of the kind of mistake to which the economic analysis of law can lead if this premise is not respected. Such mistakes have been made, and many have raised their voices against the dangers of this ill-advised proceeding.[53]

Law and economics may complement each other in the economic analysis of law and be interwoven like weft and warp. On the other hand, if the legal terms used in economic analysis are given incorrect meanings, economic science will be unravelling the tissue of legal science. There can be no proper economic analysis of law if the term 'owner' is used to refer to a 'shareholder', any more than there could be if 'intent' were used to refer to 'negligence', or if 'prescription' were confused with 'expiration', or 'validity' with 'efficacy'. This criticism does not imply a rejection of the economic analysis of law.[54] However, it is important that, when making an economic analysis of law, the question and the answer should be: *Economic analysis of law? Yes, but of the law*.

[B] Shareholder Rights and Company Rights

A lot of light can be shed on the interpretation of corporate governance regulations by determining who holds the corporate assets, since the dichotomy between 'ownership' and 'control', 'shareholders' and 'managers' is always relevant.[55]

Some writers on corporate governance, writing from a perspective that is more economics-related than legal and is influenced by the theories of the Chicago school of economics on the analysis of law, use the term 'owner' when referring to a 'shareholder'. This has even influenced some corporate governance codes which use the word in this sense and have generalized this use.[56]

An owner or proprietor (*dominus*) is the holder of a property right over a good. Shareholders do not have a property right over the corporate assets, or even over a proportion of them corresponding to their shares. They do not have a property right equivalent to ownership and enforceable against all (*erga omnes*). A shareholder has a bundle of rights of an obligatory nature – enforceable *inter partes* – against the company. If, when incorporating a company, a shareholder pays for shares in kind, the shareholder no longer owns such assets but instead becomes a holder of a bundle of

53. *See* Clarke & Kohler, n. 42, 42, where, pointing out the limits to the economic analysis of law, it is noted that 'anyone viewing property solely from an economics perspective would be in danger of getting a distorted view of how societies do and should function'. *See also* Paul L. Davies & Sara Worthington, *Gower & Davies' Principles of Modern Company Law*, 48-49 (9th ed., Sweet & Maxwell 2012).
54. This is not a criticism, but rather an explanation of why the economic analysis of law is resisted by European jurists. Up to the end of the twentieth century, legal dogmatics and legal science were more solidly developed by European jurists than by North American jurists. *See* Richard A. Posner, *Legal Scholarship Today*, 115 Harv. L. Rev. 1314 (2001-2002); *ibid*, *Overcoming Law*, 70 et seq. (Harvard University Press 1995); and Jesús Alfaro, *Los juristas – españoles – y el análisis económico del Derecho*, Working Paper No 417 Indret 12 (2007).
55. *See* Blair, n. 45. While several decades have passed since the publication of this work, the debate remains open.
56. The term 'asset owners', relating to *shareholders*, is also found in the Proposal for a Directive amending Directive 2007/36/EC (recitals 1 and 2).

obligational rights in respect of the company. The bundle of rights allows a shareholder, for example, to demand payment of a distributable dividend, if this has been agreed at the general meeting. It also allows a shareholder to claim part of the net assets in proportion to their shareholding upon liquidation of the company, etc.[57]

The shareholders acting together in a general meeting are the supreme governing body of the company. While the managers may make decisions about the day-to-day administration of the company, the shareholders have the ultimate power to decide.[58] This right of the shareholders, called the 'reserve power', was recognized in the United Kingdom (UK) in 1909 in the case of *Quin & Axen v. Salmon*.[59] This was subsequently developed in the 'residual claimant' theory of institutional economics.[60] However, while the sovereign power of the shareholders is certainly a key element in company law theory, its relevance should not be exaggerated nor lead people to think that the shareholders have proprietary rights over the company's assets.[61] To attribute proprietary rights over the corporate assets to the shareholders, i.e., to consider them owners, means ascribing them powers which do not correspond to the legal nature of their rights, and which shareholders do not need in order to exercise their function as the decision-making body of the company.

A proprietary right is like a bundle of rights,[62] including the rights to possess, use, manage, generate income, consume or destroy, alienate, transmit, devise or bequeath.[63] Thus, it is not accurate to use the terms 'property' and 'ownership' synonymously, since 'ownership' is a legal category covered by the term 'property'. However, since the narrower legal category is included in the broader, effectively both may be considered equivalent. Part of the bundle of rights granted by ownership, which best encapsulates the essence of a proprietary right, is the right of exclusion, i.e.,

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57. Some shareholders' rights have been harmonized by Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies. *See* the equal treatment of shareholders (Article 4), information prior to the general meeting (Article 5), the right to put items on the agenda of the general meeting and to table drafts (Article 6), etc.

    See also the general catalogue of shareholders' rights in the Spanish legal system in Article 93 of the Companies Act 2010: the right to receive a dividend, the right to a proportion of the assets on liquidation of the company, a preferential right to subscribe for new shares, the right to attend and vote at the general meeting, and the right to be informed.
58. However, the nature of sovereignty depends on national law; *see* Mathias Siems, *Convergence in Shareholder Law* (Cambridge University Press 2008); and David Cabrelli & Mathias Siems, *Convergence, Legal Origins and Transplants in Comparative Corporate Law: A Case-Based and Quantitative Analysis*, 63(1) Am. J. Comp. L. 109 (2015).

    In Spanish law, Arts 159 and 161 of the Companies Act 2010 establish the sovereignty of the general meeting.
59. *Quin & Axtens v. Salmon,* [1909] AC 442.
60. *See* Iris H-Y Chiu, *The Meaning of Share Ownership and the Governance Role of Shareholder Activism in the United Kingdom*, 8 Rich. J. Global L. & Bus. 117, 124 (2008).
61. For a favourable view of the recognition of such property rights, *see* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94(4) J. Pol. Econ. 691 (1986).
62. *See* John Lewis, *A Treatise on the Law of Eminent Domain in the United States*, 43 (Callaghan & Co. 1888).
63. *See* Anthony M. Honoré, *Ownership*, 107, esp. 113-120, in Anthony G. Guest (ed.), *Oxford Essays in Jurisprudence* (Oxford University Press 1961).

the right to prevent others disposing of, using or enjoying the assets which are the subject of the proprietary right.[64] In a positive sense, the essence of a proprietary right is that the holder of a such right is entitled to enforce it against all (*erga omnes*), while third parties (the *omnes*) must respect the right and help the owner's enjoyment of it.

There is no doubt that a shareholder does not have a right of exclusion over the company's assets, nor are third parties legally obliged to help the shareholder's enjoyment of such assets. It is neither necessary nor correct to rely on property rights to define the position of shareholders. But it is correct to stress the importance of shareholders' rights and the role they play within a company, while recognizing that the legal system grants shareholders some governance rights.[65] Shareholders share these governance rights with the management and, when appropriate, with other stakeholders, such as long term creditors and employees, though the participation of long term creditors and employees in governance may be somewhat less in proportion to the extent of their interests.

It is the corporate legal person which acquires proprietary rights over the company's assets.[66] This statement leads us to look again at the managers and to establish the balance of power between them and the shareholders. The governing body represents the company. The managers are not titleholders of the company's rights, but they do embody the legal personality of the company.[67] It is they who make statements in the name of the company, sign contracts on its behalf, represent it in court, sit in the dock if it is sued and manage its assets. They represent the owner of the company's assets, which is the company itself and not the shareholders.[68]

64. *See* Reed, n. 41, at 487-489, where it is noted that in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board, 527 US 666, 673 [1999]* the US Supreme Court acknowledged that 'the hallmark of a protected property interest is the right to exclude others'; *see also International News Service v. Associated Press*, 248 US 215, 250 [1918], where it is stated that '(a)n essential element of individual property is the legal right to exclude others from enjoying it'.

    The right of exclusion, as an essential aspect of the concept of property, was addressed by Hobbes; see Thomas Hobbes, Leviathan (1651), 297, Crawford B. MacPherson (ed.), (Penguin Classics 1985), where he stated: 'the propriety which a subject hath in his lands, consisteth in a right to exclude all other subjects from the use of them', though he added: 'and not to exclude their sovereign, be it an assembly, or a monarch'.

65. *See* Chiu, n. 60, 124.

    See also the opinion of Smith, who declares that governance is not to be regarded as ownership; Henry E. Smith, *Exclusion and Governance: Two Strategies for Delineating Property Rights*, 31 J. Legal Stud. 453 (2002).

66. While there was a subsequent debate on the legal theory, the courts had already ruled in *Macaura v. Northern Assurance Co. Ltd. [1925] AC 619 (HL)*.

    However, the corporate legal person does not always have the ownership of every item of its assets; *see* below ss §2.03[D] and §2.04.

67. '(A)lthough the legal fiction of the corporation actually owns any asset, the proprietary rights over the assets are more significantly exercised by management', *see* Chiu, n. 60, 122. *See also* John McDermott, *Corporate Society: Class, Property and Contemporary Capitalism*, 80-91 (Westview Press 1991).

68. On this, *see Short v. Treasury Commissioners, [1948] 1 KB 116*, where it was stated: 'shareholders are not, in the eye of the law, part owners of the undertaking'; and more recently, *Her Majesty's Commissioners of Inland Revenue v. Laird Group PLC*. [2003] UKHL 54, where the court insisted that shareholders do not have a proprietary stake in the assets of the company; *see* Chiu, n. 60, 135.

The shareholders do not own the company's assets. This is why it is best to avoid using inaccurate terminology to interpret the corporate governance rules correctly. The appropriate term is 'member' or 'shareholder' – not 'owner'.

[C] Why Are Shareholders Not Owners if They Purchase Their Shares?

[1] Derivative Acquisition of Shares by a Contract for Sale and Original Acquisition by Subscription

In most cases and, necessarily in transactions carried out via a stock exchange, the great majority of shares are acquired by a contract for sale. Legally, shares are financial instruments and, more specifically, when they are represented by certificates or book-entry they are transferable securities.[69] Listed securities must be represented by book-entries. The fact that shares are represented by book-entries, like the system of representation by certificates which the book-entry system replaces, means that its legal nature is that of *a good* that may be the subject of property rights of real nature – like possession, usufruct and, obviously, property – and thus may be transmitted by a contract for sale.[70]

A buyer of shares does not acquire proprietary rights over the company's assets but over the financial instrument, the share itself. Therefore, a shareholder who acquires shares by a contract for sale becomes the holder of the bundle of obligational rights which their status as a shareholder entitles them to.[71]

While a contract for sale is the most usual way of acquiring shares and becoming a shareholder, it is not the only way. Certainly, a contract for sale is the most common way to acquire shares derivatively, whether by negotiation, via an unregulated market or via an organized market for financial instruments such as a stock exchange. However, if the shares of a non-listed company are not represented by book-entries or certificates (bearer shares) they can be transmitted by any contract that is proper under the law of obligations.[72]

On the other hand, when shares are issued, either when the company is set up or when there is a capital increase, they are acquired by subscription. In this case, the shareholder has a legal relationship with the company (legal person) and with the other

69. *See* Annex I, section C(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID).
70. *See* Alfonso Martínez-Echevarría, *Valores mobiliarios anotados en cuenta. Concepto, naturaleza y régimen jurídico*, 213 et seq. (Aranzadi 1997); *ibid.*, *El régimen jurídico de los instrumentos financieros y de los valores negociables anotados en cuenta*, 51, esp. 75, Guillermo Cabanellas (dir.), *Mercado de Capitales* (Heliasta 2009).
71. This can be handled by considering the two perspectives from which the shares can be analysed: the *external dimension* of a share – a share as an investment security which can be the object of property rights, given that the share *itself* is an asset; and the *internal dimension* of a share – a share as a bundle of rights, which does not grant to the shareholder any proprietary rights over the company assets; *see* Chiu, n. 60, 120-121.
72. Thus, in the Spanish system, Article 120.1 of the Companies Act 2010 refers implicitly to Arts 1526-1536 of the Civil Code.

shareholders. From this perspective, the multilateral contract which constitutes the company regulates the rights and obligations of the shareholder.[73] This contract will say nothing about the shareholder acquiring any proprietary right or having the status of owner. The contract will give the acquirer the status of shareholder – neither more nor less.

Where the status of shareholder is acquired by a contract for sale subsequent to the issue of the shares, the contract may give the wrong perception that a person buying the shares acquires the property rights over part of the company's assets. But, as we have seen, this is not the case since what the purchaser of a share is really buying is the ownership of the share certificate (where there is one) or the proprietary right over the transferable security (when the shares are represented by book-entries). In either case ownership of these assets gives the status of shareholder. A shareholder is entitled to exercise the rights of a shareholder, but these rights do not include rights over the property of the company.

[2] Shareholder's Property Right Over Net Assets Following Liquidation

A shareholder's right to a share of the net assets of the company following its liquidation may cause some confusion. Any such distribution will make a shareholder the owner of their aliquot part of the company's assets, corresponding proportionally to the nominal value of their shares. However, as long as a company has not formally begun the liquidation process, the shareholders are not owners of an aliquot part of the corporate assets.

Corporations often outlive shareholders who are natural persons. The corporation may exist before the shareholders are born and continue to exist after they die.[74] Thus, while a shareholder may consider the theoretical possibility that their right to an aliquot part of the corporate assets may give a real proprietary right over part of the assets upon liquidation, the shareholder should not be led by this expectation into considering themself a prospective owner.

[D] Ownership and Contributions in Kind

It is also wrong for a shareholder whose consideration for shares is a contribution in kind to regard themself as the 'owner' of any asset so contributed once it becomes part of the company's assets.[75] However, the company itself may not always be the owner of the asset if it does not receive the title to property contributed in kind, so it is also not possible to ensure possession vis-à-vis the contributing shareholder.

73. *See* Davies & Worthington, n. 53, 64 et seq.; and José Girón, *Derecho de sociedades*, I *Parte General, Sociedades colectivas y comanditarias*, 220 (El autor, 1976).
74. With reference to the indefinite duration of a company, Posner refers to the 'perpetual existence of the corporation'; *see* Richard A. Posner, *Economic Analysis of Law*, 536 (8th ed., Aspen Publishers-Wolters Kluwer 2011).
75. *See* Jesús Rubio, *Introducción al Derecho Mercantil*, 500 (Ediciones Nauta 1969).

It is possible that a shareholder whose consideration for shares is a contribution in kind may not transfer to the company ownership of the goods supplied, but some other right such as a lease or usufruct, etc.[76] Also, a shareholder whose consideration for shares is in the form of a contribution in kind may not necessarily own the asset supplied, but may have some other right over it. Thus, on the one hand there can be different kinds of rights conferred on a company by those making contributions in kind, and on the other hand a contributor in kind can have different kinds of rights over the assets conferred. Thus it may be that neither the title conferred nor the title by virtue of which the contribution is made is that of ownership. This might be the case where a shareholder contributes an asset of which they are a lessee, thereby making the company a sub-lessee of the asset.[77]

From all the above, it can be seen that using the term 'owner' to mean the same as 'shareholder' may lead to incongruous situations. Such would be the case if a shareholder contributes in kind an asset of which they are the lessee, making the company a sub-lessee of the asset, and if the shareholder were subsequently to be considered the owner of the asset. This would be a surprising consequence of shareholder providing to the company an asset which they do not own and which the company does not then own.

§2.04 CORPORATE GOVERNANCE: THE BALANCE BETWEEN OWNERSHIP AND CONTROL

The doctrinal debate on corporate governance dates back to the beginning of the twentieth century, when Thorstein Veblen published his studies on business theory.

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76. As regards the title *conferred by* a contributor in kind to a company, the general theory of company law (*see* Girón, n. 73, 217-218) distinguishes between:

    – contributions *quoad dominium*, giving the company full ownership of the goods, but reserving the right of the contributor to reclaim their contribution if the company is wound up;
    – contributions *quoad dominium* and *quoad sortem*, where the contributor does not reserve the right to reclaim their contribution;
    – contributions *quoad sortem*, where the company is given the right to dispose of the contribution provided;
    – contributions *quoad usum*, where the company is only given the right to use the contribution;
    – contributions *quoad usum* and *quoad sortem*, whereby the company is given the right to use and to dispose of the contribution.

    On the contribution of the right to use, *see* Cándido Paz-Ares, *La aportación de uso en las sociedades de capital*, 5 Revista de Derecho de Sociedades 33 (1995).

77. In a certain sense, this example may be seen as a test case, but many large multinational listed companies have signed *sale and lease-back* contracts which make them the tenants of the buildings they occupy. In Spain this is covered in recommendation No 3 of the Unified Code of Corporate Governance of listed companies of 19 May 2006 – 2013 version.

    As regards leasehold right and its capacity to constitute a contribution, *see* José J. López Jacoiste, *El arrendamiento como aportación social* (Publicaciones del Estudio General de Navarra 1955).

He identified the existence of a new economic agent: the corporate manager.[78] In this context, it is also classic to mention the work by Berle and Means *The Modern Corporation and Private Property*.[79]

The debate on the US doctrine has resulted in the publication of extensive literature on this subject and the international dissemination of the ideas in this literature. The undeniable advantages of importing rules and principles from the other side of the Atlantic are coupled with the difficulty which any such *transplantation* entails. Three main doctrinal trends can be identified in the development of the doctrine and principles of corporate governance, depending on who is considered to have the main decision-making power in the company: the administrators (*managers)*, the members (*owners* or *shareholders)*, or the *stakeholders*. The rules of corporate governance have incorporated elements from all three trends.

This debate would have been more productive if some of the US doctrine had not misapplied the term 'owner' to shareholders. The proper terms for the forces that shape corporate governance are not 'ownership' and 'control',[80] but rather 'control' and 'management'.

[A] Managers' Governance of the Company

The allocation of competences in a large corporation differs from that in a small company. Nevertheless, the management plays an important role in both, regardless of whether the company has a one-tier or two-tier board structure.[81]

In small companies, the general meeting elects the members of the board to deal with the day-to-day decisions of the company's ordinary operations. Commonly most of the shareholders participate in the general meeting to debate, argue and approve the most important decisions of the company, since they usually know the business and have opinions on the matters decided on.[82]

In a large company the shareholders are not so closely involved in the adoption of governance decisions. The fact that the shareholders are geographically dispersed makes it impossible for all of them to be actively involved in formulating and deciding proposals. Prior to the general meeting there will have been efforts to collect proxy votes and groups will have been formed to support the adoption of corporate resolutions.[83]

78. *See* Thorstein Veblen, *The Theory of Business Enterprise* (Charles Scribner's Sons 1904); *ibid.*, *The Engineers and the Price System* (B. W. Huebsch 1921).
79. *See also* Adolf A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* (10th impresssion, Transaction Publishers 2009).
80. *Ibid.*, 84, speaking about 'separation of ownership and control'.
81. As it is well known, in some jurisdictions, like the US and the UK, the company management structure is more complex, since not only the shareholders and the board of directors participate in decision-making; there is a third category, that of the officers, who implement the decisions of the board of directors.
82. *See* Guillermo Guerra, *El gobierno de las sociedades cotizadas estadounidenses. Su influencia en el movimiento de reforma del Derecho Europeo*, 196 et seq. (Thomson-Aranzadi 2003).
83. *Ibid.*, 197.

When there are three categories of participants in the company's governance (the shareholders, the board of directors and the executive managers), its structure can be represented as a pyramid. Power is located at the base of the pyramid, with the shareholders; there is an intermediate level consisting of the executive managers; and at the peak of the pyramid there is the board of directors.[84] This model is reflected in North American corporate law, inherited from the nineteenth century, known as the *statutory model*. Subsequently the system evolved to become the *working model*, where some executive managers are also members of the board of directors, merging these two categories into one.[85] This distances the board members even further from shareholders, who were already far from them, given the size of the corporation. In the last third of the twentieth century, state and federal corporate regulations were amended to reflect the working model in the statutory model.[86]

This same trend towards reinforcing the position of managers vis-à-vis shareholders may be seen in the reforms of continental European corporate law in the mid-twentieth century: in Germany in 1937 and 1965, in France in 1966, in Italy in 1942, and in Spain in 1951. While some of these laws allow a wide margin of private autonomy, their organic structure of the public limited company is similar to the management structure of large corporations. The management is given wide scope for autonomous decision-making, and the general meeting no longer has general competences but has special powers over basic structural, financial and constitutional matters.[87]

In abstract terms this model benefits the company, since the management can be more agile and professional. This can also benefit the shareholders indirectly. However, in practice this model needs to be counterbalanced since it too easily allows the interests of the shareholders to be disregarded, to their obvious detriment.[88]

The power of managers in the corporate governance of large companies began to run out of steam in the 1980s, particularly in the US and the UK, given the growth of stock markets and of institutional investors which enabled the concentration of small investors' votes.

[B] Shareholders' Control of the Company Management

In contrast to the managers' governance of the company discussed above, *shareholder theory* focuses on the protection of shareholders' interests and considers the general

84. *See* Melvin A. Eisenberg, *The Structure of the Corporation. A Legal Analysis* (Little, Brown & Co. 1976).
85. The management of a company tends to extend its prerogatives, believing that the company's governance will be more efficient if it is left the directors to adopt both the ordinary administrative decisions and the major corporate resolutions.
86. In the federal system, this reform led to the *Revised Model Business Corporation Act* of 1984.
87. *See* Guerra, n. 82, 201.
88. *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment. Responses to Increasing Shareholder Power*, 119 Harv. L. Rev. 1735 (2006); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L. J. 663 (1974); and Robert W. Hamilton, *The Law of Corporations*, 65-66 (5th ed., West Group Publishing 2000).

meeting of the shareholders to be the ultimate decision-making body of a company, as can be seen from both 'reserve power' and 'residual claimant' theories.[89] It seems reasonable that the shareholders should have an importance in relation to their role in the company. However, it is not reasonable to consider shareholders to be the owners of the company's assets, or to refer to them as 'residual owners'.[90] In any case, even though the shareholders are not the asset-owners, serving the interests of the shareholders should be the priority of the executive management of the company.[91] The essential message of this doctrine is that the due importance of shareholders' interests should be restored by giving them the means to overcome any restriction on their participation in the company's decision-making, as illustrated by the saying: 'Strong managers, weak owners'.[92]

Of course, company law recognizes the rights of shareholders vis-à-vis managers. However, while the legislation establishes mechanisms to enable shareholders to exercise their rights, to hold managers to account and to challenge corporate resolutions, corporate governance doctrines and codes have done most to strengthen the position of minority shareholders and have been the driving force behind this trend. Though, in the last decades of the twentieth century and in this century, corporate governance doctrines and codes have also given shareholders increased importance in large corporations. This has largely been due to the publication of corporate governance codes in countries with market economies.[93]

The relationship between shareholders and managers is sometimes seen as an *agency* relationship. However, this is contrary to the principles of company law, as the managers are not the agents of the shareholders. Nor can it be said that the company is their principal.[94] The management is more than an agent; it is a body of the company, specifically its representative and administrative body.[95] The representative powers and competences of the management have not been acquired by a contract. These powers have their origin in law, and they cannot be restricted by agreement.[96]

89. *See* s. §2.03[B] *supra*.
90. *See* Blair, n. 45, 5; and Chiu, n. 60, 124-125.
91. *See*, in this book, Beate Sjåfjell, *Achieving Corporate Sustainability: What Is the Role of the Shareholder?*, Ch. 18 s. §18.02[B]. 'The Destructive Effect of the Shareholder Primacy Drive'.
92. *See* Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1994).
93. Corporate governance rules were first codified in non-mandatory texts in the 1990s. Among the first codes published were: *Report of the Committee on The Financial Aspects of Corporate Governance (Cadbury Report)*, 1992, United Kingdom; *Guidelines for Improved Corporate Governance (The Toronto Report)*, 1994, Canada; *King I Report*, 1994, South Africa; *Corporate Practices and Conduct (Bosch Report)*, 1995, Australia; *The Boards of Directors of Listed Companies in France (Vienot I Report)*, 1995, France; *Corporate Governance in Europe*, 1995, European Union; and *Proposed Rules for Better Performance of the Board of Directors (Businessmen Circle)*, 1996, Spain.
94. *See* s. §2.03[A][2] above.
95. *See* a critical comment on this use of the term 'agency' in Chiu, n. 60, 122-123.
96. This is set out in Arts 38.b, 39 and 43 of Council Regulation (EC) 2157/2001 of 8 October 2001 approving the Statute for a European Company (SE), a corporate rule directly applicable in all Member States of the European Union.

Following the logic of this theory, and disregarding the lack of precision of the term 'agency', it can be said that the shareholders have given the managers the task of maximizing the returns on their investments in the company. The remuneration of the managers is the cost of assigning such a task to them – this 'agency cost'. If the value creation is satisfactory, an agency cost will be considered acceptable.[97]

Minority shareholders of large corporations have specific requirements. They are not interested in exercising their rights to participate in the day-to-day management of the company and setting the business strategy. Rather than exercise their management rights, they are interested in exercising their economic rights: the right to receive a dividend and the right to sell their shares in the market, confident of making a capital gain. It could be said that they are more investors than shareholders.[98] The market price of shares can be seen as an instrument for evaluating management performance. Consequently, it is an inviolable rule of the market that one of the main objectives of managers is share-value creation.[99]

The roles of shareholders differ, depending on whether they are minority shareholders or holders of a significant stake in the company, as in the case of institutional investors, for example.[100] The inevitably passive role of minority shareholders is expressed in the saying: 'vote with your feet'. In other words, if shareholders are unhappy with the management of the company, they can sell their shares and leave the company. The consequences of this attitude are particularly dangerous for the managers if shareholders decide to sell following a hostile takeover bid; this can lead to the dismissal of members of the governing body. In recent years, there has been a rise in *shareholder activism*, with greater involvement of shareholders with a significant stake in the company's business.[101]

97. Before the 2008 financial crisis, the payments of some top executives of *Fortune 500* companies were more than tens and hundreds of millions of dollars per year – *see* Hamilton, n. 96, 392; *see also* Carsten Gerner-Beuerle, *The Contractual Structure of Executive Remuneration in the UK*, 73-98 in *Executive Directors' Remuneration in Comparative Corporate Perspective: The Regulatory Framework* (Christoph Van der Elst ed. Kluwer Law International 2015).
98. *See* Alfonso Martínez-Echevarría, *El aumento del capital de la sociedad cotizada*, 21, n. 1 (Thomson-Civitas 2006).
99. *See* Antoine Rebérioux, *European Style of Corporate Governance at the Crossroads: The Role of Worker Involvement*, 40(1) J. Com. Mkt Stud. 111, 112 et seq. (2002); and Cándido Paz-Ares, *El gobierno corporativo como estrategia de creación de valor*, Working Paper No 182 InDret 1 (2004).
100. Shareholders can also be institutional investors or Collective Investment Institutions; *see* Hanne S. Birkmose, *You Can Lead a Horse to Water, But Can You Make it Drink? Institutional Shareholders and Corporate Voting*, 20(5) Eur. Bus. L. Rev. 717 (2009); José M. Garrido & Ángel Rojo, *Institutional Investors and Corporate Governance: Solution or Problem?*, 427 et seq.; Klaus J. Hopt & Eddy Wymeersch (eds), *Capital Markets and Company Law* (Oxford University Press 2003); and Geoff P. Stapledon, *Institutional Shareholders and Corporate Governance* (Oxford University Press 1996).
101. *See* Birkmose, n. 108, at 738; Kathleen Rehbein, Sandra Waddock & Samuel B. Graves, *Understanding Shareholder Activism: Which Corporations are Targeted?*, 43(3) Bus. & Soc'y 239 (2004).

[C] Stakeholders' Involvement in Governance of the Company

The differing aims of managers and shareholders can obscure the view of the ultimate purpose of the company.[102] The managers must take care of the interests of the shareholders and they are entitled to receive compensation for their work. But there are other stakeholders whose rights should also be taken into account in the governance of a company. This is the basis of the *stakeholder theory*.[103] 'Stakeholder' is an all-inclusive category that includes the company's shareholders (or owners), managers, employees, suppliers, creditors and neighbours, as well as local, regional and national governments.

While the interests of stakeholders have been incorporated in modern codes of corporate governance, such codes are still being developed.[104]

One of the positive consequences of the stakeholder theory is that it takes the company's interests as a guideline for corporate governance. The interests of each stakeholder are important, but these interests must be served while also serving the company's interests.[105] It is also positive to emphasize the importance of the company's interests in the present context of identifying who are the holders of the corporate assets.[106]

§2.05 ARE THE SHAREHOLDERS' DUTIES THE DUTIES OF OWNERS?

As discussed above, the term 'owner' has been widely misused. It has often been used incorrectly to refer to 'shareholders', though this does not appear to have damaged shareholders' interests. Hitherto, company law has mainly been concerned to regulate shareholders' rights. The misconception of considering shareholders as holders of ownership rights could only lead to more favourable treatment of shareholders.

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102. *See* Stephen M. Bainbridge, *Corporation Law and Economics*, 464 et seq. (Foundation Press 2002), where the author's ideas are set out in a section entitled 'Why shareholders and only shareholders?'.
103. *See* R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pittman 1984), where the term 'stakeholder' was first used; Robert A. Phillips, *Stakeholder Theory and Organizational Ethics* (Berrett-Koehler 2003).
104. The Principles of Corporate Governance in the OECD, in 2004, Part I, IV, establishes that: '(t)he corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises'.

    In Spain, recommendation No. 7 of the Unified Code of Corporate Governance of listed companies of 19 May 2006 – 2013 version – addresses the board of directors and establishes 'that [it] should also ensure that in its relations with stakeholders, the corporation should comply with laws and regulations; fulfil its obligations and contracts in good faith; respect the uses and good practices of the sectors and territories where it implements its activity; and observe those additional principles of social responsibility that he would have voluntarily accepted'.
105. In the legal system of the UK, it can be said that 'the legal framework is also heavily based on the "real entity" theory, as the company's interest is regarded as distinguishable from shareholders' interests and directors' duties are defined as duties to the company'; *see* Chiu, n. 60, 134-135.
106. *See* s. §2.03[A][2] *supra*.

This legal context changes as soon as company law provides for the regulation of shareholders' duties, as in the proposal for a directive to amend Directive 2007/36/EC, which will re-establish the balance between rights and duties which has been the traditional basis of every legal relation. It is clear that the list of shareholders' duties cannot include duties that typically pertain to true owners, such as liability for impediments or hidden defects and warranties of title, the duty to respect easements and rights, and the owner's obligations to holders of a usufruct.

§2.06 CONCLUSION

Since it first appeared, thinking of 'shareholders' in terms of 'owners' has been criticized in doctrinal debates and legal writing. Despite the continuing criticisms and arguments clarifying the mistaken attribution of proprietary rights to shareholders, some have continued to equate 'shareholding' with 'ownership'.

What is of more concern is that this confusion of thinking and terminology is found in some corporate governance codes and even in some companies legislation.

Giving the term 'ownership' two different meanings has been detrimental to the doctrinal debate. The proper use of the terms 'shareholder' and 'shareholding', rather than 'owner' and 'ownership', would not deprive shareholders of any rights since they have never enjoyed any proprietary rights. The doctrinal debate would be clearer and more productive if there were greater terminological precision.

In the corporate governance debate the increased recognition of the rights of stakeholders and the defence of their interests, which are not based on proprietary rights, has taken attention away from shareholders. The debate becomes more focused when the company's interests are placed in the centre, as these interests are shared by all participants in the company's activities, knowing that the corporate legal person is the holder of the assets.

The future regulation of shareholders' duties should stimulate renewed arguments to stop the mistaken use of the term 'owner' as a synonym for 'shareholder'. Continued use of such terminology would not only harm the doctrinal debate but, ultimately, to demand that shareholders should comply with the duties of an owner would be to the disadvantage of shareholders.